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FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2012

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS

JO ANN EMERSON, Missouri, *Chair*

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JO BONNER, Alabama
MARIO DIAZ-BALART, Florida
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JOSÉ E. SERRANO, New York
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NOTE: Under Committee Rules, Mr. Rogers, as Chairman of the Full Committee, and Mr. Dicks, as Ranking Minority Member of the Full Committee, are authorized to sit as Members of all Subcommittees.

JOHN MARTENS, WINNIE CHANG, KELLY SHEA, and ARIANA SARAR, *Subcommittee Staff*

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Treasury Inspector General for Tax Administration	**375**
Department of the Treasury	**475**

Printed for the use of the Committee on Appropriations

Part 7

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FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR 2012

WEDNESDAY, MARCH 30, 2011.

FEDERAL COMMUNICATIONS COMMISSION

WITNESS

JULIUS GENACHOWSKI, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION

Mrs. EMERSON. The hearing will come to order. Thank you so much, Chairman Genachowski, for being here. I really do want to thank you for being here today and talking about the fiscal year 2012 Budget Request for the Federal Communications Commission.

Your agency plays quite an important role in this country's telecommunications, television, radio, internet, and cable industries. And probably almost every American citizen, business, or even noncitizens, are touched by something that you regulate.

The changes that we are seeing in the industry, just with the blink of an eye, something is new. When did we get our iPads, Joe? We got them last fall, and suddenly we need a new one. Technology keeps changing, and it is important for us, and certainly important for you, to be able to strike a balance between regulating all of these industries, but at the same time, not hindering competition or innovation. Among all of the jobs in the government, I think yours is probably one of the most challenging, with many business technology and consumer groups watching every single move you make, along with Congress, as well.

While the FCC is funded by fees, congressional oversight over your budget is an important check on agency activities, and our committee is committed to fiscal responsibility and oversight of the agencies under our jurisdiction. The American people have tightened their belts, and it is important that the government do the same thing.

We in Congress consistently hear from our constituents about the cost of government regulations, whether it is health care, greenhouse gases, financial institutions, or the telecommunications industry. The administration's new regulatory proposals are providing great uncertainty for businesses, and in particular, small businesses. The regulations, in many respects, are hurting the economy, and I have to say that I personally have very strong concerns with the FCC's Net Neutrality Rule, and I am sure you are prepared to get into discussion on that.

You passed this rule even though you knew it would be opposed by a majority of members of Congress, and it was quite obvious that this played out in consideration of H.R. 1, when the House

overwhelmingly rejected your proposed rules. I do not think the issue is going to go away any time soon, and I hope that, because of the controversy that it has created, that you would be willing to work a little more closely with the Congress on these types of proposed regulations. Once again, thank you so much for being here. I look forward to your testimony. I would now like to recognize my friend and colleague, Joe Serrano.

Mr. SERRANO. Thank you so much. And I also want to welcome the Chairman to this hearing. The Commission's request for Fiscal Year 2012 is $354 million in new budget authority, and I look forward to discussing the request with you during our questions.

High-speed internet access is critical to helping people find and participate in education and employment opportunities. I am pleased to see that, in the request, the FCC is moving forward with your broadband plan to increase access across the country. One way to increase access is to improve wireless service, and I am encouraged by your continuing efforts to open up more spectrum for broadband services. Doing so will help to encourage innovation and improve competition among broadband services.

As you move forward with all of your plans, I would urge you to remember one of my main concerns; that the people in the territories are not forgotten, and that they are treated equally. In addition, as we embrace these technologies, it is important that we do not destroy existing successful programs. PEG channels are one such program. Arising from a previous technological leap to cable television, we should make sure that they continue to thrive as telecommunication systems continue to change.

Finally, you provide an important check to make sure that consumer interests are being served, and that there is a level playing field in telecommunications. And I look forward to hearing more from you about your important work, and I welcome you again.

Mrs. EMERSON. Thank you, Mr. Serrano.

Mr. SERRANO. Thank you.

Mrs. EMERSON. And thanks to our colleagues Mr. Diaz-Balart and Mr. Graves for being here today. Please go ahead, Mr. Genachowski.

Mr. GENACHOWSKI. Thank you, I will be brief. I have submitted a longer statement for the record, and I will do an edited version here, if that is okay. First of all, thank you, Chairwoman Emerson, Congressman Serrano, for the opportunity to be here before the subcommittee. Thank you, Congressman Graves and Congressman Diaz-Balart, for joining.

A year ago this month, a unanimous FCC approved a joint bipartisan statement of principles which said, "Broadband service can be an indispensable engine for unleashing innovation and investment, spurring job creation and economic growth, and ensuring our country's global competitiveness." That statement continued, "Working to make sure that America has world-leading high-speed broadband networks, both wired and wireless, lies at the very core of the FCC's mission in the 21st century." I was pleased to give that bipartisan statement. And, since issuing that statement, the FCC has been focused on harnessing the power of broadband and communications technology to drive our economy, improve U.S.

competitiveness, benefit consumers, and unleash innovation, including in areas like education, health, IT, and public safety.

The benefits of broadband increase every day. Consider small businesses. Like no technology since electricity, high-speed internet helps new businesses start and small businesses grow by expanding their reach to new markets and lowering their cost through cloud-based services. Challenges to seizing the opportunities of broadband increase every day too, as do the costs of exclusion from our digital economy as job postings and other essential information move online.

About 25 million Americans simply cannot get broadband where they live. And about 100 million, one-third of our population, does not sign up. That is an adoption rate of about 67 percent in the U.S., which compares to 90 percent in Korea or Singapore.

In recent weeks, several expert reports have been issued that confirm concerns raised by earlier studies; for too long, the U.S. has been losing ground to our global competitors, and leadership in information and communications technology is critical for us to stay on top.

In this context, we submit our fiscal year 2012 budget. As in the past, the budget we have prepared is derived entirely from fees the FCC collects and auction proceeds. The budget will allow the FCC, which currently has its smallest staff in 10 years, to continue our efforts to boost our economy and ensure that more Americans can be full participants in our 21st century economy.

Our budget will support vital new initiatives to improve public safety and help first responders communicate with each other and protect lives. The FCC's proposed budget will allow the agency to pursue its core goals of fostering investment, unleashing innovation, promoting competition, and protecting and empowering consumers.

The budget is consistent with our agency's commitment to fiscal responsibility, and deriving the most benefit for consumers and our economy from public resources. For example, the budget will help us unleash Spectrum, the invisible infrastructure that sustains our wireless communication, so that U.S. companies lead the world in mobile innovation. It will help us drive more efficient use of this scarce public resource, and free up spectrum for auctions. In the last two decades, the FCC has raised $52 billion for tax payers through such auctions. Our voluntary incentive auction proposal, a market-based proposal, can raise significant money in the $20 to $30 billion range. The budget will help us transform and modernize the universal service funds, so that it focuses on broadband deployment and adoption, not old telephone service. USF and inter-carrier compensation reforms will eliminate waste, improve efficiency, require greater accountability, and connect millions of Americans to our digital economy.

The budget will help us drive forward our broadband acceleration initiative, which is cutting red tape and removing barriers to broadband build out, lowering the costs of and encouraging the massive private investment we need in our communications infrastructure. The proposed budget will help us improve public safety communications in the United States by ensuring interoperability of first responder broadband communications, by moving toward

next generation 9–1–1, so that people can send, and first responders can receive, text messages, photos, and videos from mobile phones, and by aiding in vital efforts to protect against cyberthreats and other illegal activities.

The proposed budget will help improve the operations and efficiency of the FCC, reducing burdens on business and the public. For example, the budget will allow us to complete work consolidating multiple out-of-date licensing systems into one modern and upgradable system, which will save over $35 million for tax payers, and provide more efficient licensing services to the private sector, including small businesses.

Finally, the budget will ensure that we can continue our efforts to combat waste, fraud, and abuse, including by providing necessary funding to the agency's Office of Inspector General. These cost-saving enhancements are being built on significant progress we have already made from reforming, for example, the video-relay service, which will save tax payers $250 million annually, to reducing contracting costs of the agency by over $2 million a year. The Commission's commitment to reforming the agency into a model of excellence was recognized when the Office of Personnel Management named the FCC the most improved agency in the Federal Government. I look forward to working with this committee on initiatives to harness information and communications technology to get our economy moving and to expand opportunity for all Americans. Thank you for the time, and I look forward to your questions.

[The information follows:]

Statement of
Chairman Julius Genachowski
Federal Communications Commission

Hearing on the FCC's Fiscal 2012 Budget Request

Before the
Subcommittee on Financial Services and General Government
Committee on Appropriations
U.S. House of Representatives

March 30, 2011

Thank you, Chairwoman Emerson, Ranking Member Serrano, and the other members of this Subcommittee. I appreciate this opportunity to present the FCC's Fiscal Year 2012 budget and provide you with details of our work at the Commission.

A year ago this month, a unanimous Commission approved a joint, bipartisan statement of principles, which said, "Broadband service can be an indispensable engine for unleashing innovation and investment, spurring job creation and economic growth, and ensuring our country's global competitiveness."

The statement continued: "Working to make sure that America has world-leading high-speed broadband networks – both wired and wireless – lies at the very core of the FCC's mission in the 21st century."

Since issuing that statement, the FCC has been focused on harnessing the power of broadband and communications technology to drive our economy, improve U.S. competitiveness, and to unleash innovation in areas like education, health IT, and public safety.

The importance of these efforts to promote opportunity and prosperity through communications technology grows every day.

The value of broadband connectivity increases every day for consumers and businesses.

Consider small businesses. They are a primary engine for creating new jobs in our economy. Like no technology since electricity, high-speed Internet connectivity helps new businesses start and small businesses grow by extending their reach to new markets and customers, and lowering their costs to provide valuable goods and services.

As the opportunities of wired and wireless broadband communications increase, so do the challenges and the costs of our failure to deploy essential telecommunications services.

Telecommunications industries now represent a critical and growing part of our nation's economy. Yet even as the communications industry has grown in size and complexity, the FCC has remained relatively small and focused. More than ten years

after the turn of the 21st Century and even after the explosive growth in telecommunications services, the FCC is at a ten-year low for FTE levels. During the past two decades, the FCC raised over $52 billion through spectrum auctions and worked through tectonic industry developments that changed us from a hardwired voice-oriented nation to a hybrid voice-data, wireless world power.

We cannot be complacent in our work or we will suffer the consequences of this inaction. In recent weeks, several reports have been issued – from McKinsey, Kleiner Perkins, and the World Economic Forum – which confirm concerns raised by earlier studies: the U.S. is losing ground to our global competitors, and leadership in information and communications technology is critical for us to stay on top.

Nearly 100 million Americans – almost one-third of our population – are still being bypassed by the broadband revolution. That's about a 68% adoption rate, which compares to a 90% adoption rate in, for example, South Korea.

Meanwhile, the costs of digital exclusion are rising as job postings go online, and as vital services like education, health care, and public safety increasingly require online access.

With limited resources, the FCC has been making significant progress toward fulfilling its Congressional mandate to ensure that all Americans have access to a robust communications infrastructure for a wide range of purposes – including public safety,

personal communications, consumer services, medical care, business expansion, employment, and education.

I have worked with the FCC's Managing Director to apply his private sector know-how to the task of identifying cost savings, creating budgetary efficiencies, and accomplishing strategic goals. The FCC's staff has worked hard to develop lean and flexible mechanisms and methodologies that make use of the resources that we already have first – before considering alternatives that might require additional financial resources.

The FCC understands well that everyone from the consumer increasingly using communications devices to the smallest amateur HAM operator to the largest ISP provider wants an efficient, well-tuned agency focusing on our statutory mission. In response to input from stakeholders, the Commission reformed its operations, breaking down the silos separating bureaus and fostering the healthy debate and discussion that ensures that we will incorporate the best ideas into our policies. We have maintained a commitment to focusing on facts and data, and understanding the benefits of proposed actions, as well as their costs. We've reformed and improved the way we review transactions, with an emphasis on processes that are fair, thorough, efficient, recognize benefits of private-market transactions, and protect consumers and the public interest.

Much has been done with limited resources to make the Commission transparent and more responsive to consumers. We have used new media to open up the digital

doors of this agency, empowering a broad range of people around America, from teachers to small business owners to a whole range of citizens to participate in our proceedings directly through workshops streamed online, the FCC's first blog, and other smart uses of modern communications technologies. Our staff is also close to completing work on an update of the agency's website, which had grown dramatically out-of-date, underserving consumers, businesses, and others who engage with the agency.

In the wake of these reform efforts, the Office of Personnel Management named the FCC the most improved federal agency.

We also have worked with this subcommittee to upgrade our staff within current FTE levels by implementing an early-out program. This past year we received reprogramming permission to use $3.5 million of de-obligated funds to hire engineers, technologists, economists, and econometricians with the skills to tackle the challenges of the digital age. While many of these employees are essential to cyber-security and ramped up homeland security efforts, all of these employees are expected to have the experience and knowledge to support the complex and unprecedented data-driven and fact-based effort the Commission faces in achieving our country's broadband goals. Given the ongoing changes in technology and growing importance of this sector, we need to continue upgrading our workforce for the digital age.

Last year, I outlined some of our strategic goals and provided you with our programmatic initiatives. During the past year the Commission has taken concrete steps

forward and expended its resources responsibly to achieve each of the initiatives that we discussed in June. Here is a snapshot of some of our work:

Develop and Implement National Broadband Plan

- Prepared and released the country's first National Broadband Plan, a comprehensive strategy to foster the most vibrant broadband ecosystem in the world – unleashing private investment and world-leading innovation, creating jobs, and expanding opportunity and bringing the benefits of high-speed Internet to all Americans. The Commission's work on the Plan drew praise from more than 3,000 companies and nonprofit organizations.

Reform Universal Service

- Launched a proceeding to convert inefficient 20th century telephone programs into efficient and effective 21st century broadband programs that ensure fiscal responsibility and accountability.
- Initiated reforms the Lifeline and Linkup programs to prevent waste, fraud, and abuse and ensure that vulnerable populations receive needed support.
- Updated the successful E-rate program to enable greater flexibility for schools and libraries, faster connections, and the use of wireless education tools.
- Initiated work on our U.S. Health Connect program, so patients at rural clinics can benefit from broadband-enabled care, like remote consultations with specialists anywhere in the country.

Ensure Spectrum Availability and Efficiency for Future Economic Growth and U.S. Competitiveness

- Freed up the most significant amount of unlicensed spectrum in 25 years – to enable new technologies like "Super Wi-Fi" and machine-to-machine Internet-connected devices that drive innovation and efficiency in areas like health care, energy, and business operations.
- Eliminated unnecessary restrictions on the use of certain spectrum bands. This has allowed us, for example, to open 25 megahertz of spectrum for mobile broadband in the 2.3 GHz band, which is already being used for broadband in Korea.
- Encouraged dynamic spectrum sharing and secondary markets for spectrum, as well as development and deployment of femtocells, smart antenna technology, and devices that can access unlicensed spectrum like Wi-Fi to off-load traffic from cellular networks.
- Completed baseline spectrum inventory, and created a Spectrum Dashboard and LicenseView on the FCC's website to provide instant information about available resources.

Spur Broadband Deployment

- Launched the FCC's Broadband Acceleration Initiative, which is cutting red tape and removing barriers to broadband buildout – lowering the costs of and encouraging the massive private investment we need in our communications infrastructure.
- Adopted an order to make it easier and more affordable for carriers to access utility poles, and established a shot-clock to speed the process for decisions on cell tower siting.

Protect and Empower Consumers

- Cracked down on wireless "mystery fees" that were costing consumers millions of dollars and secured a record $25 million settlement.
- Issued rulemakings to protect consumers from bill shock and other forms of billing abuse.
- Approved mergers with conditions that fostered innovation, investment and competition, and protected and empowered consumers.
- Held workshops and events to help educate consumers about mobile safety issues, including distracted driving and cyberbullying.
- Took more than 1,400 enforcement actions, including reaching a settlement with Purple Communications, which restored more than $18 million to Telecommunications Relay Service (TRS) Fund.

Foster Public Safety Efforts

- Convened first meeting of the Emergency Response Interoperability Center Public Safety Advisory Committee to assist first responders in building essential public safety networks.
- Initiated action to advance Next Generation 9-1-1 services.
- Provided important waivers to ensure that spectrum was available for shovel-ready regional programs designed to develop interoperable networks.
- Developed plans and launched initiative to aid in efforts to protect cyber security.

Reform Agency Operations

- Appointed a Special Counsel for FCC Reform, as part of an effort to improve agency operations and processes.
- Launched a comprehensive review of our current telecommunications regulations, seeking public comment on which regulations are no longer necessary or in the public interest.
- Launched a Data Innovation Initiative and established the position of Chief Data Officer, not only to ensure our policies are fact-based and data-driven, but to eliminate unnecessary data collection. An example of this initiative's impact are proposals to eliminate the majority of reports we currently collect on international

communications, to reduce reporting requirements in those studies that remain, and to exempt hundreds of small businesses from having to report.

FY12 Request

This year, we are building on past work to complete projects previously initiated and we will move ahead with the priorities identified. I'm pleased to report that we have been successful in developing a budget for the Commission that maintains essential services, focuses on critical upgrades, and provides the level of knowledge and experience in its employees that the American people demand of expert agencies. The FCC's spending goals reflect our statutory mandate and respond to the demands of the evolving telecommunications ecosystem.

The Commission is requesting a budget of $354,181,000. The FCC would continue to raise all of its funds through assessment of fees and permissible auction proceeds. Base funding increases are set at $2.5 million and programmatic initiatives are expected to cost $15.9 Million. Most of the base funding increase is for the Office of Inspector General.

Base Spending Levels

The base amount includes the non-salary increase of $1.6 million for inflationary increases related to rentals, equipment, and supplies. We have taken significant steps to keep costs down, reducing the budget by $2.3 million in non-salary areas. Specifically, we saved more than $2 million across our IT, administrative, financial, and other service

contracts by consolidating and streamlining the services they provide. Another example, we recently cut back on the number hard copies of publications delivered to the Commission, netting $50,000 in cost savings. We also saved tens of thousands of dollars on equipment, supplies, travel, and printing costs.

The remaining $3.2 million from the base amount would fund an additional 19 FTE positions in the Office of Inspector General in order to replace the 19 NTEs acquired with the transfer of $21.48 million from the Universal Service Fund in 2008. The NTE terms expire in 2012 but the personnel are essential to continued efforts to properly monitor USF and other programs and prevent waste, fraud, and abuse.

Programmatic Increases

The requested budget includes $15.9 million in programmatic initiatives to: (1) finalize and support ongoing Commission-wide technology initiatives designed to improve efficiency and save costs; (2) implement specific components of the National Broadband Plan; (3) support the Commission's public safety role; (4) follow-through on studies necessary for finalizing a statutorily required report; and (5) upgrade and maintain services in the Office of Inspector General to combat fraud, waste, and abuse.

Information Technology Initiatives ($5.7 million)

Almost one-fourth of the requested programmatic spending authority would cover costs associated with the consolidation of the Commission's licensing system, improvements to the FCC's website, and consolidation of the FCC's existing data centers. These projects would ensure that the FCC's internal technology resources operate efficiently to effectuate later cost savings. An additional $1.7 million would fund the FCC's development and maintenance of the National Broadband Map website.

The projected cost savings for this technology investment are substantial. We estimate that the FCC will save millions of dollars annually by consolidating our licensing system. These savings will begin to accrue shortly after the system is implemented and last for years. We also estimate that the cost savings for the data center consolidation is $1.3 million annually after implementation.

Broadband Programs ($4.9 million)

Broadband is an indispensible platform for economic growth, job creation, and our global competitiveness. The Commission proposes to focus resources to ensure the U.S. has world-leading wired and wireless broadband networks. The FCC has released a Report and Order proposing the conversion of the Universal Service Fund's High Cost Fund from a voice-centric program to one that ensures universal access to broadband ("Connect America Fund"). Our reforms will reduce waste, fraud, and abuse, and ensure greater fiscal responsibility and accountability in this multi-billion dollar program.

The $3.5 million of funds requested here will cover the cost of contractors assigned to develop, with public input, a model that calculates support levels for the estimated $4.5 billion in annual CAF disbursements. One million dollars of the requested funds would continue the Consumer and Small Business end-user survey initiated in 2009 to measure broadband usage and adoption. It is required by the Broadband Data Improvement Act that the FCC conduct this survey periodically. The survey results must be compared over several years to adequately measure growth. The remaining $400,000 would provide contractual services to create and execute a wireless network measurement test for broadband speeds. These are all designed to ensure that the FCC's policies are effective and efficient, while providing enormous gains for the public through economic growth, job creation, and spectrum auction proceeds. Additionally, many of these data collections and process refinements were General Accounting Office (GAO) recommendations. In a series of GAO reports, the Commission has been urged to collect more and better data to inform its Universal Service and broadband policy-making.

Public Safety ($1.8 million)

Homeland security activities consume a significant portion of the Commission's budget and are essential to our core mission. The bulk of the funds requested for public safety operations will fund the Emergency Response Interoperability Center ("ERIC"). The Advisory committee for this program met this past month, and the Commission is moving aggressively to facilitate a nationwide interoperable communications network. ERIC will establish a technical and operational framework that will ensure nationwide

interoperability for the 700 MHz network. The request also provides $500,000 for the establishment of a Cyber-Security Certification Program so that the Commission is prepared to analyze and document threats and develop operational information to work with sister agencies. The remaining $350,000 upgrades the Commission's Portable Direction Finding System to ensure that we are able to track illegal activities and other forms of interference.

Media Ownership, Competition Report Resources ($1 million)

Congress requires the Commission to review media ownership issues and competition and develop a Quadrennial Review to analyze trends and identify information for use in legislative oversight activities. This subcommittee permitted the reprogramming request last summer providing $1 million in de-obligated funds to be used for expert studies related to local media market structures. The current request provides $1 million for New Entrant Studies.

Office of the Inspector General ($2.4 million)

The Commission shares Congress' commitment to preventing the misuse or abuse of valuable government resources and is placing an emphasis on this issue during the current budget cycle. The Commission's efforts to crack down on abuse have already led to enforcement actions that have led to tens of millions in payments to the U.S. Treasury, as well as the reform our Video Relay Service, which will save taxpayers $250 million

annually by eliminating fraud in this program that provides vital communication to people who are deaf or hard-of-hearing. As part of its continuing efforts to root out waste, fraud, and abuse, and to ensure the future efficiency of the Universal Service Fund as well as FCC-initiated projects related to broadband initiatives and TRS, the Commission is requesting $2.4 million for IG programming. The funds will cover a range of legal support, audit contracts, investigation travel, training, and software (IDEA license renewal). This request reflects the independent Inspector General's request, which is made based on internal calculations related to increased caseloads, particularly in the USF area.

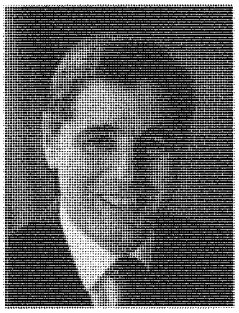
Spectrum Auctions Funding Cap

The Commission is authorized to retain from auction revenues those funds necessary to develop, implement, and maintain the auction program. These funds cover the personnel and administrative costs required to plan and execute spectrum auctions; operational costs to manage installment payments and collections activities; development, implementation, and maintenance of all information technology systems necessary for Auctions operations, including development of a combinatorial bidding system, and a proportional share of the general administrative costs of the Commission. Congress has routinely capped these funds at $85 million annually to ensure the continued viability of the program and to ensure the ability to conduct auctions quickly and efficiently. The Commission anticipates that the $85 million cap will be sufficient to ensure program upkeep during the next fiscal year.

Conclusion

The Federal Communications Commission is a fee- and auction-proceeds funded agency focused on harnessing communications technologies to spur economic growth, job creation, U.S. competitiveness, and solutions to national challenges like public safety. The FCC's FY12 budget reflects a fiscally responsible effort to continue necessary programs without undercutting the Commission's core missions in a way that would have a counterproductive effect. This past year, the Commission has identified workplace efficiencies and successfully initiated modernization with available resources, while simultaneously implementing the National Broadband Plan and accomplishing a range of other strategic goals. The FY12 funds will provide the FCC with the resources necessary to complete and finalize programs initiated in past years, and those essential to keep the Commission responsive to changes in technology. The funds will ensure that the Commission is capable of performing the tasks mandated by Congress in an effective and efficient manner.

FCC Chairman
Julius Genachowski



Julius Genachowski was nominated by President Barack Obama as Chairman of the Federal Communications Commission on March 3, 2009, and sworn into office on June 29, 2009.

Chairman Genachowski has two decades of experience in public service and the private sector. Prior to his appointment, he spent more than 10 years working in the technology industry as an executive and entrepreneur. He co-founded LaunchBox Digital and Rock Creek Ventures, where he served as Managing Director, and he was a Special Advisor at General Atlantic. In these capacities, he worked to start, accelerate, and invest in early- and mid-stage technology and other companies. From 1997-2005, he was a senior executive at IAC/InterActiveCorp, a Fortune 500 company, where his positions included Chief of Business Operations and General Counsel.

Genachowski's public service spanned broadly across government. His confirmation as FCC Chairman returns him to the agency where, from 1994 until 1997, he served as Chief Counsel to FCC Chairman Reed Hundt, and, before that, as Special Counsel to then-FCC General Counsel (later Chairman) William Kennard. Previously, he was a law clerk at the U.S. Supreme Court for Justice David Souter and Justice William J. Brennan, Jr. (ret.), and at the U.S. Court of Appeals for the D.C. Circuit for Chief Judge Abner Mikva. Genachowski also worked in Congress for then-U.S. Representative (now Senator) Charles E. Schumer (D-N.Y.), and on the staff of the House select committee investigating the Iran-Contra Affair.

Genachowski has been active at the intersection of social responsibility and the marketplace. He was part of the founding group of New Resource Bank, which specializes in serving the needs of green entrepreneurs and sustainable businesses, and has served on the Advisory Board of Environmental Entrepreneurs (E2). He also served as a board member of Common Sense Media, a leading non-partisan, non-profit organization seeking to improve the media lives of children and families.

Genachowski received a J.D from Harvard Law School (magna cum laude), where he was co-Notes Editor of the Harvard Law Review. He received a B.A. from Columbia College (magna cum laude), where he was Editor of Columbia Spectator's Broadway Magazine, re-established Columbia's oldest newspaper (Acta Columbiana), and was a writer and researcher for Fred Friendly. He was also a certified Emergency Medical Technician who served on the Columbia Area Volunteer Ambulance, and taught cardiopulmonary resuscitation (CPR).

Genachowski, a son of immigrants, is married to Rachel Goslins and has three children.

Mrs. EMERSON. Thank you so much, Chairman Genachowski. And again, I apologize for trying to take your opening statement time. While your appropriation is offset by fees, we really do have to look at all agencies in our bill to find ways for them to become more efficient, no matter what their funding source is. So can you give me three specific examples of the impact on your operations if we were to go back to fiscal year 2008 levels?

Mr. GENACHOWSKI. Sure. One is it would interfere with our ability to unleash spectrum for auctions. We need the engineers and the data work to do that. That is one important example. A second is it would interfere with our ability to transform the Universal Service Fund and inter-carrier compensation. This is a complicated endeavor. It will save money; it will make the programs more efficient and deliver better broadband to more Americans. But we need the resources in order to be able to do that work. It would interfere with the operations of our Inspector General's Office. The headcount increase in the budget is all an IG request, which I support, to make sure that they can continue their efforts to root out waste, fraud, and abuse. Through their efforts, along with our Enforcement Bureau, we have identified fraud in one program that has saved over $250 million annually. And finally, just one last point, it would interfere with our ongoing efforts to improve the internal technology at the FCC, which will save money. I mentioned the consolidated licensing system, we are also consolidating data centers. These are things that, when I was in the private sector, every company did, and you had to do to save money. So in each of these areas I feel strongly that these are real investments that will have a measurable positive return for the American people and the American economy.

Mrs. EMERSON. But you do not have any existing sources that could be reprioritized within the agency, as it exists today, to do some of this work?

Mr. GENACHOWSKI. The work that we have done in preparing the budget took that into account. We brought in, as our Managing Director who oversees the budget process, someone who had spent 14 years doing budgets and running P&Ls in the private sector. And my directive to him was, we are going to root out waste and fraud at this agency and run it as efficiently as a private company would. And so, we have been able to find significant savings, and I have great confidence that we are doing as best we can to apply private sector budgeting principles to what we are doing. And the budget has been tight, and we are doing a lot with the money that we have.

Mrs. EMERSON. In spite of the 15.9 million increase that you have asked for?

Mr. GENACHOWSKI. Yes, so one example was the headcount for the Inspector General's Office. They have a series of temporary employees whose contracts will be up. These are employees who have helped root out fraud and literally made sure that we can save $250 million in the VRS program. If we cannot fund them, they will go. We will lose their expertise and their ability to root out waste, fraud, and abuse.

Mrs. EMERSON. You have asked for 19 people in the IG's Office at a cost of $3.2 million. That is pretty hefty amount for salaries, is it not?

Mr. GENACHOWSKI. Well that figure reflects not only salaries, but the work that they do to do their investigations. And so there is underlying work, whether it is data-oriented work, expert work that they need to do their work and as the investigator of waste, fraud, and abuse, they are very sensitive to making sure that their budget is as tight as possible.

Mrs. EMERSON. Okay. So you really felt, or at least agree with the Inspector General, that they are too short-staffed to do their jobs?

Mr. GENACHOWSKI. I do. And again, the request here is not to increase headcount over what it is. For historical reasons, they have had a team of, I believe the number is 17 or 19, I cannot remember exactly, that has been working on these issues. They have been on a term-contract. We can find out the history of why that is so.

Mrs. EMERSON. Why they could not just simply stay on the contract.

Mr. GENACHOWSKI. Either way, the money is being spent for them.

Mrs. EMERSON. With the exception of all the benefits that attach to a permanent employee versus a temporary employee.

Mr. GENACHOWSKI. That may be. These are professionals who I think it would be in our interest to keep in government doing exactly what they are doing. At what point do they say, if we are not wanted here to do this job as a full-time employee, maybe we will go find something else to do. I presume we could replace them. I do not think we could replace the institutional memory and knowledge that they have accumulated in the investigations that they have done, which have been very successful.

Mrs. EMERSON. Okay. We will talk a little bit more about this.

[The information follows:]

OFFICE OF INSPECTOR GENERAL FULL TIME EQUIVALENTS

MR. GENACHOWSKI. I appreciate this opportunity to provide more information concerning the $3.2M baseline increase for 19 FTEs in the Office of Inspector General to replace 19 NTE positions previously funded by USF funds. These employees are necessary to adequately audit and investigate fraud in the $8 billion dollar Universal Service Fund program, the almost $1 billion dollar Telecommunications Relay Service Fund program, and the multi-billion dollar auctions program. The OIG also audits other FCC-related activities – contracting, personnel misconduct, and mission efficiency. Tangible results of the OIG's work include stopping $10M in fraudulent claims from TRS and $1.5M in false claims from the Low Income Program, as well as preventing tens of millions of dollars in fraudulent reimbursements from VRS.

OIG has invested considerable time and money to train the NTEs and risks losing them when their terms expire in 2012 or even prior to the conclusion of their contracts. The OIG already has lost six NTEs to non-term-limited employment with other agencies and organizations. Any further loss of trained, experienced staff would be a setback in fulfilling the mission of this office. Also, the USF-funded NTEs were hired to work solely on universal service matters, but FTEs could cover a broader scope, gaining greater expertise and protecting a wider range of FCC missions and programs.

Of the 19 FTEs requested, 17 positions are designated for senior or mid-level professionals. The 19 positions requested include a statistician, an experienced computer forensic and support specialist, a senior attorney advisor, six auditors and eight investigatory attorneys. The OIG also has two administrative NTEs: a senior management analyst who can be promoted to a GS13-10 level and a senior budget analyst who can be promoted to a GS14-10. We calculated salary and benefits at a GS-15/10 level for the senior and mid-level professionals, approximately $200k per FTE, or approximately $3.4M, with the GS 13/14 FTEs at approximately $130k each, bringing the total to just under $3.7M.

To the extent the budget for FTE salary and benefits is not fully used in any fiscal year, the money would be allocated to contract litigation and accounting support, which is needed to fill the gaps when FTEs are unavailable for necessary work. For example, the OIG has contracted for accounting support for investigations because of a lack of sufficient internal accounting/audit staff to support required investigative needs. The OIG also has contracted audit work to perform audits of program fund recipients for which there were not sufficient staff auditors. The OIG would always have some need for specialized contact expertise, but experienced FTEs would reduce that need on an on-going basis.

Mrs. EMERSON. Thanks. Mr. Serrano.

Mr. SERRANO. Thank you. Thank you so much. Mr. Chairman, PEG channels are a valuable part of our communities, providing them with local information and learning opportunities for people and the communities they serve. The channels were originally created along with cable service. However, now that we are moving to a new technology, the channels are in danger of being left out. In January 2009 the Alliance for Community Media filed a petition concerning unfair treatment of PEG channels. It has now been more than two years since this petition was filed. Can you tell me why it has taken so long for there to be a ruling, and when we can expect one?

Mr. GENACHOWSKI. Well, a couple of points, if I may. One is, I share your recognition that PEG channels play an important role in the landscape, providing a type of programming that you would not get in other places. And also they face challenges of the sort that you described, chiefly around cable companies or other multichannel video providers upgrading from analog to digital, and doing that in a way that makes it hard for PEG channels to come along. The good news that I am happy to report is that, in the year since we talked about this at the last appropriations hearing, about half of the complaints that PEG operators have filed have been resolved in a way that has been successful from the point of view of the PEG operators. Keep in mind that there is a lot of state and local involvement here, because the number and many of the requirements around PEG channels are done at the local level during the franchising process. And our abilities at the national level are somewhat constrained. There are some open issues, though, as you mentioned. And we look forward to continuing to work with you to make sure that PEG is treated fairly in this evolving world.

Mr. SERRANO. Do you remember, when we discussed this last time, there was not just the issue of this desire not to have PEG channels run anymore, but it was also those that were around in some areas were just being treated in a way where it was very difficult for them to exist. I remember the testimony we had about, in some cases, the PEG channels went from an easy place you could find them to Channel 900, and then there was a dropdown menu different from the rest of the channels, where you had to go find them. So, it really became an adventure to try to find them, which was, we think, just a way to try not to have them function. So, I hope as you resolve some of these issues and the complaints that you also look at the general treatment because, they were there at the beginning.

Here is what is interesting about that. I remember when cable first came to the Bronx, and I say I remember because, as you know, New York had a reputation of having great stations and nobody thought cable was necessary. So we got it after most of the nation got cable. It was very weird. But I remember that that was very much a part of the agreement. We will have all of this, then there will be public access and there will be PEG channels, and so on. Now, people seem to forget this earlier agreement, so I hope that you stay on top of this, because this is very important.

Mr. GENACHOWSKI. Understood. And I am hopeful that the positive resolutions over the last year can provide a baseline and a set

of practices that will make it easier to resolve the ones that are still outstanding.

Mr. SERRANO. Right. Now, Mr. Chairman, we always talk here about, we have in the last couple of years, about the digital divide, which continues to be a problem in this country. But there is a digital divide in terms of the small business community. They do have not access to the services necessary, and, in some cases, have not used technology properly. So, our question is, What are the major impediments to faster implementation of IT among small businesses? What are you encountering? What are we doing to help them? At the expense of getting some people on this panel angry at me, what is government doing to help them move along? What is in the future for small businesses?

Mr. GENACHOWSKI. I think this is a very important topic and sometimes in all the discussion about broadband adoption or broadband goals, it can be very focused on individual consumers. That is very, very important, but the opportunities of small businesses online are just enormous. You can expand your businesses to other markets, increase your customers, increase your revenue. You can move to lower cost services, by using your services online or in the cloud. More revenue, lower services, more profit, more jobs.

The obstacles that we have seen in our work on this are somewhat similar to the obstacles that we see in our consumer research. A lack of appreciation of the relevance of online benefits. In some cases, digital literacy, just not knowing how to do it. In some cases, affordability. In some cases, trust. Here are some of the things that we are trying to do. We have teamed up with the Small Business Administration to make sure, as they have boots on the ground in communities all over the country helping small businesses, that those people are able to help with new technologies and new opportunities. That has been a successful program so far with their initiative called SCORE. We are also taking steps to make sure that small businesses have access to more choices in the marketplace for broadband access.

Finally, we are addressing some of the trust issues that small businesses have. I have talked to small business owners who say, Yes, it seems like a good idea, but I am really worried about putting my sensitive data online or in the cloud. A reasonable worry, but there are steps to take. In the next month, we expect to do a forum on this, where we will present best practices for small businesses, steps that they can take to increase the security of their information online. Some of these things we all know; do not click on a link in an e-mail from someone you do not know. It would help to increase the level of understanding in small businesses and we think that we can help on that education campaign, and that will help increase small business adoption.

Mr. SERRANO. All right. Thank you. Madam Chair, in view of the fact that we may vote soon, I will stop now.

Mrs. EMERSON. Thank you very much, Mr. Serrano. Mr. Graves.

Mr. GRAVES. Thank you, Mr. Chairman, for being here. First, I want to thank you for your work. I know that you have a big task ahead and, as I ask everyone that comes before our subcommittees, I would love for your cooperation in providing us with some options

in how you can achieve the objectives of your commission with 10 percent less resources, 20 percent, and 25 percent.

[The information follows:]

BUDGET CUT OPTIONS AT PERCENTAGES: 10, 20, 25 %

MR. GRAVES. I would love for your cooperation in providing us with some options in how you can achieve the objectives of your Commission with 10 percent less resources, 20 percent and 25 percent.

MR. GENACHOWSKI. I appreciate this opportunity to provide information related to potential cuts and impacts. As you know, the Commission is fee-funded and reductions would be deficit-neutral. I appreciate the need for austerity in addition to the self-imposed fiscal restraint that we have exercised in the development of our FY12 Budget request but additional reductions would adversely affect agency operations.

The following table shows reductions of 10%, 20% and 25% to the FCC's FY 2012 Budget Request, and notes their relative impacts:

	Current FY 2012 Budget Request	**10%**	**20%**	**25%**
Budget Level	354,181,000	318,762,900	283,344,800	265,635,750

At the 10% level -- $35,418,100 reduction -- the FCC would maintain its current operational levels but delay or eliminate funding for the following initiatives:

1. Public Safety – the FCC requested $1.85M for targeted programs related to telecommunications activities. For instance, we have requested $1 million to create the Emergency Response Interoperability Center – ERIC. Lack of funding could negatively affect public safety interoperability initiatives and delay efforts to ensure that first responders such as policeman and firefighters are able to communicate seamlessly across mobile networks. The Commission also requested $350,000 for the Portable Direction Finding System. Without this funding we anticipate a growing problem from GPS jammers, higher interference to FAA air traffic control, more cellular and wireless drops, declines in local points of broadband deployment, more pirate radio stations, and related issues. Also, $500,000 for the Cyber Security Certification Program would be eliminated.

2. Universal Service Fund Reform – the FCC has requested $3.5 million to support efforts to reform and modernize the Universal Service Fund to reduce waste, fraud, and abuse and transition the program to support broadband. The Commission has already released a Notice of Proposed Rulemaking to update and improve USF, and a reduction in funds would delay the development of the data necessary for examining all relevant issues in this proceeding. The funds would cover the FY2012 portion of the cost of hiring

an external contractor to develop a model, and gather and incorporate public input, to determine how to disburse $4.5 billion in annual High-Cost Fund support.

3. Office of Inspector General – OIG – the OIG has requested $3.2 million for 19 full-time employees. This amount includes salaries, benefits, and other costs associated with supporting these positions, for the purpose of combating, waste, fraud and abuse. In addition to the request for additional full-time employees, the OIG has requested $2.7 million for necessary investigation and auditing contract services support.

In the event of a reduction to the requested funds, the OIG would continue its efforts to provide effective oversight of the FCC's programs and operations. Any reduction to the requested funds, in particular reductions in the range of 20-25%, would severely degrade its ability to conduct audits and investigate allegations of fraud, waste and abuse. The immediate impact of this funding reduction would be to scale back audits and investigations in all areas, including oversight of the $8 billion per year USF program. OIG audits and investigations are currently pursuing hundreds of millions of dollars in potential recoveries.

4. Information Technology Savings – the FCC requested $5.7M for Information Technology improvements, of which $4M would be used to complete the consolidation of the FCC's licensing systems into one system, finish the consolidation of the FCC's data centers, and effectuate final improvements to fcc.gov. The projected savings to the Commission from consolidation of the FCC licensing system are over $5M in annually, through the life of the system or seven years, with over $35M in cost savings. We estimate over $1.3M in annual savings after finalizing the data center consolidation. The other $1.7M of the $5.7M would have been used for maintenance of the broadband.gov website and interactive, searchable map. In addition to cost savings at the FCC, regulated industries would realize savings based on better data availability and collection methods.

5. New Entrant Studies – the FCC requested $1M for data collection to complete media diversity studies to help fulfill statutory duties. Every three years the FCC is obligated to review our rules regarding new entrants. This report would help the FCC collect data to inform our decision making. This has been done on a bi-partisan basis and is a long standing mission of the FCC.

6. Other Broadband Initiatives - $1.4M for a Broadband Data Improvement Act Survey – BDIA – and broadband speed testing equipment. It is essential to repeat the BDIA survey over several years to develop measures of success for broadband adoption and deployment.

NON-INITIATIVE REDUCTIONS AT 10 PERCENT

At the 10% level, in addition to the reductions described above, the Commission would reduce its base budget by $5.8M. To accommodate this reduction we would reduce travel, eliminate awards for employee achievement, implement a hiring freeze and if necessary, cut approximately 39 FTEs. These reductions would have both an adverse impact on the Commission's ability to fulfill its congressionally-mandated obligations and disrupt essential ongoing projects. Given the Commission's current low level of FTEs – the lowest in 10 years – a reduction at this juncture could delay routine Commission processes related to licensing, complaint resolutions, and also reduce consumer outreach efforts.

For example, the Commission's Office of Engineering and Technology is relied upon to certify that new devices do not cause excess interference or Radio Frequency emissions. FTE reductions would result in slower product approval for new devices at a time when smartphones and other mobile devices are surpassing personal computers in consumer demand. From 2009 – 2010, rates of adoption accelerated by 74 percent, with 298 million smartphones sold worldwide.

In addition, the reduced FTE levels likely would have an adverse impact on the Commission's ability to resolve disputes between regulated entities. Our Enforcement Bureau is routinely called upon by carriers, licensees and other entities to assist with disputes with one another related to commercial arrangements pertaining to our rules. Examples are intercarrier compensation disputes, retransmission consent agreements, interconnection agreements and a wide range of other matters.

Enforcement field agents would continue to focus on safety-of-life issues, but would have less time to investigate non-safety interference issues raised by wireless carriers, federal and state government entities, broadcasters, and consumers. Fewer resources would cause significant delays in the resolution of formal complaints filed by the public alleging that telephone companies have violated FCC rules, adversely affecting both consumers and businesses that are relying on EB's dispute resolution processes.

20 PERCENT REDUCTION LEVEL

At the 20% level ($20,339,212 reduction), in addition to the above impacts the following would occur:

- Severe impact on the everyday operations of the FCC and significant headcount and contractor reductions.
- Delay of the Public Safety Bureau's 911 proceedings, which include improving location-based standards and next-generation services.
- Reduced staffing levels for cyber-security initiatives, which would dilute the FCC's expertise in this important area.
- Reduced operations in field offices leading to less monitoring for interference across the wireless spectrum, which would cause an increase in harmful interference across the country.
- Potential additional cut of 136 FTEs.

25 PERCENT REDUCTION LEVEL

At the 25% level, ($38,048,262 reduction), in addition to the above impacts this level of reduction would have a severe impact on all FCC operations by increasing shortfalls in staff and operations. As noted above, the Commission would be unable to conduct some mission-critical operations related to enforcement, while experiencing delays in application processing, waiver processing, and other administrative activities. The Commission would be forced to implement furloughs and/or reduce more FTEs. If the Commission cut only FTEs then the reduction would be approximately 254 FTEs total.

Mr. GRAVES. I will be submitting a letter for the record as well and your office should receive that. I hope we can get your assistance in that and we can work together as a partner in that way.

If not, I imagine that this committee, as the Chairwoman has already brought up, will be looking to make some of those decisions for you. We would rather have your help in that, so I hope you can help us. I want to go back to November, when the FCC opened an investigation on privacy, the invasion of privacy of Americans, and just ask what is the status of that investigation into Google and the harvesting of personal data?

Mr. GENACHOWSKI. You are referring to a specific investigation, which I cannot comment on. In general, I would say that any uses of spectrum or communications facilities that are in our jurisdiction are things that we would take seriously.

Mr. GRAVES. So when do you expect that will be concluded?

Mr. GENACHOWSKI. Again, I cannot comment on a specific investigation. It is in front of our Enforcement Bureau. So, with apologies, I can only comment generally, but not in a specific investigation.

Mr. GRAVES. Okay, so really no idea when that will be concluded, even though there is by Google's own admission that data was collected, could be 62 million American e-mail addresses and personal data, but no idea when something may occur.

Mr. GENACHOWSKI. Nothing that I can say about an ongoing investigation.

Mr. GRAVES. Would you consider their admission that data has been collected? Do you consider that eavesdropping on innocent Americans?

Mr. GENACHOWSKI. Again, it would not be right for me to comment on a specific investigation. In general, the FCC has had privacy rules in place for some time. They protect consumers when they make phone calls over wires, they protect consumers when they make mobile calls. They protect consumers when they are using various kinds of telecommunications facilities. We consider the privacy rules in our governing statute and in our rules to be very important. People have an expectation of privacy.

Mr. GRAVES. So, do you consider it eavesdropping?

Mr. GENACHOWSKI. Again, I will not comment on a specific investigation, but if there are any violations of our rules, we would take them very seriously.

Mr. GRAVES. But would you consider anybody who harvests data from unknowing, innocent Americans identity theft, if it is personal data?

Mr. GENACHOWSKI. There are many instances in this country of violations of privacy, misuse of communications facilities. We have other areas where we have investigated privacy violations. We take those very seriously. I understand what you are asking. I apologize that I cannot answer, but I just cannot talk about a specific investigation.

Mr. GRAVES. So you are not certain if it is eavesdropping, not certain if it is an invasion of privacy or identity theft. Do you agree with the FCC's Enforcement Bureau, Michele Ellison, who said that it is a breach of privacy? Do you agree with that?

Mr. GENACHOWSKI. I do not remember her quote exactly, but I remember at the time agreeing with what she said. If I could see the full quote, I am sure I would agree with the full quote.

Mr. GRAVES. Right. She referred to it as a breach of privacy and it seems that this has been ongoing for awhile, because, prior to November, it was actually in May in which it was reported to the FTC. Is that right? They might have closed their case on that, but then you opened up one. So it has been going on awhile, three years of data has been harvested. I think the American people expect some action on that and I would hope that you would move swiftly. Because I can only imagine, and I would love for your response on this, if the government drove around taking pictures of homes, and at the same time was harvesting data over unencrypted Wi-Fis. How would the American people react to that?

Mr. GENACHOWSKI. They would react badly, as they should. Americans should and do react badly to any invasions of privacy or violations of the rules that exist in privacy.

Mr. GRAVES. So they should expect the same with anyone else, whether it was me or a large corporation, or the federal government themselves?

Mr. GENACHOWSKI. I cannot disagree with that.

Mr. GRAVES. All right. Thank you.

Mrs. EMERSON. Ms. Lee.

Ms. LEE. Thank you very much. Good afternoon, Mr. Chairman. I apologize for being late. We had several meetings going on at the same time, and hearings. So, if my question is redundant, I apologize. First, I just want to say how important the FCC is to communities of color and underserved communities. So much of what we have been trying to do is close this digital divide and I would just like to get your sense of how that is going, if we are heading in the right direction. Secondly, in terms of any dramatic cuts to your budget, I would like to know how that would impact the work of the FCC. Thirdly, with regard, I am glad that you have reinstituted collecting data on the involvement of minority and women participation in the media and broadcast industry, because we have to be able to rely on data to make intelligent decisions about public policy.

Along those lines, the Comcast-NBC merger, I know that is done, but in terms of the memos of understanding and all of the oversight responsibility, some of us thought the deal really was not what it should be, given the lack of minority participation in this. How, moving forward, will the FCC make sure that whatever those memos were, that they are complied with, for the full participation in minority and women-owned businesses?

Mr. GENACHOWSKI. Thank you Congresswoman. In general, you identify a set of issues that have been historically bipartisan issues at the FCC, the goal of providing new entry to minority communities and others who are at risk of being left behind, the ability to participate in these technologies, these opportunities. In the area that is fastest growing and has the greatest opportunity, which is broadband and mobile-related opportunities, we are seeing two things. One is, there are across-the-board issues where, as a country, we are not where we should be. I mentioned some statistics earlier. Our adoption rate in the U.S. for broadband is about 67

percent, which compares to about 90 percent for Singapore and South Korea. But in certain communities, that number is even lower: minority communities, the elderly, rural communities, low-income.

Meanwhile, the costs of digital exclusion are rising. Five years ago, if you were looking for a job and you did not have internet access, it was okay. You would find the classifieds in the newspaper and you would call up. You would at least be in the running. Today, if you do not have access to the Internet, you cannot even find the job, because the classifieds have moved online. And if you do not have basic digital skills, you are probably not eligible for the job. I do hear from business owners around the country who say, Actually, we do have some jobs open, but we need people who have digital skills, and they cannot use the Internet and they cannot use Excel and they cannot use Microsoft Word. So these are very big problems. There's no single silver bullet.

Here are the kinds of initiatives we are working on. One, we are looking at reforming our Lifeline Link-Up program in a sensible way. This is the program that for many years has helped with adoption of telephone service. So, as part of our overall USF reform effort, bringing that program into the 21st century is an opportunity and a challenge, but it is one we are taking on. Second, we have been running activities to bring together entrepreneurs from diverse communities with capital. We call them speed-dating sessions, but they have been successful in overcoming barriers and getting the private market to work better for entrepreneurs. As I mentioned earlier, we are working with the Small Business Administration, so that their outreach to small businesses across the country includes education about the opportunities of the Internet for small and diverse businesses. So, these are just some of the areas we are working on. If I could mention one other example, on adoption, we are working on public-private partnerships. This is one of the areas where there is as much an opportunity for a win-win as you can find anywhere else.

Any new subscriber for an Internet service provider is a win for that person who had previously been excluded, and also a win for the company because they get another subscriber. There are some innovative programs going on in the country that are focused on low-income Americans, communities that would otherwise be left behind. One of the things we are trying to do is work with companies to see if those, call them pilot programs, those pilot public-private partnerships, can be expanded and have more of a positive effect across the country.

Ms. LEE. Comcast-NBC merger.

Mr. GENACHOWSKI. I think with respect to any merger that has conditions, we have an obligation to make sure that the conditions, that the commitments made to the agency are honored, and we will have a process to make sure that that is so.

Ms. LEE. Finally, the budget cuts.

Mr. GENACHOWSKI. Budget cuts I will answer briefly, because the chairwoman asked the same question. Our ability to free up spectrum, generate auction revenue, would be hurt. Our ability to investigate waste, fraud, and abuse with our inspector general's office would be hurt. Our ability to transform the Universal Service Fund

and take an inefficient program and make it an effective program would be hurt. We provide various services for consumers such as call centers, that would be hurt. We are in the middle of projects to upgrade our infrastructure in a way that would save money, consolidated licensing, consolidating data centers. Stopping those would have, as would these other things, a negative return on investment. This is an important area to me. I spent the last 10 years in the private sector. The head of our managing director's office, who is in charge of this, spent the last 14 years in the private sector. We both tried to drive here a private-sector mentality of making sure that we are getting the most bang for the buck in everything that we do; that we are taking costs out and delivering a greater return for the public.

Ms. LEE. Thank you. Thank you, Madam Chair.

Mrs. EMERSON. Thank you, Ms. Lee. Our vice chairman, Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you Madam Chairwoman. How are you, sir, Mr. Chairman?

Mr. GENACHOWSKI. I am good, thank you.

Mr. DIAZ-BALART. Let me ask you, in the history of mankind, can you think of anything where there has been more innovation, so much innovation that has connected more people, that has employed more people, that has led to more inventions and innovations and spin-offs and launched more businesses and had more of an impact in such a short time? In the history of mankind, can tell me a couple of those that have done more than the Internet?

Mr. GENACHOWSKI. I do not know that any has. It is an extraordinary boon to innovation, investment, job creation.

Mr. DIAZ-BALART. It truly is. It is one of those things that we are living in this incredible time and yet it looks like the answer to that is more government intervention and regulation. I guess government, who is not known as the innovator, the job creator, the efficient animal, is not doing enough. I guess the FCC now believes that government would have done better, could have done better, or regulation that government will come up with is better. I want to go back to your statement on page two.

Mr. GENACHOWSKI. I would be happy to answer that, if you would like.

Mr. DIAZ-BALART. I think you already answered the issue about the fact that the Internet has clearly been among the most innovative things in the history of the planet, probably the most innovative, and yet it is clear that the FCC now wants to intervene there further. But let me just go back to your statement. You talk about how, even as the communications industry has grown, telecommunications is a critical and growing part of our economy. Yet, as the communications industry has grown in size and complexity, the FCC has remained relatively small and focused. You talk about how after the turn of the 21st century, even after the explosive growth in telecommunication services, the FCC is at a 10-year low in FTE. So, have you ever thought that maybe part of the reasons for that explosive growth is precisely because the FCC has not been meddling in every single decision? Have you ever thought, is that a possibility, that there is a correlation between this explosive growth? This innovation that you have just stated has no prece-

dent. Could there be some relationship with not too much government regulation and that explosive growth?

Mr. GENACHOWSKI. Two quick reactions. One is, with respect to preserving the freedom and openness of the Internet, and I could not agree more strongly with you that that is a central driver of innovation and our global competitiveness, on a bipartisan basis for the last five years, it has been thought at the FCC that basic rules of the road that give the broadband economy certainty and predictability would allow that to continue. That is what we did at the FCC, bringing in constituents and stakeholders from across the spectrum, internet-service providers, as well as early-stage businesses. There are many areas where we are working very actively to reduce regulations, reduce burdens on businesses. For example, opening up uses of spectrum, bringing market forces into uses of spectrum. There are areas where the FCC has responsibility for public resources, where it takes work and effort to make sure that those resources are being used for innovation and economic growth, like spectrum. So I would very much enjoy the chance to work with you on bringing market-driven policies to spectrum. I think there is some enormous opportunities for bipartisan efforts to unleash even more innovation in our mobile space.

Mr. DIAZ-BALART. Am I correct that the Net Neutrality vote was a split vote?

Mr. GENACHOWSKI. It was a split vote at this FCC. Yes.

Mr. DIAZ-BALART. At the FCC, because there was obviously many, even in your board, that had those concerns about, frankly, over-regulating, and that you might have just the opposite effect. Sometimes government is in search of a problem. They have a solution for a problem that they later invent, and it seems that this may be one of those areas, but what you are potentially putting at risk again. And we agree with this, is the most innovative, the most dramatic, the most open, the most wealth creating animal maybe in the history of mankind. And yet, it seems that now, you know, a small group of people in the FCC people that they may know better than this incredible, dramatic thing.

It is frankly a little frightening because now I hear rumors that the FCC may also be looking at wireless. And then, we will talk a little bit about that. But let me just ask you, do you have a cell phone?

Mr. GENACHOWSKI. I do.

Mr. DIAZ-BALART. All right. I do too and I actually have two of them, because we are all weird in this place. Right? I am pretty sure that your first cell phone, like mine, that was in the second generation of that brick. The first one was too expensive. I am assuming that your first cell phone just made calls.

Mr. GENACHOWSKI. True.

Mr. DIAZ-BALART. I am also assuming that you either have a BlackBerry or a Smartphone today that you can get phone calls, that you can get video, you can do SMS, MMS, Twitter, everything else. These are all new technologies that did not exist 10 years ago. Is it not because of the private sector innovation? Or is it government that comes up with all of these wonderful ideas and then tells the private sector, This is what you have to do and this is how you have to pursue it. I mean, which one is it?

Mr. GENACHOWSKI. It is absolutely private sector. It is one of the reasons I am pushing so hard for a tool to use more spectrum auctions, two-sided auctions to bring more market forces into allocation of spectrum, free up spectrum for auction, billions for the Treasury, and even more innovation. And I was very, very supportive of the historically very important move that was made about 15, 20 years ago from spectrum lotteries and comparative hearings to auctions.

Now the FCC has to run the auctions and it has to do a lot of work to identify spectrum to auction. A last quick point that I would make is I completely agree with you about the devices, the Smartphones that we each have, use about 22 more times spectrum than the old feature phones. The tablets that many of us have use 122 times more spectrum. We are facing a spectrum crunch in the country, and I very much look forward to working on a bipartisan basis to come up with market-based solutions to solve them.

Mr. DIAZ-BALART. And we need to, just again it does not seem like it has been a very bipartisan effort within the FCC.

Mr. GENACHOWSKI. Over 95 percent of the FCC's decisions are unanimous or bipartisan.

Mr. DIAZ-BALART. Right, not net neutrality. And again, that one seems to be a solution trying to find a problem. And I think we all agree that clearly there has been innovation. In 1997, the average cell phone bill was $98.63. In 2010, it was $47.21. In 1995 there were 340,000 cell phone subscribers in the United States and now there are 300 million subscribers. And again, these are private sector innovations.

And here is my concern, Mr. Chairman. We all know that there is a need for some regulation. There is no doubt about it. But there seems to be this attitude, now, within the FCC, with your FCC, that it is almost like addicted to government; addicted to power. That now the federal government knows how to regulate the internet, the most innovative thing in the history of mankind because, I guess it has maybe been too innovative? It is crazy because it is too innovative? But the reality is that there a lot of us who are really concerned including almost half of your FCC board, with net neutrality, that is frankly, highly concerned that you are basically now meddling into something that has been an incredible advance. One of the most historic advances in the history of humanity as far as quickly. And because the federal government, the FCC, frankly knows best.

Mr. GENACHOWSKI. If I may, the driving force behind what we have done is preservation of the incredible freedom and openness of the internet and the role that plays in driving innovation and job creation. And it is why we sought out to and were able to build very broad-based support for the sensible balance that we ended up with, from early stage and late stage technology companies, to the cable industry, major ISPs.

Mr. DIAZ-BALART. On that thought, though; you were talking about preservations of that. Well, wait a second. How is it possible then, to create it? You have to preserve it, I guess. But how was it created and preserved before you decided that government was going to be know-all, do-all. In other words, how did it become so

big? What is it that you have to preserve? How would it be there if it was not for the federal government to take care of it originally?

You are preserving something that was already created without your involvement, without the need of the federal government to do it, without taxpayer funding. So how was it created, without you being there originally to take care of it?

Mr. GENACHOWSKI. Putting aside for a moment the origins of the internet its own story of the healthy relationship between the government and the private sector; what the FCC started realizing about 5 years ago, on a bipartisan basis, is that there were threats to freedom emerging and that sensible, high-level balanced rules would preserve freedom, and competition, and innovation on the internet. Not everyone agrees and I respect different points of view. But that was the goal. It has been supported on a bipartisan basis but the resolution that we came up with was not satisfactory to many of the people who were arguing for the stronger measures. There were many people who thought we did not go far enough. But fundamentally, it brought together different segments of our broadband economy, added certainty and predictability to the marketplace, because I want to see our broadband economy not fighting with each other. I want to see them competing with each other. But I do not want to see them having, you know, non-productive policy fights. I want to see that energy go and compete with the rest of the world, where we are in danger of falling behind unless we really take advantage of the wonderful entrepreneurial assets that we have in the United States and tackle some of the strategic issues that we face as a country.

Mr. DIAZ-BALART. Madam Chair, I do not know if I have much time as I have a few more questions, but maybe for the second round.

Mrs. EMERSON. Yes. for the second round, please, and we will let Mr. Bonner go and then what we are going to do, just so everyone knows, when we start the next vote, at about a minute and a half, we will take about a 10 minute recess and then we will be right back because we will have two more votes. Okay.

Mr. DIAZ-BALART. Sure.

Mrs. EMERSON. Thanks. Mr. Bonner.

Mr. BONNER. Thank you, Madam Chair. Mr. Chair. I do not know if you received, or if you are aware even, that I wrote you a letter last week and I would not hold you accountable to being aware of that, but I have a copy of it that I will give you. But I want to just say briefly, it addresses the Commission's proposed spectrum policy. I am sure I am not the only member of Congress who has written about this.

During the national transition from analog to digital television, both the American consumer and broadcasters made significant investment in digital equipment. In the FCC's efforts to re-allocate spectrum for broadband development and deployment, what steps is the Commission taking to guarantee the public's ability to continue to receive high-quality over their digital television programming and to protect television broadcasters' ability to deliver vital local news programming to their viewers?

Mr. GENACHOWSKI. The challenge we are seeking to address is the one we were talking a little bit about before. It is the gap cre-

ated by all of the new, exciting devices on spectrum creating tremendous demand for more. Spectrum supply is essentially flat. And we need to solve this gap for a couple of reasons.

One is, consumers are going to be incredibly frustrated as they use their Smartphones and their tablets, and they know what dropped calls feel like; they are going to hate dropped internet connections. They are going to hate having bad connections. And that will, I fear, frustrate and slow down the incredible economic opportunities that come from the mobile revolution.

And that is agreed to by many industries that are involved in this, the wireless industry, the consumer electronics industry, the technology industry, et cetera. And they specifically support the tool that we have suggested and that has been supported on a bipartisan basis, for the FCC to have the tool to conduct incentive auctions. Simply, an auction of the sort we are familiar with, but where the supply of the spectrum would come from licensees who voluntarily contribute their spectrum in exchange for a portion of the proceeds.

It is a way to bring market incentives, market forces into allocation of spectrum. In that process, if it were applied to broadcasting, our expectation is that the vast majority of broadcasters would continue to broadcast exactly as they are, because any digita1 to digital transitions are very different in kind from the analog to digital transition. And we are committed to addressing the kinds of issues that you are mentioning and I look forward to working with you on that, and finding a solution that helps drive our economy and frees up spectrum to raise money for the Treasury.

Mr. BONNER. I look forward to it as well. I note in your discussion, in your written testimony, about the FCC's investment in cyber-security and homeland security efforts. Given that we already have a Department of Homeland Security and the Cyber Command within the Department of Defense, not to mention cyber security spending in other federal agencies, like Treasury, Health and Human Services, Agriculture, and Transportation, to name just a few, which is estimated to reach $55 billion a year by 2015. Do you think it is fair to say the FCC's entrance into this field is an example of mission creep?

Mr. GENACHOWSKI. I do not, sir. With respect to public safety spectrum, the FCC has had responsibilities in these areas for years and years, and whether it was with respect to the older phones that firefighters and police officers used around the country or our efforts to upgrade that to a mobile broadband public safety network, and also move to next generation 911. These are activities that the FCC has been recognized as having very important responsibilities for decades. With respect to cyber security, the FCC is the agency of the government that interacts with the commercial companies that carry internet traffic, and so it has been recognized in all of the inter-agency cyber security efforts that as a result, the FCC has an important role to play in cyber security and connecting with the other agencies that are focusing on other parts of the problem.

So I appreciate the question, and I can understand why you would ask it, but there is, I think, a proper history. Just last night, I was at a dinner where the FCC was honored for its work on 9–

1–1 and specifically for helping to move to next generation 9–1–1. As I mentioned in my statement, I think it is close to a crime that people today cannot text to 9–1–1. You cannot take a photo on your smartphone of a crime and zap it to 9–1–1, and we are working very hard with the first responder community, with Congress, and with others to make progress. And for many years, the FCC has been involved in improving 9–1–1.

Mr. BONNER. Well, as a quick follow-up, though, I mean, is there any area of jurisdiction at the FCC that you think is redundant with some other federal agency or department that we do not need? I think there is a real disconnect in Washington with the rest of America. It is hard for people who only visit this city to come to the tourist attractions or perhaps to come see their members of Congress. I think, sometimes, they have a real reason to believe that we are totally in the land of disbelief. When you are talking about the kind of debt that we have got, the kind of deficit that we have got, that is why I am asking about redundancy in programs when other agencies are doing similar things. I think it is a fair question at this difficult time.

Mr. GENACHOWSKI. I agree it is a fair question, and when I arrived at the FCC we asked that question internally. What are we doing that is redundant, where can we save money?

Mr. BONNER. And what did you find?

Mr. GENACHOWSKI. Well, one of the things that we found was that we had multiple licensing systems that kind of grew up historically that were inconsistent, that took longer for employees internally to use, and that were incredibly frustrating to the private sector that relied on them, and we embarked on a mission to consolidate our licensing services. We also found that the rules at the FCC were such that people in different parts of the agency were discouraged from working together, across bureaus and silos, even though almost every issue we face involves both wired and wireless. We removed those barriers, and I think we have become a more efficient organization in part because of it. I mentioned we have identified other areas of cost-saving, and I do not think you were in the room at the time, but I come from ten years in the private sector. I hired a managing director who came from 14 years in the private sector managing budgets, managing P&L, and while I am sure there is always room for improvement, we have been focused on bringing private sector best practices into budgeting and operations at the FCC.

Mr. BONNER. I think we are going to get another vote called. Let me try to get a couple questions, and if you cannot answer them at this time, maybe you can get it to us on the record. How many employees do you have working at the FCC today versus 10 years ago?

[The information follows:]

FTE COMPARISON LEVELS

Mr. BONNER. How many employees do you have working at the FCC versus ten years ago?

Mr. GENACHOWSKI. The requested FTE level for FY 2012 is 1,794, which is 198 FTEs lower than the FY 2002 level of 1,992 FTEs.

Mr. BONNER. What is the budget request today versus ten years ago?

[The information follows:]

BUDGET COMPARISON LEVELS

Mr. BONNER. What is the budget request today versus ten years ago?

Mr. GENACHOWSKI. The requested budget for FY 2012 is $354.2M which is $109.1M above the FY 2002 level of $245.1M.

Mr. BONNER. A lot of times when we are budgeting out for 50 years or 100 years, that is beyond most people's ability to comprehend. So let us look backward and see where you are today in terms of number of employees, and budgets. Now I do not want you to actually hire anyone new to do this, but assuming you have got someone in your capable staff who could do it, I would love to know how many words of new regulation have come under your leadership with FCC during the last two years and have been published in the federal register.

[The information follows:]

NEW REGULATIONS

MR. BONNER. I would love to know how many words of new regulation have come under your leadership with the FCC during the last two years that have been published in the Federal Register.]

MR. GENACHOWSKI. Based on our search of the Federal Register and Commission records, I have listed our new regulations published in the Federal Register during the past two calendar years. I have broken them down by category to assist you in evaluating their basic necessity and I can provide further information on each regulation and its history if you need further assistance. Please note that I did not include changes to the tables of allocations, amended rules and similar materials, which are also published in the Federal Register.

Total new regulations = 20*

A. Statutory requirements – 3 – the Commission is required to initiate these proceedings per Congressional mandates.
    1. Terrestrial-programming delivery (Sec. 628(b))
    2. Satellite Television Extension and Localism Act – two regulatory actions
B. Public safety – 4 – the Commission has focused on public safety programs within its statutory mandate, for instance, the Emergency Alert System for broadcasters, technological issues to update 911 systems, and interoperability.
    1. Emergency Alert System
    2. E-911
    3. ERIC
    4. Public safety priority on PLMR
C. Spectrum – 6 – as part of its ongoing work and in an effort to move ahead on National Broadband Plan recommendations, the Commission created better spectrum efficiencies and provided more spectrum for industry and consumers.
    1. White spaces
    2. Spectrum allocation for on-body medical devices
    3. BAS Relocation
    4. Increased bandwidth for fixed microwave
    5. Puerto Rico 800 MHz Band Plan
    6. FM power
D. Disabilities – 2 – the Commission updated its rules to ensure accessibility for different communities and to create more efficiencies in TRS.
    1. Hearing Aid Compatibility rules
    2. TRS
E. Consumer Protection – 2 – the Commission acted to assist consumers in receiving more and better communications services.
    1. Extension of discontinuance notice requirements to VoIP
    2. DTV translators – allow broadcasters to cover analog footprint

F. Other - 3
   1. Established Forbearance procedures
   2. E-Rate (2 items)
   3. Regulatory Fee methodology for submarine cables

Mr. GENACHOWSKI. I also promised a list of regulations that we have deleted, and I want to clarify that we have rules that have been eliminated and we also have targeted data collections because we consider them unnecessarily burdensome. I have provided more details on the data review process in my answer to a question for the record submitted by Chairwoman Emerson.

In addition, we are undertaking our biennial review to determine if unnecessary rules are on the books. Also, in compliance with the Regulatory Flexibility Act, we have initiated a review of rules adopted by the FCC in calendar year 1999 which have or might have a significant economic impact on a substantial number of small entities.

Below is a table of specific rules deleted, omitting our Table of Allotments:

Sections removed	**Effective date**
90.20(g)(3) 90.20(g)(4)	3/2/09
23.1 23.11 23.12 23.13 23.14 23.15 23.16 23.17 23.18 23.19 23.20 23.21 23.22 23.23 23.24 23.25 23.26 23.27 23.28 23.29 23.31 23.32 23.35	1/6/2010

23.36 23.37 23.38 23.39 23.40 23.41 23.42 23.43 23.44 23.45 23.46 23.47 23.48 23.49 23.50 23.51 23.52 23.53 23.54 23.55	
90.247(b) 90.247(c) 90.267(e)(3)	5/14/10
27.53(a)(9)	9/1/10
54.501(a)	1/3/11
54.51(c)(3)	1/3/11
0.191(o) 0.392(g) 97.5(b)(4)	2/14/11
97.311(d)	4/29/11

Mr. BONNER. You talked about small business and you mentioned that you have a private sector background. I live in Alabama. I do not live up here. I just work up here. Most of the small businesses that I have talked to, whether they are in the industry or not, are begging for relief from regulation. We need regulation. I am not saying you do not need it, but I am just telling you it would be interesting to know how many new words of burden, regulation, expense, that this government is imposing on them and their ability to compete in a global marketplace. And again, if you can answer those now, that is great. If not, we would love them for the record.

Mr. GENACHOWSKI. I am not sure I can tell you the words, but we will get back to you on that. And we will also send you the list of regulations that we have found that we can repeal because they did not serve a purpose anymore. Early in my tenure, we set up FCC reform task force to do a sweep and identify unnecessary regulations and repeal them. I believe they identified 20. And we are in the process of doing that. And so I would be happy to put that together for you. In terms of the number of FTE's, I think we are at a lower number of FTE's now than we were 10 years ago and approximately 1,775 now, and I cannot remember exactly the number 10 years ago, but we will get that for you. And you had a third question?

Mr. BONNER. Just how the budget has grown or shrunk over the last 10 years.

Mr. GENACHOWSKI. We will get that for you. I do not remember what the budget level was ten years ago, but we would be happy to get that for you.

Mr. BONNER. Great. Thank you. Madam Chair.

Mrs. EMERSON. Okay. Let's just go ahead and vote, because we do not have enough time to really go through another question. We will go vote and take a 10-minute break and we should be back hopefully by five past two. Thanks.

[Recess.]

Mrs. EMERSON. Okay. We are going to start again. I am going to allow Mr. Serrano to ask his next round of questions since Mr. Yoder is not quite ready yet.

Mr. SERRANO. Rather than go through all the prefacing comments on this, this whole thing with the FCC granting conditional approval for a company called LightSquared to build a terrestrial wireless broadband, now, the concern is that what they are building will interfere with GPS. And GPS, I do not know how long ago, to follow up a bit on Mr. Diaz-Balart's line of questioning today, GPS stopped being a fun, innovative thing and became very much a necessity for so many people, and so many law enforcement agencies, and so on.

So the concern is that this will interfere with that service. And that is a big no-no. What can you tell us about that, and what precautions are you taking to make sure that that does not happen? And what is it exactly that they are going to do?

Mr. GENACHOWSKI. Protecting safety, making sure that there is no interference with GPS, that harms safety is very central to what we are doing. Let me take a step back. An important part of our job is finding ways to unleash spectrum, make more spectrum

available for new uses, for innovation, for job creation, for investment. And, in this case, this particular company has a proposal to build an innovative network, to invest literally billions of dollars, create hundreds of thousands of jobs, and provide mobile broadband services.

Now as it is very common in the history of the FCC that when a new service proposes to launch, that interference issues are raised with existing services. And this is something the FCC has done for years. It has fantastic engineers that work with the engineers from the various parties, and others, to resolve interference disputes. There is an interference dispute right now about whether this new service would interfere with GPS.

Mr. SERRANO. And this new service would be used for what?

Mr. GENACHOWSKI. It is called LightSquared, they are providing mobile broadband services for consumers and businesses.

Mr. SERRANO. So no different than what we have now, just more?

Mr. GENACHOWSKI. Exactly. This is what we were talking about before, we are running out of spectrum, and in this case, it is proposing to use some spectrum and it is not worth getting into the details; but the short answer is, yes, it would be more and we need more.

The GPS industry has raised interference issues, as I said. We are running the kind of process that we have run many times in the past to study the facts, to study the engineering, and to make sure that anything that we ultimately approve addresses interference issues that were raised. And obviously we are not going to do anything that would create safety issues with GPS.

Mr. SERRANO. Just one last question. Existing broadband services do not seem to be a problem for GPS. Why do the supporters of GPS services' technology feel that this particular one would be a problem? What is different about this delivery of service that is different from what we have now?

Mr. GENACHOWSKI. It is a good question. Part of the answer is where on the spectrum chart this new service would be provided. And, again, this is something that is very common at the FCC, when any band of spectrum that is being used for a particular service in a way that it has not before, it raises new issues.

And there are people who have been doing this at the FCC for decades: resolving interference disputes between parties. They are very, very good, they have tremendous credibility and respect, and they have earned it, because their track record over the years of making engineering-based, fact-based determinations about interference disputes is exactly what you would want the FCC to do to make sure that we are getting the balance right between driving investment, driving job creation, driving innovation and new services, while also protecting against interference to existing services, particularly interference that may cause harm and threaten safety, which we will not allow.

Mr. SERRANO. Okay. I have one more question. Ten years and we are still talking, in many ways, and rightfully so, about 9/11. But one of the issues of 9/11 and that whole period of time was the inability of first responders to communicate with each other. And a lot has been said, a lot has been done. And you folks proposed some dramatic changes which some folks are opposing. Where is that

whole issue? How much different are we now, heaven forbid we should ever be in that situation again?

I was, unlike most members of Congress, I was in New York on 9/11, and in fact I always comment on the fact that we spoke about everything the terrorists did on that day. And one of the things that was never really written about is that there was an election going on which was suspended, or postponed, at 11 a.m. in the morning. So not only did they bring all that harm, and they attacked symbols of who we are, Wall Street, and the Pentagon, and they were trying to attack the legislative body, or the White House. But also the fact that they interfered with the electoral process, if you want to carry it that far. It was a wide effect.

And I remember that, at that moment, and for quite a while, there was no way to communicate by phone or anything else. If we were having that problem and we know first responders were having similar, or even more difficult, problems? Where are we now, 10 years later?

Mr. GENACHOWSKI. Not where we should be. The most important thing that we recommended on this was we absolutely need to get a mobile broadband public safety network built for our first responders that would be interoperable. And it is an unfortunate reality, even in these times of a budget crunch; it will cost money to do this. And as a society, we have to find an answer because the private sector will not, on its own, build a mobile broadband public safety network for police officers and firefighters.

One of the things that I think is a positive in the voluntary incentive auction idea that many are looking at, is that it would generate, the estimates are between $20 and $30 billion in new revenue for the Treasury, which would be more than enough to finally take care of funding a mobile broadband public safety network.

The other important issue is moving forward on standards for interoperability, so that when the network is built it is not just built, but different services in different regions can talk to each other. We are moving forward on making sure that we have interoperability standards. In fact, over the last year, we granted some waivers that allowed first responders in a handful of communities to move forward, where they have the resources, to start building. We have conditioned that on having interoperability standards and our Public Safety and Homeland Security Bureau is working hard on that process. We have a proceeding now to develop those standards.

Mr. SERRANO. Thank you so much. Thank you.

Mrs. EMERSON. Thank you, Mr. Serrano. Mr. Yoder.

Mr. YODER. Thank you, Madam Chair. Sir, I appreciate you coming today and giving testimony, and certainly there are a lot of issues. I did want to follow up on the questions that Mr. Serrano was asking, particularly related to LightSquared's use of the GPS spectrum. I noted your answers, and I also noted some of the conversation that is out there right now. Clearly there are hundreds of millions of GPS users in this country. It is a very significant usage of consumable goods. A lot of people rely on these. And all these devices were deployed in reliance on the FCC's rules prohibiting a terrestrial-only network in the band adjacent to GPS. That

is where you now have authorized LightSquared to deploy such a network. Do you agree with that statement, first of all?

Mr. GENACHOWSKI. Generally, yes. But in addition to that, the companies that provide GPS also have to comply with certain standards with respect to their emissions and their ability to hear signals.

Mr. YODER. But there was a reliance on the fact that it would not be a terrestrial-only network in a band adjacent to GPS?

Mr. GENACHOWSKI. I do not think that is right.

Mr. YODER. Okay, that is what I want to know. Do you agree with that statement?

Mr. GENACHOWSKI. No. I do not think that is right. There are interference issues here that have to be resolved, but I do not think that reliance statement is correct.

[The information follows:]

LIGHTSQUARED RELIANCE ISSUE

Mr. GENACHOWSKI: To clarify for the record, when the International Bureau released the MSV ATC Order in 2004, there was no promise, implied or otherwise that would have provided interested parties with this sort of assurance, especially since the Commission routinely provides licensees with the flexibility to deploy technologies they believe best serve market demand. Also, LightSquared does not propose to provide terrestrial-only service.

Mr. YODER. Okay. I want to talk a little bit about the process that you are using in relation to this issue, and so the committee can understand the decision making process that you go through, the standards you are going to use. And I know that you made clear in the comments to Mr. Serrano, that certainly you would not want to jeopardize GPS. That is not a goal. You would want to make sure that GPS has its full range of functionality. But the Commander of the U.S. Space Command testified to the House Armed Services Committee about two weeks ago, you may have seen this, that, "We believe from what we have seen thus far, that virtually every GPS receiver out there would be affected". This is a serious claim, clearly. Why did you go forward with even a conditional grant of LightSquared's application given the gravity of these concerns from the Department of Defense, which runs the national GPS system?

Mr. GENACHOWSKI. Well, to make a couple of things clear; the waiver that was granted was conditioned on resolution of the GPS interference issues, and there is also information that suggests that the interference issues can be resolved. Why bother at all? The answer is massive private investment, jobs, and new innovative services. So the company that is pursuing this venture expects to invest billions of dollars, create hundreds of thousands of new jobs, literally, and provide new services in the marketplace. I think it would have been completely unacceptable to say, Well, we are not going to look at it. We are not even going to study the interference issues.

And so what we decided to do is to say look, We understand the plan for providing these services. We understand how it could lead to massive private investment and job creation. We are going to treat this as we have many other interference disputes that the FCC has had for years. Like some of the other issues we face, you

get people with very strong feelings on both sides that are absolutely sure that they are right. And I am proud of the career staff at the FCC that has the very hard job of getting into the engineering, doing the field tests, doing the work, and on behalf of the American people, getting the balance right to protect public safety and make sure that Spectrum is used to drive private investment and create jobs.

Mr. YODER. And so the idea is you give a conditional grant so you can see what the effect will be. Is that correct?

Mr. GENACHOWSKI. Yes. It allows us to move to the next stage. It allows the company to move to the next stage. It allows us to move to the next stage, which we have, of running a process to resolve the interference issues.

Mr. YODER. Okay. And so, what I understand is that the Department of Defense, Homeland Security, Transportation, Interior, have each individually raised concerns about the proposal. And clearly, the comments from the U.S. Space Command to the House Armed Services Committee that they believe, from what they have seen so far, virtually every GPS receiver out there would be affected. From what you have seen so far, are they wrong? And if they are wrong, how so? And if they are correct, what are we doing to fix this problem?

Mr. GENACHOWSKI. My experience in this area, having watched some of these interference disputes work themselves out over time, is to create a space where the expert engineers at the FCC can run a fact-based process with participation from everyone who has a concern, pro or negative, and to let that process try to produce a result. So I would not want to pre-judge it. I think that would be wrong. We are prepared to do whatever is right to make sure we get the balance right to drive investment, jobs, and our economy, and absolutely make sure that we are protecting public safety.

Mr. YODER. And so what is the standard you use in making that decision? Is it a clear and convincing standard? Do you get to a point where the U.S. Space Command, Department of Defense, Homeland Security, other GPS providers are saying, Please do not do this, and you say, After receiving all the input, I think it is okay. And then we have an ongoing dispute, and there are clearly challenges then on the investment side for those who are producing the GPS products.

[The information follows:]

LIGHTSQUARED STANDARD OF REVIEW

Mr. GENACHOWSKI. To clarify for the record, the standard we would normally apply to this situation is whether the new service would create "harmful interference" which is defined in Section 2.1 of the rules as "Interference which endangers the functioning of a radionavigation service or of other safety services or seriously degrades, obstructs, or rapidly interrupts a radiocommunication service operating in accordance with the ITURadio Regulations."

Mr. GENACHOWSKI. Well, I hope we will not get to that point. We are running a process that is inviting the inclusion of all the different agencies and private sector players that have an interest. We are asking only one thing of everyone, which is, Let's work together to look at the evidence and see if we cannot find a commonsense resolution.

So I am hopeful that that process will work well. We have had conversations with people in the GPS industry who agree that a process is necessary, and who I understand are supportive of the kind of process that we are running. And the evidence will determine the outcome.

Mr. YODER. And this process is open, everyone has an opportunity to have input, it is open to the public. Do we have access to everything that is going on along this process?

Mr. GENACHOWSKI. The process is consistent with the kinds of processes the FCC has run in the past. I would be happy to get you more detail on exactly how this process works.

Mr. YODER. Well, I know that the NTIA provided a letter to the FCC describing the concerns that Federal users have regarding LightSquared's proposal. Are there other communications or meetings that have occurred between NTIA and the FCC?

Mr. GENACHOWSKI. Well, the NTIA and the FCC meet frequently to discuss this. I am sure there have been some discussions in getting ready for running a process on addressing the interference issues.

Mr. YODER. Well, I just hope to impress upon you today that there are a tremendous amount of concerns about what is happening here. And some of those concerns are being expressed to members of Congress, who want to make sure that you aware that these concerns are out there, and that this is a very high-stakes situation, where a lot of investment has occurred in GPS, and hundreds of millions of devices, millions of users in the United States. And so if there are these concerns out there from many of these folks, who we take very credibly, including many of our Departments and agencies, we want to make sure that you, sir, understand the gravity of that. And I want to make sure I do my part impressing upon you that the concerns are out there.

Mr. GENACHOWSKI. Well, you absolutely have, and I appreciate that. And I look forward to working together. I know we all share an interest both in making sure that there are no safety risks with respect to GPS, and also making sure that we are driving new businesses, that government is getting out of the way of new businesses that have the opportunity to lead to billions of dollars in private investment and hundreds of thousands of new jobs.

Mr. YODER. Well those are great goals, and let's hope it works out that way.

Mr. GENACHOWSKI. Terrific. I look forward to working with you.

Mr. YODER. I yield back to Madam Chair.

Mrs. EMERSON. Thank you, Mr. Yoder. You mentioned earlier, you raised the issue of 9–1–1 texting. Why can we not text 9–1–1?

Mr. GENACHOWSKI. Because as a very broadly general matter, our 9–1–1 call centers are not set up to receive the texts. And I visited a couple of 9–1–1 call centers. They are incredible operations, I mean there are heroes who work at these places every day. And with respect to landline 9–1–1 calls, it works well. The call comes in, it goes up on the computer, they know exactly where you are, and within seconds they can dispatch someone to where you are. With mobile calls it does not work quite as well, though progress has been made. And I hope you will forgive a little bit of a digres-

sion, but I think this issue is very important; about more than half, I think about 65 percent of 9–1–1 calls now come from mobile devices. But the location accuracy that the 9–1–1 dispatchers get from mobile is not as good. And in some cases it is quite bad. So in cities with tall buildings, or in very rural areas, the information may be of very little use to the dispatcher. So one line of our work involves working with first responders and industry to try to improve the location accuracy of mobile 9–1–1. And we are making progress on that, there is more to do. With respect to what we call next generation technologies, like texting, like sending photos, like sending videos, as a general rule the call centers are just not set up for it at all. The system will not receive a text. Many of them are non-IP based systems. So that is the reason. They are just not set up for it. They want to be. There are funding issues. I hate to say it, but there are. But I do think we need to work together on a bi-partisan basis to find a way, also with the states and local governments, because that is where a lot of the funding comes from. But as I said, two or three years ago, if you had said to someone, You cannot text 9–1–1, they would have said, Who cares? But texting, sending videos, have become so quickly so central to part of our daily activities, that it is no longer an acceptable answer to say, We do not have a plan for this. Even at the Virginia Tech tragedy a couple of years ago, there were students who did not know any better and tried to text 9–1–1. They did not go anywhere, there was no one to get those texts.

Mrs. EMERSON. So what is the solution?

Mr. GENACHOWSKI. Well, some of it involves funding, as I said, and one of the things that we are trying to be helpful with is, as a resource to Congress and others, working with the industry and first responders, to price out what it would cost. A second issue is having standards. This is an area where a smart standard process can potentially accelerate the move of a lot of local 9–1–1 centers to an IP-based system and also lower the costs. Because the more that this equipment is up to scale, the faster it will be rolled out and the less it will cost. So we are working on that; we have a terrific person leading this up, Admiral Jamie Barnett who runs our Public Safety and Homeland Security Bureau. I look forward to following up with you on this because I think it is a very important issue.

Mrs. EMERSON. And I would appreciate that; I would like to very, very much.

[The information follows:]

E911 TEXTING CAPABILITIES

Mr. GENACHOWSKI. With respect to your question about why Public Safety Answering Points—PSAPs—do not currently receive text messages, I wanted to clarify the two reasons for the record. First, circuit-switched 911 networks and selective routers use old technology that is designed solely to support voice telephone service and, like residential wired telephone service, are not configured to receive text messages.

Second, the texting methods that most consumers use today were not developed with 911 in mind, which affects their usefulness in emergency situations. For example, consumers using existing texting technology may not be able to transmit in real time, convey location information, or establish reliable 2-way communications between a particular call taker at the PSAP and the caller.

Since PSAPs will need to upgrade their technology to be able to receive texts, states and localities also will have a critical role in the transition to next generation

911–NG911. Stakeholders, including the FCC, industry and the 911 community, are working hard on potential solutions to make texting to 911 possible. There has already been one small text-to-911 trial in Black Hawk County, Iowa, and we anticipate that there will be additional trials in other locations later this year.

As part of a Notice of Inquiry issued by the Commission on December 21, 2010, we are seeking to gain a better understanding of how to bridge the gap between the capabilities of newer, IP-based networks and devices and today's 911 system. We also are asking for input on how to further PSAPs' transition to IP-based communications capabilities and NG911 for emergency communications. We will keep this subcommittee apprised of our work in this area.

Mr. GENACHOWSKI. Can I mention one other concern that has been raised just to note, something that we could look at together? We have heard complaints from first responders that in some states funds that have been designated as 9–1–1 funds on consumers' phone bills are not getting spent for that purpose. And I am not saying that that is an FCC issue; I am relaying a concern that I have heard from first responders who are trying to upgrade their 9–1–1 systems.

Mrs. EMERSON. I would agree with that; I am hearing the same thing from mine, and it is a little more complicated than it seems on the surface, but nonetheless it is one issue that has to get solved sooner rather than later. Let me ask you a little bit about the Universal Service Fund and your National Broadband Plan. I would like to know where you are with it, why don't you just answer that one first?

Mr. GENACHOWSKI. Well, we issued a National Broadband Plan last year that identified the opportunities of accelerating deployment and adoption of broadband, opportunities for our economy, for job creation, investment, for making progress on education, health IT, et cetera, and it had some big ticket items in there which I can discuss. One is transforming the Universal Service Fund, another is unleashing spectrum in the incentive auctions. A third is removing barriers to broadband adoption. A fourth is improving broadband adoption. I would say a couple of things. One, a year and a half ago at this time, very few people were talking about broadband. And it was much more, I think in some other countries, thought of as an important economic issue than it was here and I am pleased that more and more people are understanding the opportunities of broadband, and it is creating more of a desire to tackle the challenges.

With respect to spectrum, the challenge grows every day. There is an article in the papers today about how smart phone sales are going to be even faster next year than people thought. Again, Smartphones use more than 20 times as much spectrum, they put 20 times more demand on spectrum than old feature phones. I wish we had a warehouse of spectrum just lying around at the FCC that we can auction off, but we do not. So taking seriously the incentive auction proposal, which has had bipartisan support, and brings market incentives to the allocation of spectrum; it is a tool that the FCC does not have that is very important and we would be happy to work with you on that option. Transforming the Universal Service Fund, it does not make sense to have a fund that supports only universal telephone service. It has to support broadband. We are moving in that direction, we are doing it together with the reform of Intercarrier Compensation because it is a whole complex system that has to be done together.

I am proud that just last week, thanks to the work of our staff, all five commissioners on a unanimous basis did something that was unprecedented; we issued a joint blog. And the blog said to the community of people who are concerned about this, We are serious about USF reform. We are serious about moving forward. We are serious about doing it quickly, and we want all stakeholders to participate in our process in a way that really rolls up the sleeves and helps solve problems, as opposed to blocking reform. I can keep going, but I think on a whole series of areas, we are making very significant progress. There is always a lot of work to do, and the rest of the world is not standing still when it comes to broadband deployment and adoption.

Mrs. EMERSON. You know, it was interesting and perhaps kind of strange at the same time that the ARRA bill was passed, and in it you were asked to put together your National Broadband Plan simultaneous to lots of monies being given out through NTIA or RUS to build out the infrastructure. It was kind of putting the cart before the horse because I would have thought you would have a plan and then deploy various tools to make it work, but nonetheless.

Mr. GENACHOWSKI. If I could reserve my right to disagree with that.

Mrs. EMERSON. Well, coming from a rural area, I have to have every single type of phone, AT&T, Verizon, Century. I need really every single service there is to be able to get service in my district, and then there are still just dead spaces.

Mr. GENACHOWSKI. I do think that is why it made sense to start moving forward where we knew there was need even as we developed a plan to tackle some of the larger things like spectrum reform, like universal service. And so given a fast-moving globally competitive landscape, starting to make the first investments and taking care of the low-hanging fruit that everyone agreed made sense, I do appreciate your point of view, but I think it made sense and it will help the country make progress.

Mrs. EMERSON. Well, hopefully we will begin to make progress because I think everybody agrees, particularly in rural areas where we do so much telehealth and where it is really helpful as people want to become their own entrepreneurs and work for themselves. When you still have dial-up service on your computer that is pretty pathetic and there is no way you can compete or do things fast enough. One other quick question: there are a number of grant programs that come under the Universal Service Fund, and I know that regulators do not typically monitor grants, so how do you really ensure then that those funds are being used properly?

Mr. GENACHOWSKI. Well, we do monitor. Most of them are distributed by an intermediary organization called USAC, Universal Service Administrative Company. And we do oversight over USAC and we have been very aggressive, and we have ramped up our efforts over the last year to audit what they are doing, to make sure that money is being spent wisely. We have found issues and moved to correct them, so I think oversight of every dollar that is being spent is incredibly important and if I could come back to the budget, it is one of the things that our IGs office helps us do. They help

us do oversight on programs like VRS, where we saved $250 million, and they play an important role.

Mrs. EMERSON. So does the FCC determine the eligibility for those grants or does USAC determine the eligibility?

Mr. GENACHOWSKI. We set the rules, the parameters, and they are the operational entity.

Mrs. EMERSON. Okay. I know Mr. Diaz-Balart has some other questions, and we also have simultaneously a briefing on Libya by the Secretary of State and others, and I know people are anxious to get to that. Go ahead, Mario.

Mr. DIAZ-BALART. Thank you, Madam Chairwoman. First Mr. Chairman, we were speaking between votes, and I appreciate your willingness to continue to talk and to work out some of these issues that are very complex, but obviously very important. So I want to thank you for that attitude, I really do.

My understanding is that next week, the FCC is set to vote on a data roaming order. Now, this order can be seen as, in effect, for the FCC to over regulate the wireless industry. I want to make sure I understood you, because I am obviously concerned with—we keep talking about innovation and everything else, and that was done through the private sector. I just want to make sure that we are not over-regulating. And I also want to make sure that the FCC is not over-exceeding its statutory boundaries. Clearly if that is the case, what authority is being used in order to do so? I think it is pretty clear that Congress did not give statutory authority to impose a common carrier regulations like data roaming or wireless broadband data, et cetera, et cetera. So I just wanted to see what is going on next week at the FCC with this order and what are you looking at, and put my mind at ease, if you would.

Mr. GENACHOWSKI. I would be happy to. About five or six years ago on a bipartisan basis, the FCC adopted voice roaming rules. And that meant that a consumer who got essentially any old-fashioned phone that just did voice could know that it would have national service. And it meant that competitors in the marketplace, particularly rural companies that were providing mobile service, would know that they could offer their customers a national voice service. It has worked very well. At the time, people attacked it as an overreach and they said it would deter investment, et cetera. As it played out in practice, it helped provide better consumer services, more investment, more competition, and no complaints at the FCC. The industry said, We are just going to get the deals done.

So what we are looking at now as the world has changed along the lines that you talked about before, from old voice phones to data phones, is something very similar. Updating the rules to apply to data roaming so that a consumer, when they get a smart phone, can know that they will be able to roam anywhere, to make sure that competitive providers like rural carriers have the ability to offer competitive service, and we have heard very loudly from the rural carriers that this is a very big issue for them. And we are doing it in a way that we think will, as before, promote investment, promote competition, promote consumer benefits.

On the legal authority, we are being very careful. Obviously it is very important that we act within our authority. Title III of the Communications Act provides ample authority to adopt rules like

this. You are correct that there is a provision that says we cannot do common carriage, and we have been very careful to make sure that these common carriage rules, and in a whole series of ways, the rules that we have proposed and are discussing at the commission are not common carriage. They will, I hope, lead to companies in the private sector doing deals. We have heard many complaints from rural carriers and others, as the commission did before voice roaming, that the deals just were not getting done, and not for good reason.

Mr. DIAZ-BALART. I want to make sure that the FCC is not looking at trying to circumvent the old thing about depending on what your definition of "is" is? I want to make sure that the FCC is not looking at ways to circumvent the lack of Congressional authority. In other words, it is pretty clear what that is, and I just want to make sure that what you are not looking at doing is looking at ways to, All right, let's still do it but figure out how legally we can justify it. Because Congressional authority is pretty clear.

Mr. GENACHOWSKI. And we have been considering the options here. There were some options on the table, including options that were requested by rural carriers, that we looked at and said, Those are potentially inconsistent with the statute. The approach that we have proposed we think is well within the statute.

Mr. DIAZ-BALART. Is the purpose to allow smaller companies to use the infrastructure of some of the larger networks that are already there, that they invested the private sector with their money? Is that what you are looking at?

Mr. GENACHOWSKI. Well, the purpose is really the same as voice roaming. Roaming has become an essential feature of a competitive marketplace that gives consumers the option of something we know that they want. So essentially, this has been something that has been a success. It has served businesses, investment, and consumers well. As we move from a voice to a data world, replicating that in a cautious, smart way that has fidelity to the statute is what we have proposed, and I think it will have a positive effect on the marketplace.

Mr. DIAZ-BALART. So is that yes? Is the purpose, then, to allow some companies to use the investments of other companies, the infrastructure investments of others, in order to do that? Is that the purpose?

Mr. GENACHOWSKI. It is not how I would characterize the purpose. We think that this will, as with voice roaming, increase overall investment. What we have heard from many rural carriers and other competitive carriers is that there is a lot of investment sitting on the sidelines, because unless they have a degree of confidence that they can get roaming deals nationally, they do not want to start investing and building out a network. They know they cannot offer a business where someone says, You mean I cannot use this phone if I am outside of the area? So we think that this will unleash investment. The experience for voice roaming is that companies much prefer to have their own networks than to roam on others, because it is over time much less expensive. Voice roaming and data roaming is expensive for the company that has to get it, and once they have a service up and running and they have the capital available, it is in their interest to build out their own networks.

This was something of the theory when the voice roaming rules were adopted several years ago, but that theory has now been proven out in practice, and the voice roaming rules have had a very positive net effect on investment, and competition, and on providing better consumer services.

Mr. DIAZ-BALART. And again, I just want to make sure that I am understanding your answer. So you are telling me that that is not going to be the case, that the FCC's not looking at telling those who already have investment in infrastructure that they are going to have to allow others to use that infrastructure, correct? If you can just get to that specific part.

Mr. GENACHOWSKI. Yes. It is not how I would put it. The rules that have been proposed, and I am limited in what I can say because we are still discussing this at the Commission, but you would have a framework where carriers with national networks would have to offer roaming agreements on commercially reasonable terms.

Mr. DIAZ-BALART. Who sets that commercially reasonable term?

Mr. GENACHOWSKI. The private parties will set them, and I think as with voice roaming, we expect it to work well in the private sector and for the FCC not to have to be brought in.

Mr. DIAZ-BALART. And if there is no agreement between the two private sector or the multiple private sector parties to a price, then what happens? Does the FCC step in then?

Mr. GENACHOWSKI. We expect that there will be agreements.

Mr. DIAZ-BALART. But if there is not?

Mr. GENACHOWSKI. As with voice roaming, there is a process to come to the Commission, and complaints will be resolved.

Mr. DIAZ-BALART. Again, and I keep getting back to this because what I think I am hearing is basically that yes, that basically if they do not have an agreement, then you will basically force them to have an agreement. Correct?

Mr. GENACHOWSKI. No. Well, what the remedies would be would depend on the circumstances involved. But again, I think the core point is that we have experience with a very successful program that has worked for companies throughout the ecosystem and consumers, and we have a very good basis of evidence to believe that this would work again, promote investment, innovation, competition, help consumers.

Mr. DIAZ-BALART. And that model is to allow those that do not have the infrastructure to use the infrastructure of others. Is that what you are doing?

Mr. GENACHOWSKI. It is to make sure that companies that have national infrastructure offer roaming deals on commercially reasonable terms.

Mr. DIAZ-BALART. And I understand that, but if there is no agreement on that, does then government step in and decide what a commercial viable rate is?

Mr. GENACHOWSKI. No.

Mr. DIAZ-BALART. Does the Federal government push on making sure? Is there a penalty if they do not reach an agreement?

Mr. GENACHOWSKI. Well, some of these issues, we are still talking about, deliberating at the Commission exactly how it would work, and so I do not want to speak for the other commissioners.

My own view, as with voice roaming, once there is the basic framework that says that companies are expected to do commercially reasonable deals, there will be deals. The companies who are seeking these deals do not want to have to file complaints. They do not have the capital to file complaints. And I think we will see a successful policy that promotes investment, promotes competition, promotes consumers in this as we have in the past, assuming the Commission adopts this next week.

Mr. DIAZ-BALART. All right, so that is happening next week. Again, I am concerned, as one who believes that free markets, frankly, have created a pretty good thing here in the United States, we have a pretty good gig going here, the wealthiest nation in the history of humanity; it has been because of this free market enterprise system that we have.

Mr. GENACHOWSKI. Well, I agree, and the companies that are coming to us are companies that are trying to compete in the free markets. They are rural telephone companies from all over the country, and I would also point out that this approach has bipartisan support. It always has, it still does, and the spirit of it is to be extremely light-touch, and to promote a free-flowing market in which deals are getting done along the lines that we have planned out.

Mr. DIAZ-BALART. And I want to stay in touch with you, and obviously we will keep an eye on how that is moving, because obviously I think there are some of us that have great concerns about government being too heavy-handed on a lot of these issues. We already talked about net neutrality, and Madam Chairman, if I may just very briefly talk a little bit about this issue with LightSquared. Is that the right term?

Mr. GENACHOWSKI. Correct.

Mr. DIAZ-BALART. And the possibility that it may affect GPS. Obviously if it affects GPS, I will never be able to get out of the Rayburn Building. So let me just put that on the table first. I guess there is a comment period. Is that the case? My understanding is that there is usually 45 days, when people were talking here about the waiver. I guess that it is because the waiver is about 45 days, right? So I think 7 days. Is that correct? Is that not correct?

Mr. GENACHOWSKI. You are at a level that I do not recall.

Mr. DIAZ-BALART. Okay.

Mr. GENACHOWSKI. I apologize.

[The information follows:]

LIGHTSQUARED COMMENT PERIOD

Mr. GENACHOWSKI. I appreciate the opportunity to clarify for the record the comment period issue related to LightSquared's conditional waiver and provide additional information on this matter. In November 2010, LightSquared applied to the FCC to modify its Ancillary Terrestrial Component—"ATC" authority. Its existing authority allowed terrestrial services to dual-mode handsets using LTE technology. The request was designed to permit LightSquared to offer wholesale terrestrial service to single-mode handsets—it neither requested nor was granted any alterations to its allowed transmission power, number of cell towers deployed, or any other changes.

On November 19th, the International Bureau issued a Public Notice requesting comments, which ultimately were due on December 2, 2010, with replies due on December 9, 2010. On January 26, 2011 the FCC's International Bureau issued an Order and Authorization granting LightSquared conditional approval for its customers to offer terrestrial only devices to consumers. The waiver was granted with

specific conditions including the formation of a working group to resolve the concerns raised, but more importantly noted that a final waiver grant was conditioned on the resolution of the interference issues.

Some of the commenters in the proceeding raised the timing issue and claimed that they were precluded from fully participating in the proceeding. When the International Bureau issued its Order, the Bureau specifically addressed this concern and noted that the decision was consistent with timing for similar procedures and in accordance with our rules. As the Bureau noted, those entities that raised timing concerns also fully participated in the proceeding and filed substantive comments on the issues raised in the petition.

Mr. DIAZ-BALART. Here is one of the things that you heard today is that there clearly have been a number of federal agencies: DOT, DOD, DOT, NHS, NASA, FAA, NTIA, and others who have expressed some written concerns, I understand. And by the way, I commend you the way you talk about how we clearly want to make sure that we have investment, and that we have competition, and that we have innovation. So that is good. But you rarely get those agencies having objections. I just want to make sure that we are very careful that if the waivers have been granted; it is, to my understanding, that there are test results due on January 15, 2011.

And does the waiver or whatever is happening now, has the FCC allowed LightSquared to build out its infrastructure prior to the test results of January 15?

Mr. GENACHOWSKI. My understanding is that the infrastructure that they would be building out now will relate to the interference testing. It is interesting to put these issues together, because what we are being asked to do is interfere with the private operation of the market and deals that could, theoretically, be negotiated to resolve interference issues without government involvement. Now, that is not the way the process has worked and I think we are playing an appropriate role here, as we do in other areas, to make sure that there is a framework that protects against important issues. And we are going to be very careful in making sure that there is a framework that protects health and safety.

Mr. DIAZ-BALART. No, and there is no doubt. And you are always going to have the naysayers whenever there is new competition. And that is why I said a little while ago I am glad that you talked about that. We have got to make sure that we can, whenever possible, allow for innovation and competition. But when you are dealing with DOD and NASA; I know you are aware of it and I just wanted to make sure that we are not doing something that will jeopardize. Because that is, in essence, the purpose of your organization.

Mr. GENACHOWSKI. Absolutely. Yes, sir and we take it very seriously.

Mr. DIAZ-BALART. Not to regulate things that are working, not to regulate things that are being innovative, not to regulate things where there is competition; i.e., Internet, which I, for some reason, insist you all are being very aggressive in regulating that part, but to make sure that there is no damage if that would be the case. And I am not saying that is the case with LightSquared. I mean, hopefully it is not, but I just want to make sure. I think that you and I do not disagree, and that there is a case for your organization. I think the cases that deal with those issues when they are legitimate concerns: to see if they are legitimate. I do not think that your role should be to intervene and regulate, when in fact,

something is not broken; i.e., as you and I agreed at the beginning of our conversation, probably the most dramatic case of innovation, job creation, wealth creation, opening societies, that has taken place in the history of mankind: that is the Internet.

I am a little concerned that for some reason you are emphasizing that in such a strong manner; I think you may be stepping a little bit too heavily there. But we will continue to have the conversation and we will continue to work together. And I appreciate the opportunity to do that with you and I look forward to it.

Mr. GENACHOWSKI. Thank you.

Mr. DIAZ-BALART. Thank you, Madam Chairwoman.

Mrs. EMERSON. Thank you, Mr. Diaz-Balart. Chairman Genachowski, thank you so much for being here. I have some questions I would like to submit for the record; so does Mr. Serrano. And any others will also be submitted for the record. And if you can respond to us within 30 days, I would be very grateful. Thanks again for being here.

Mr. GENACHOWSKI. Thank you.

[The information follows:]

Financial Services and General Government Subcommittee
Hearing on the Federal Communications Commission FY 2012 Budget

[The following questions were submitted to be answered for the record]

NET NEUTRALITY

MRS. EMERSON. What problem is the FCC trying to solve with the net neutrality rule?

MR. GENACHOWSKI. In the record developed in response to the *Open Internet Notice of Proposed Rulemaking*, many of the nation's leading entrepreneurs and early-stage investors who build new companies explained that their willingness to deploy capital and start and grow businesses was at risk without high-level rules of the road to ensure the Internet would remain an open platform.

Economists and other market analysts also commented that broadband providers have the incentives and demonstrated ability to leverage their position as companies that control access to the Internet. Broadband providers explained that their engineers need discretion to manage their networks to address challenges such as spam and congestion. We also heard that broadband providers need flexibility to innovate with respect to business models to earn a return on their investments and invest in network infrastructure, and that there were real costs from the ongoing lack of certainty regarding the scope of open Internet protections. Based on this record, we adopted strong and balanced rules of the road that provide greater certainty in this long-contested area.

MRS. EMERSON. What are the tangible impacts of this issue for both businesses and consumers?

MR. GENACHOWSKI. The *Open Internet Order* ensures that consumers can make informed choices about purchasing and using broadband services, and that they have the freedom to choose to go where they want, use the services they want, and read and say what they want online. The *Order* also ensures that innovators have the information they need regarding broadband performance and network management practices to effectively develop and market online offerings. Content, application, service, and device innovators can be confident that their offerings will compete on a level playing field, without fear of blocking or degradation.

By providing certainty that the Internet will remain free and open and that broadband providers can reasonably manage their networks and innovate with respect to technologies and usage-based pricing, the *Order* facilitates a virtuous cycle of Internet innovation and investment, including massive investment in wired and wireless broadband infrastructure. That should lead to more robust broadband—wired and wireless—for more Americans and access to more innovative content, applications, services, and devices.

MRS. EMERSON. If investors are fearful of the government's involvement in internet regulation, how will that impact the expansion of broadband to all Americans? Has the Commission looked into this issue?

MR. GENACHOWSKI. The *Open Internet Order* comprehensively analyzed the effect of the framework on investment in broadband infrastructure, and concluded that high-level protections for Internet freedom and openness will enhance the deployment of broadband to all Americans, consistent with the Commission's statutory obligations. As the *Order* explains, there is a "virtuous circle of innovation" fostered by Internet openness, in which new uses of the network—including new content, applications, and devices—lead to increased end-user demand for broadband, which drives network improvements, which in turn lead to further innovative network uses. As numerous commenters explained, by preserving the virtuous circle of innovation open Internet rules will increase incentives to invest in broadband infrastructure. Most Wall Street analysts see the framework as a positive outcome for the telecommunications sector generally, and have not identified losses in broadband deployment.

MRS. EMERSON. While I understand that the case filed by Verizon challenging the net neutrality rule is pending, do you have any idea of the timeline for a final decision on this issue?

MR. GENACHOWSKI. On April 4, 2011, the United States Court of Appeals for the District of Columbia Circuit dismissed the case filed by Verizon (and a companion case filed by MetroPCS). Potential litigants may seek review of the *Open Internet Order* after it is published in the Federal Register, following completion of procedures mandated by the Paperwork Reduction Act.

AT&T/T-MOBILE MERGER

MRS. EMERSON. While I know the AT&T/T-Mobile merger was announced just last week, do you have any thoughts on the merger of two these two telecom companies?

MR. GENACHOWSKI. I cannot comment on the substance of the Commission's review of the proposed AT&T/T-Mobile merger. I can assure you that the Commission will conduct a thorough, fact-based review. The parties filed their applications on April 21, 2011, and on April 28, 2011 we issued a public notice establishing a cycle for public comment.

MRS. EMERSON. How could this merger affect wireless service across America?

MR. GENACHOWSKI. The Commission will carefully study this issue during its review of the transaction.

REGULATIONS

MRS. EMERSON. I understand that the FCC is looking into how to make regulations less burdensome on business. What, if anything, have you all found so far?

MR. GENACHOWSKI. We are vigorously looking to lift unnecessary regulatory burdens on the private sector. One of my first actions as Chairman was to assemble an FCC Reform Team, which I charged with identifying and removing regulatory barriers to a thriving broadband economy. In the last year, the Commission found a number of areas where we believed regulations were impeding new broadband deployment or imposing unnecessary burdens, and we have taken action to address these problems. These include:

- Reformed rules concerning access to utility poles to speed broadband deployment;
- Changed rules to immediately make 25 megahertz of spectrum available for mobile broadband services;
- Lifted restrictions on some mobile satellite spectrum that can be used for broadband;
- Established a shot clock for wireless tower siting;
- Modernized the E-rate program, through streamlining of the application process, so that schools and libraries can get faster Internet connections and access 21st century learning tools;
- Eased process for radio stations to certify compliance with our technical rules;
- Streamlined the Cable Price Survey to reduce the burden on cable operators; and
- Sponsored a broadband acceleration conference and formed a task force to streamline rules.

In addition, the Reform Team launched the FCC's Data Innovation Initiative, a comprehensive effort to modernize and streamline how the Commission collects, uses and disseminates data. While it is vital that the Commission collects the data it needs to do inform its decisions and serve the public, unnecessary data demands can impose significant burdens on private business. That team has already identified a number of data collections that may be candidates for elimination. These are collections that once made sense, but appear to have become unnecessary as technology, markets, and policies have evolved. In February, the Commission formally proposed eliminating two such data collections.

Several other efforts to identify and streamline regulations are also ongoing. In December 2010, we launched our statutorily-based biennial review of the FCC's telecommunications regulations to determine which of our regulations are no longer necessary as a result of increased competition.

In February, we also hosted a Broadband Acceleration Conference, bringing together officials from federal, state and local governments, broadband providers, telecommunications carriers, tower companies, equipment suppliers, and utility companies to identify opportunities to remove regulatory and other barriers to broadband buildout. As a result of input from stakeholders, earlier this month the Commission released a *Notice of Inquiry* addressing best practices for rights-of-way and wireless facilities siting policies, two areas that hinder broadband deployment.

In addition, last month the Commission released a *Public Notice* in compliance with the Regulatory Flexibility Act to review rules adopted by the FCC in calendar year 1999 which have or might have a significant economic impact on a substantial number of small entities. The

review will determine whether the rules should continue without change or be amended or rescinded.

In each of these areas, we have found that public input and an ongoing dialogue are essential to ensuring common sense rules that spur business development.

MRS. EMERSON. How does the FCC balance regulation versus encouraging competition and innovation?

MR. GENACHOWSKI. During my tenure at the Commission, we have made competition and innovation top priorities. We have comprehensively reviewed our regulatory requirements to make sure they are advancing, not inhibiting competition and innovation.

Whenever possible, we provide opportunities for marketplace-based regulation to encourage spectrum use and efficiency. For example, on September 23, 2010, the Commission released final rules for the use of white space for unlicensed wireless devices to encourage innovation and growth. That decision will promote more efficient use of the spectrum by allowing for the use of unlicensed TV bands devices in the unused spectrum to provide broadband data and other services for consumers and businesses. In addition, the Commission recently relaxed restrictions on some mobile satellite spectrum to make more available to new entrants with innovative technologies and business plans where the demand is greatest. Incentive auctions also would provide a new, market-based approach to spectrum allocations.

MRS. EMERSON. Do you conduct cost benefits analyses before implementing new rules?

MR. GENACHOWSKI. Yes. The Commission carefully weighs the potential costs and benefits of proposed rules before adopting them. The Administrative Procedure Act ("APA") requires reviewing courts to set aside agency actions that are arbitrary, capricious, or an abuse of discretion, and courts have interpreted that standard to require agencies to consider all relevant factors in making their decisions. The Commission must evaluate the potential benefits and costs of its proposed rules, as they are revealed in the record that is developed in our proceedings. The Commission is aided in this regard by its highly-skilled professional staff of economists, who endeavor to ensure that we have the proper data on which to make an informed decision.

My goal is to ensure that the Commission is a data-driven agency and to that end, we have worked to shore up our economist workforce and provide them with the tools necessary for the complex analyses related to the telecommunications sector. The Commission also encourages commenters to submit cost-benefit analyses as part of their comments to receive more complete picture.

MRS. EMERSON. Do you study the costs of new regulations on businesses and consumers before implementing new regulations?

MR. GENACHOWSKI. Yes. As noted above, the Commission evaluates the costs of proposed regulations on businesses and consumers before implementing them as required by the APA. In addition, the FCC is subject to the Regulatory Flexibility Act (RFA), which requires the Commission to include an analysis of the impact of its rules on small organizations, including small businesses and small governmental jurisdictions. Additionally, the RFA requires us to describe how the agency has minimized any significant economic impact on small entities, including a description of why alternatives that could affect the impact on small entities were rejected. In accordance with these laws, and as a matter of good agency practice, the Commission thoroughly evaluates costs associated with proposed rules before implementing them.

SPECTRUM

MRS. EMERSON. Is the FCC currently, or do you have plans to do a comprehensive inventory of spectrum?

MR. GENACHOWSKI. The Commission has conducted a baseline spectrum inventory to better understand the overall spectrum landscape. This baseline inventory is one of the most substantial and comprehensive evaluations of spectrum in the Commission's history. Through our systematic process, we have developed two tools – LicenseView and the Spectrum Dashboard – that reflect our understanding of the location and availability of our most significant spectrum opportunities.

LicenseView is a comprehensive online portal to information about each spectrum license. It presents data from multiple FCC systems in a searchable, user-friendly manner. The Spectrum Dashboard, released last year, identifies how non-Federal spectrum is currently being used, who holds spectrum licenses, and where spectrum is available. In addition, the Commission just released an upgraded version of the Spectrum Dashboard - 2.0 - which provides more granular information about spectrum holdings, including the ability to determine who holds licenses on a county-wide basis and on tribal lands and offers additional insights on the secondary market in spectrum licenses through the addition of leasing information.

MRS. EMERSON. Do you believe there is enough interest in incentive auctions to help free up spectrum?

MR. GENACHOWSKI. Yes. This concept has generated support from a broad range of stakeholders with a shared interest in spectrum efficiency and benefits for the Treasury. Voluntary incentive auctions have the support of, among others, potential spectrum users, potential auction participants, the President, those on both sides of the aisle in the House and Senate and a wide array of economists.

The looming spectrum crunch has highlighted the need for the application of new spectrum allocation principles. Industry analysts including Cisco Systems, Coda Research, and the Yankee Group have projected strong economic growth in mobile traffic from 2009 levels – on average by a factor of five in 2011, more than 20 times by 2013 and reaching 35 times by

2014. This trend remains upward in 2014, indicating continued growth beyond the forecast period.

Wireless industry representatives support incentive auctions as a solution to these growing spectrum demands. The Consumer Electronics Association and CTIA released a white paper lauding voluntary incentive auctions. The paper not only detailed the value of the spectrum to current and emerging industries, but also noted that repurposed spectrum could net more than $30 billion that could be put toward deficit reduction and other important uses.

Recently, 112 of the nation's leading economists from across the ideological spectrum released a letter endorsing voluntary incentive auctions. Signatories to this letter included Nobel and Nemmers Prize winners, former members of both Republican and Democratic administrations, and FCC Chief Economists who served under Chairmen of both parties. They disagree on many things, but they agree on the importance and necessity of adding voluntary incentive auctions to the FCC's toolbox.

In addition, the President's budget included language regarding the implementation of voluntary incentive auctions and estimated that auction proceeds would be $28 billion. Voluntary incentive auctions also form part of the assumptions supporting the FY 2012 budget resolution recently passed by the House. These assumptions note that that voluntary incentive auction authority could generate $24 billion in revenue over the next 10 years.

Broadcasters have been engaging in a dialogue with the FCC concerning the potential auctions. The FCC's Media Bureau has conducted extensive outreach and sponsored a series of webinars to provide more information about voluntary incentive auctions. Nearly 500 broadcasters from almost every state have participated in these sessions.

Because voluntary incentive auctions are a market-based mechanism, the market will determine how much spectrum is volunteered for repurposing to mobile broadband. I share the view of leading economists and many others that a well-designed, voluntary incentive auction, free of artificial restraints, will elicit a substantial amount of spectrum and provide significant financial benefits for American taxpayers.

MRS. EMERSON. Do you believe there are a significant number of occupants sitting on, or hoarding spectrum? If so, why are they doing this?

MR. GENACHOWSKI. No. I do not believe that hoarding is a significant problem or a contributing factor to the nation's looming spectrum crunch. The Commission's rules and market forces safeguard against hoarding and ensure that those who paid for spectrum at auction promptly put it to its highest and best use.

The Commission's rules include construction requirements that obligate licensees to operate service on their spectrum within a specific time period. For example, the recently-auctioned 700 MHz licenses all have either population-based or geography-based construction milestones. While buildout requirements may not be a perfect mechanism, they are designed to

accommodate the need for a winner of spectrum at auction to line up financing for capital expenditures, navigate the tower siting process and actually construct a network.

Moreover, the cost of spectrum acquired at auction serves as an incentive to build out expeditiously. Licensees need to recoup their auction investment by providing services that generate revenue. Deploying spectrum also allow carriers to better compete in the marketplace by enhancing the speed and quality of the services they offer. Furthermore, commercial wireless licenses can be used flexibly for different services and technologies. This gives licensees the incentive to put their spectrum to its highest and best use or to sell the licenses to someone else who will.

PUBLIC ACCESS TELEVISION

MR. SERRANO. At our hearing you indicated that the Commission had resolved about half of the PEG matters to the satisfaction of the PEG parties. Could you provide a list of the PEG proceedings that the FCC resolved in the last year?

MR. GENACHOWSKI. During the hearing, I reported that in the last year the Commission resolved approximately half of the pending PEG matters. Specifically, I was referring to the Comcast dispute in Dearborn, Michigan and the Time Warner dispute in McAllen, Texas. In both cases, the Commission worked with the parties to reach resolutions that minimized disruption to the local PEG community. Following successful negotiations between the parties in the Dearborn-Comcast matter, we granted their joint motion to withdraw the petition for declaratory ruling. In the Texas case, Media Bureau staff met with Time Warner and community representatives and urged a solution to the dispute. They did so, and McAllen withdrew its petition.

MR. SERRANO. Also, could you explain the delay in acting on ACM *et al.'s* Petition challenging AT&T's treatment of PEG channels on the grounds that it is discriminatory? Please provide a timeline in relation to the FCC taking action on this matter.

MR. GENACHOWSKI. Although the parties in the Dearborn and McAllen cases were able to forge solutions with our assistance, the ACM *et al.* and Lansing, Michigan petitions are still pending. The Commission's staff met with ACM and its counsel to discuss the difficult legal matters presented in the petitions. The Media Bureau currently is developing recommendations on how to proceed with this case. I will continue to encourage our staff to develop a viable solution and I will keep you and your staff apprised of our progress in this matter.

FIRST RESPONDER INTEROPERABLE COMMUNICATIONS

MR. SERRANO. The 9/11 Commission highlighted the problem that our first responders – police, fire, and emergency medical – could not communicate with each other. It recommended a robust, interoperable network to guarantee that first responders could communicate during emergencies. To create such a network, the FCC arranged an auction of the D Block that failed to attract a bidder willing to pay the minimum bid.

The five FCC commissioners proposed a different arrangement in the Broadband Plan. Although endorsed by key members of the 9/11 Commission, it has been opposed by some organizations of first responders.

Some first responder groups say that they need "ruthless pre-emption" to guarantee their priority of the airwaves in an emergency and that your Plan fails to provide that. Since this network will be based on broadband technology, is "ruthless preemption" necessary?

MR. GENACHOWSKI. The Commission remains firmly committed to ensuring that America develops a nationwide, wireless, interoperable public safety broadband network. The National Broadband Plan provided several recommendations with respect to creating such a network, most notably Congressional funding of the initiative. The Plan also discussed the advantages of today's 4G technologies which, unlike today's circuit-switched cellular networks, can offer public safety data immediate priority without waiting for commercial capacity to be freed up.

The Commission stands ready to work with Congress during its current deliberations on how best to create and maintain a nationwide, interoperable public safety broadband network.

MR. SERRANO. Given the objections of some first responder organizations, what steps do you plan to take so that we can soon have a robust, interoperable communications system for first responders?

MR. GENACHOWSKI. The Commission will continue to work with Congress and stakeholders to foster a nationwide, interoperable public safety broadband network. The agency has taken numerous steps on its own to encourage the buildout of the network and ensure that it is interoperable. For example, the Commission formed the Emergency Response Interoperability Center (ERIC), a division of the Public Safety and Homeland Security Bureau. ERIC focuses on ensuring the technical interoperability and operability of the nationwide public safety broadband network. The Commission has requested $1.8 million in new funds to ensure the availability of essential expertise and programmatic resources to perform our public safety mission, including $1 million for ERIC. We also have targeted funds currently available to the agency to foster interoperability programming.

The FCC has also issued waivers to twenty-two jurisdictions for early deployment of the public safety broadband network. To ensure that these early deployments are integrated into the nationwide, interoperable public safety broadband network, these jurisdictions must comply with the terms of a December 2010 Public Safety and Homeland Security Bureau order which sets forth interoperability requirements. We are closely watching progress related to these deployments to ensure that successes are duplicated nationwide.

In addition, this past January the Commission unanimously adopted an order and further notice of proposed rulemaking on the important issues of technical operability and interoperability of the network. In particular, the Commission adopted LTE to ensure a common technology platform for the public safety broadband network. The Commission requested and

has received public input from a broad array of stakeholders, including first responder organizations, on a series of interoperability issues, including the network architecture, roaming, performance requirements, open standards, network interconnectivity, and coverage requirements. We will continue to work on these matters in the near term.

SPECTRUM ISSUES

MR. DIAZ-BALART. Mr. Chairman, I understand the National Broadband Plan as well as the Presidents FY2012 budget advocate for spectrum management tools or what I like to call spectrum taxes. If you couple an incentive auction with the spectrum taxes, the voluntary incentive auction plan suddenly seems less "voluntary" and really seems to amount to a much more coercive approach. In my view, implementation of spectrum taxes could constitute a financial penalty for those who elect not to participate by becoming a toll booth for licensees. Depending on the amount and nature of a spectrum tax requirement, in some instances it could pose a burden so great that it forces so-called "voluntary" participation. Is this an aspect of the NBP that you intend to implement?

MR. GENACHOWSKI. The FCC currently lacks the authority to impose the type of spectrum fee that you have mentioned. We would be permitted to impose spectrum user fees only under whatever terms Congress may authorize. For this reason we are not engaged in any initiatives related to this matter although proposed spectrum user fees have been discussed in the President's budget since 1999 and discussed in the National Broadband Plan as well.

MR. DIAZ-BALART. Spectrum taxes or fees could be a crude tool for choosing winners and losers on the spectrum bands. To effectuate the end goal of forcing broadcasters to give up some or all of the spectrum to which they currently hold licenses, the FCC could slowly ratchet up spectrum fees until it becomes economically infeasible for broadcasters to remain on the band. Doing so in my opinion, the FCC would bypass natural economic processes and substitute its judgment for the judgment of the marketplace without public participation. Mr. Chairman, do you care to comment?

MR. GENACHOWSKI. As noted above, the FCC currently lacks the authority to impose the type of spectrum fee that you have mentioned. I am supportive of market-based mechanisms to foster spectrum efficiencies. For instance, I have asked Congress to grant the FCC the authority to conduct voluntary incentive auctions, which are a market-based tool to compensate existing spectrum licensees for voluntarily returning their licenses to make spectrum available for innovative new uses like mobile broadband. The FCC would auction the spectrum that licensees voluntarily return for wireless broadband services, with licensees retaining a portion of the auction proceeds. By creating a new marketplace for valuable spectrum resources, voluntary incentive auctions can create significant value for the economy and for consumers.

A wide range of stakeholders support the voluntary incentive auctions concept, and I have provided a detailed discussion of this support in my answer to Mrs. Emerson's QFRs. I am submitting for the record an April 6, 2011 letter from 112 leading economists, including Nobel laureates, former members of the White House Council of Economic Advisers, and former FCC Chief Economists from across the ideological spectrum, supporting voluntary incentive auctions.

The economists state that they support voluntary incentive auctions, which they describe as "a valuable tool to increase the efficiency of spectrum use in the United States by granting the FCC the authority to auction spectrum it controls at the same time as it auctions spectrum licenses held by commercial entities." They urge Congress to give "the FCC the authority to implement incentive auctions with flexibility to design appropriate rules" in order to "increase social welfare."

Gregory L. Rosston
Deputy Director

April 6, 2011

President Barack Obama
The White House
1600 Pennsylvania Avenue
Washington, DC 20500

Dear President Obama,

We are 112 economists who specialize in telecommunications, auction theory and design, and/or competition policy. We understand that Congress is considering legislation that would give the FCC explicit authority to run "incentive auctions" in which it would have the ability to distribute some portion of the auction proceeds to licensees who voluntarily give up their license rights. We support such an effort and think it would increase spectrum efficiency in the United States.

Spectrum policy is very important for the United States economy. In 1993, Congress took the important, but politically controversial step of authorizing spectrum auctions. The decision led to substantial benefits including more efficient spectrum allocation and substantial revenues for the U.S. Treasury. The Federal Communications Commission ("FCC") worked with auction experts to develop the simultaneous multiple-round auction that worked in the United States and has been replicated around the world.

Congress has another chance to give the FCC a valuable tool to increase the efficiency of spectrum use in the United States by granting the FCC the authority to auction spectrum it controls at the same time as it auctions spectrum licenses held by commercial entities. Auction design and practice is sufficiently advanced that the FCC can successfully implement this type of auction. Incentive auctions can facilitate the repurposing of spectrum from inefficient uses to more valuable uses while minimizing the transaction costs incurred. Giving the FCC the authority to implement incentive auctions with flexibility to design appropriate rules would increase social welfare.

Historically, the FCC allocated spectrum for specific uses such as television, radio, or satellite services. Spectrum rules are meant to resolve conflicting uses, much as a city might engage in zoning to protect homeowners from noisy or dirty industrial developments. Because of changing technologies, demand, and relative costs, old spectrum allocations based on out-of-date assumptions have become inefficient, wasting valuable spectrum resources. Existing laws do not give the FCC the tools it needs to allow spectrum to be reallocated efficiently and quickly from

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old uses to newer, currently more valuable uses.

The United States has a long tradition of relying on private market transactions to guide resources to their highest value uses. Voluntary transactions in free markets ensure that trades happen only when the buyer and seller both benefit. Just as for most assets, when radio spectrum is used inefficiently and appropriate property rights are in place, the potential buyers and sellers will be encouraged to find terms that capture and share the benefits of transitioning spectrum to higher valued uses.

Transitioning spectrum to more valuable uses is relatively easy and almost spontaneous when simple, single transactions can provide most of the joint benefits. But repurposing radio spectrum can entail complex transactions involving several parties. For example, a buyer may be reluctant to acquire licenses piecemeal because of the risk that it might fail to aggregate a sufficient quantity of appropriate licenses. However, a centralized auction that incorporates package bidding helps assure the buyer that it would not be saddled with an inefficiently small aggregation of licenses, and also allows a buyer to compare alternative acquisition strategies more systematically. A centralized marketplace can also reduce the transaction costs and hold out problems that sometimes arise when the ability to set up a service requires negotiating rights from many different parties (sometime referred to as a "thicket of rights" or "anticommons" problem). For example, current broadcast licenses have many overlapping geographic areas; it might be difficult to come to satisfactory agreements in a timely manner with a sufficient number of incumbent licensees in any particular geographic area, or enough geographic areas across the country, to establish a viable wireless service.

Implementing an efficient "incentive auction" will require substantial thought and care – we look forward to working with the FCC to develop an efficient auction system and to address potential concerns about the auction and how it will work. The original simultaneous multiple-round auction system implemented in 1994 was novel, but the FCC was able to implement the path-breaking auctions that were the basis for successful auctions around the world. We expect that the same will be true of incentive auctions.

Sincerely,

Paul Milgrom
Stanford University

Gregory Rosston
Stanford University

Andrzej Skrzypacz
Stanford University

Cc: Austan Goolsbee, Chairman, President's Council of Economic Advisors
Eugene Sperling, Chairman, National Economic Council

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MR. DIAZ-BALART. Mr. Chairman, will all spectrum reclamation plans be voluntary? Can you confirm that television stations that want to continue to serve the public interest will be held harmless?

MR. GENACHOWSKI. Under our voluntary incentive auction proposal, no broadcaster would be required to give up spectrum involuntarily. Those stations that want to continue to broadcast on all or part of their current 6 MHz channel will be able to do so.

To ensure that the spectrum freed up in a voluntary incentive auction is useful for mobile broadband, the FCC may need to assign new frequencies to some television stations. We intend to minimize the number of stations that need to change frequencies and fully support reimbursing broadcasters for any costs incurred in relocating. Our goal is to limit any inconvenience to broadcasters and maintain a strong over-the-air television broadcast service.

LIGHTSQUARED ISSUE

MR. DIAZ-BALART. Numerous government and private sector users and providers of GPS have raised serious concerns that about the harmful interference that the high-power LightSquared network will overwhelm low power GPS devices in the adjacent spectrum band. I share their concern. Critical segments of our economy and communications networks, including those used by our first responders, rely on the accuracy and availability of GPS. If GPS reception is disrupted, there will be an immediate and devastating impact on our economy and the safety of life and property. I understand that a technical working group that includes GPS providers is studying the interference issue and will issue a report or reports in June. Can you assure us today that the FCC will not authorize LightSquared to proceed to commercial operations if there is any credible evidence that LightSquared's network will create interference to GPS receivers – even if some reports suggest otherwise?

MR. GENACHOWSKI. I share your view that GPS devices play a critical role in our economy and communications networks, including those used by our first responders and the military. That is why it is important, as we look to free up spectrum for mobile broadband, that we work through the important interference issues raised by the GPS community before moving forward. The FCC's International Bureau's January 26, 2011 Order provides that LightSquared may <u>not</u> commence commercial operations until the Commission determines that the GPS interference issue has been resolved. As I noted during the hearing, the Commission's expert staff, especially its engineers, have a long history of dealing with these spectrum matters fairly and effectively. This matter will be resolved in compliance with the Commission's rules after a data-driven review process.

MR. DIAZ-BALART. The conditional grant of LightSquared's application was granted by the Commission's International Bureau, but the order provides that LightSquared is not authorized to commence commercial service until "the Commission, after consultation with NTIA, concludes that the harmful interference concerns have been resolved." Given the potential impact on GPS, we believe that this determination should be made by a vote of the full

Commission will vote on this matter before LightSquared is permitted to begin commercial service?

MR. GENACHOWSKI. The Commission's rules delegate authority to its bureaus and offices to address a range of matters and act accordingly. The rules require full Commission action in specified instances. Also, staff decisions using "delegated authority" may be subject to review by the full Commission. The Commission will resolve issues related to this matter in accordance with these procedural rules and within the dictates of the *Communications Act*.

MR. DIAZ-BALART. We understand that the Departments of Defense, Homeland Security, Transportation, and Interior have each individually raised serious concerns about LightSquared's proposal in comments to the Department of Commerce, which manages government spectrum. Could you please take a moment to explain to the Subcommittee why these Departments are concerned?

MR. GENACHOWSKI. The Departments of Defense, Homeland Security, Transportation, and Interior have each individually expressed concern about LightSquared's proposal in comments to NTIA. They have stated that LightSquared services will adversely affect Global Positioning System or "GPS" and Global Navigation Satellite System, or "GNSS" receivers.

The departments also indicated that LightSquared's application may have an impact on the bands allocated for Aeronautical Mobile-Satellite Route Service, or "AMS(R)S." The departments are concerned about the impact on use during en-route oceanic flights and for maritime emergency communications as part of the Global Maritime Distress and Safety System or "GMDSS," as well as MSS earth stations using Inmarsat commercial services.

We have a long history of working through difficult interference issues with our federal partners, and will continue to do so with respect to the spectrum currently licensed to LightSquared.

MR. DIAZ-BALART. Can you assure us that you will not allow LightSquared to proceed if, after the interference study you've ordered is completed, these Departments continue to have these concerns?

MR. GENACHOWSKI. The Order conditions approval of LightSquared's request for commercial operating authority until resolution of the GPS interference concerns. I take the concerns raised seriously, and will work closely with our federal partners to resolve these issues.

MR. DIAZ-BALART. The Commander of the U.S. Space Command testified to the House Armed Services Committee about two weeks ago, "We believe from what we have seen thus far that virtually every GPS receiver out there would be affected." That is a serious claim. Why did you go forward with even a conditional grant of LightSquared's application given the gravity of these concerns from the Department of Defense, which runs the national GPS system?

MR. GENACHOWSKI. It is important to reiterate that under the January 26, 2011 Order, LightSquared may not commence commercial operations until the Commission determines that the GPS interference issue is resolved. Thus, the Commission will not permit LightSquared to proceed until the interference concerns raised are adequately addressed.

MR. DIAZ-BALART. Can you unequivocally tell the Committee today that if technical studies suggest that LightSquared's network will interfere with the GPS system, as the DOD suspects it does, that you will not allow the new system to proceed?

MR. GENACHOWSKI. The Commission will not allow LightSquared to commence commercial operations pursuant to the January 26, 2011 Order until resolution of the harmful interference concerns. Prior to a final resolution in this matter, the Order requires consultation between the FCC and NTIA, which represents DOD's interests in this matter.

MR. DIAZ-BALART. You say you conditionally granted LightSquared's application because you wanted to make more spectrum available for wireless broadband. While I share that goal, this seems like the wrong spectrum to use to meet that objective. Why don't you complete your pending spectrum inventory and find more appropriate spectrum to reallocate for broadband, rather than creating this significant risk to GPS?

MR. GENACHOWSKI. The Commission already has conducted a baseline spectrum inventory to better understand the overall spectrum landscape. This baseline inventory is one of the most substantial and comprehensive evaluations of spectrum in the Commission's history. Through our systematic process, we have developed two tools – LicenseView and the Spectrum Dashboard – that reflect our understanding of the location and availability of our most significant spectrum opportunities.

This baseline spectrum inventory also confirmed that the MSS bands, including the L-band in which LightSquared is licensed, are among the frequencies most appropriate for mobile use. They have sufficient bandwidth to offer clear opportunities for increased spectrum access. The Commission's staff has acted to review the spectrum's productivity while taking into consideration the concerns of operations in adjacent bands. The Commission's overarching goal is to free up additional spectrum for broadband use in the near term, while continuing to harvest available spectrum identified in the inventory.

Spectrum is a unique driver of our economy and a key component of our global competitiveness. It is important that we do not allow any spectrum – a finite resource – to unnecessarily lie fallow. We must work hard to find solutions to interference issues, as the Commission has done over its 75-plus year history.

MR. DIAZ-BALART. In the order conditionally granting LightSquared's application, the FCC established a process by which it will get input from a technical working group comprised of the GPS industry representatives and LightSquared before it authorizes LightSquared to begin commercial operations. Will the results of this process be made available for public review and comment before the Commission determines whether to allow LightSquared to commerce commercial service?

MR. GENACHOWSKI. Yes. The Federal Communications Commission maintains a transparent record process in compliance with its own rules and the APA. Not only is there an open public record in this proceeding, but all interested parties will be given an opportunity to comment on the final working group report.

LightSquared already has filed four progress reports that are available to the public both online and at the Commission's headquarters. LightSquared is required to submit a final report to the FCC by June 15, 2011 containing its plan for avoiding harmful interference to GPS operations, as well as the respective analyses and recommendation of the parties participating in the working group. The Commission will place that report in the public record and accept comments from any interested person or entity.

MR. DIAZ-BALART. What will you do if the working group cannot reach a consensus on the interference risks?

MR. GENACHOWSKI. While the Authorization Order does not ask or require LightSquared to develop a consensus recommendation among the working group participants, it specifically mandates that LightSquared may not commence commercial operations pursuant to the waiver until the Commission determines that the GPS interference issue is resolved. The Commission's staff will evaluate the final report along with all other relevant comments and technical information submitted into the record. The Commission will collaborate with NTIA to assess the interference risk and determine what actions will be appropriate.

MR. DIAZ-BALART. Can you assure us that you will not authorize LightSquared to commence commercial operations unless the reports – particularly reports from entities other than LightSquared – are crystal clear that LightSquared's network will not create harmful interference to GPS?

MR. GENACHOWSKI. As I have noted previously, LightSquared may not commence commercial operations pursuant to the January 26, 2011 Order until the Commission is satisfied that he GPS interference issue is resolved.

MR. DIAZ-BALART. LightSquared has announced that it has raised over $2 billion in debt and equity over the last eight months. Just last month, it raised over a half a billion dollars in debt – presumably on the FCC's approval of its business plan. Can you tell us unambiguously today that you have not prejudged the outcome of the interference review, that you are in fact prepared to revoke LightSquared's authorization if the technical studies do not clearly and convincingly prove there will be no harm to GPS, and that any investments made in LightSquared while the studies are pending are at the investors' risk?

MR. GENACHOWSKI. I have not prejudged this matter and the Commission will not permit LightSquared to move forward with commercial service until it is completely satisfied that the interference issues raised have been satisfactorily resolved.

MR. DIAZ-BALART. Given the importance of our GPS system, the evidence must be clear and convincing that LightSquared will not cause harmful interference before it is permitted to commerce commercial operations. Can you assure us that you will adhere to this standard in assessing the technical reports and making the determination whether to allow LightSquared to proceed to commercial operations?

MR. GENACHOWSKI. The conditional waiver Order provides that LightSquared may not commence commercial operations until the GPS interference issue has been resolved. As with all matters before the Commission, that determination will be made in accordance with Commission rules and precedent, the Administrative Procedures Act, and the record evidence before the Commission.

LIGHTSQUARED: GOVERNMENT AGENCY PARTICIPATION

MR. DIAZ-BALART. Are government entities participating in the technical review that the Commission ordered when it conditionally granted LightSquared's application? If not, do you have a process for making sure you have their input before you grant LightSquared the authority to commence commercial applications?

MR. GENACHOWSKI. LightSquared and the GPS Industry Council co-chair the Technical Working Group. Working group members also include subject matter experts representing a broad cross-section of GPS stakeholders from industry, wireless providers, engineering firms and public safety agencies. Federal departments are participating both directly and indirectly in the working group. Overall, the working group consists of more than 100 participants – with more than 40 members including Air Force, FAA, and NASA, and more than 50 advisors including representatives from NIST and the program office for the federal inter-agency committee on position, navigation and timing, and several observers.

MR. DIAZ-BALART. Press reports indicate that some within the FCC believe that GPS receivers are to blame for the interference that LightSquared may cause. There are hundreds of millions of GPS devices in use by consumers, not to mention devices operated in critical commercial and government sectors. All of these devices were deployed in reliance on the FCC's rules prohibiting a terrestrial-only network in the band adjacent to GPS, where you have now authorized LightSquared to deploy just such a network. It would be unreasonable to make users scrap their existing GPS devices. Can you assure us that LightSquared – and not users of existing GPS equipment – will be required to bear all of the costs of mitigating any harmful interference?

MR. GENACHOWSKI. The working group's report and the public record will provide an analysis of the source of, and potential solutions to interference problems. The Commission will carefully weigh this information and consider the public interest prior to making any determination in this regard.

It should be noted that incumbent spectrum users are expected to design receivers that reasonably discriminate against reception of signals outside of their allocated spectrum. Also, the Ancillary Terrestrial Component (ATC) concept has contemplated terrestrial service in

mobile satellite spectrum for over a decade. The Commission adopted rules for deploying terrestrial stations in mobile satellite spectrum in 2003. The Commission granted the first ATC authorization to LightSquared's predecessor in 2004. GPS stakeholders, including federal agencies through NTIA, participated in that open and transparent rulemaking process and strongly influenced the technical and operational conditions on all ATC authorizations.

MR. DIAZ-BALART. In addition to the grave threat that LightSquared poses to GPS, the process you took to grant their application troubles me. LightSquared submitted its request on November 18, 2010, the FCC sought public comments on the request the next day, and the FCC granted LightSquared's request on January 26, 2011. That's a total of only 69 days – basically overnight for a regulatory agency to act. It is my understanding that even routine processing of applications takes longer. Can you explain why the FCC moved more quickly on this request?

MR. GENACHOWSKI. The Commission moved on this request in accordance with its normal rules and procedures. There were, however, some aspects of this request for waiver, that likely explain why its consideration would not have been unduly delayed. First, unlike an application that proposes an altogether new type of operation or technology, LightSquared based its modification application on existing authorizations under its satellite license as initially granted to its predecessor in 1989, as well as its associated Ancillary Terrestrial Component authority as initially granted in 2004, and the 2010 grant of technical modifications to its license. Second, LightSquared's proposal did not require any significant technical or engineering review with one exception, due in large part to newly raised GPS interference concerns stemming from the previous determinations made in granting these existing authorizations. Third, the exception on the technological front – the question of the newly raised concerns about compatibility with GPS – could be handled most efficiently by isolating it for later disposition, so that any grant of the application would be conditioned on resolution of the interference issues.

MR. DIAZ-BALART. Your grant of LightSquared's application was conditioned on the outcome of the work of a technical working group that is looking into the risks of interference to GPS. That seems like a curious way to proceed. Why didn't you complete the interference study first, before granting the application? It is no answer to say that you didn't think the GPS industry would participate in the study if you hadn't granted LightSquared's application first. Given the grave risks to GPS and the government and commercial entities dependent on it – not to mention tens of millions of ordinary citizens – it seems like you put the cart before the horse here.

MR. GENACHOWSKI. The January 26, 2011 Order granted a waiver conditioned on resolution of the GPS interference issues. This conditional waiver permits limited "build-out" to allow for interference testing and the further collection and review of data. The Bureau determined that the interference issue could be handled most efficiently by isolating it for later disposition, so that any grant of the application would be conditioned on resolution of the interference issues.

MR. DIAZ-BALART. The technical working group that you ordered to review the interference issues is lead by LightSquared – which, of course, has a direct stake in a finding of

no harmful interference. Why didn't you appoint an independent expert that has no financial stake in the outcome to conduct this critical review?

MR. GENACHOWSKI. LightSquared and the GPS Industry Council co-chair the working group. Both parties have a financial stake in the outcome of the working group and a mutual interest in resolving concerns of interference to GPS. Subject matter experts representing a broad cross-section of GPS stakeholders from industry, wireless providers, engineering firms, public safety and various federal agencies participate in the working group. Overall, it consists of more than 100 participants – more than 40 members including 9 members from federal agencies, more than 50 advisors and several observers. All of the deliverables from the working group will be placed into the public record.

MR. DIAZ-BALART. The Subcommittee understands that besides the GPS interference issue, there are potential interference issues with the federal INMARSAT system as well as the emergency communications equipment on aircraft owned by any nation which has international flights. Please provide an explanation of these issues.

MR. GENACHOWSKI. The INMARSAT system is a privately-owned satellite system licensed by the United Kingdom. The customers for its service include U.S. Government agencies and international airlines. In December 2007, Inmarsat and LightSquared through its predecessor in interest SkyTerra, made an agreement that provided a framework for resolving long-standing difficulties concerning coordination of the L-Band frequencies on which Inmarsat and LightSquared operate. The agreement contemplates that over time both companies will make changes to their operations in order to significantly improve the efficiency of spectrum use. These changes will involve, in some circumstances, alterations to customer equipment, for example by deploying receivers with improved resilience to interference.

The FCC discussed the agreement in an Order dated March 26, 2010, in which it modified SkyTerra's authority for an ancillary terrestrial component. In addition, Inmarsat indicated, in a letter submitted in the LightSquared proceeding dated January 28, 2011, that work is ongoing, in coordination with its U.S. Government customers, to address the implementation of the coordination agreement and any interference issues it may present. Inmarsat indicated that it "is committed to ensuring its customer base is satisfied" with the operating experience provided by its system.

Regarding concerns about the impact of LightSquared's proposed operations on emergency communications equipment on aircraft used for international flights, LightSquared is required to present the Commission and NTIA, no later than six months prior to commencement of commercial operation, with a detailed written demonstration of how operations will comply with the priority and preemption requirements for mobile systems operating in spectrum shared with aeronautical mobile satellite, en-route service.

LIGHTSQUARED STAKEHOLDER ISSUES

MR. DIAZ-BALART. Please provide the Subcommittee with a complete list of the entities that, since LightSquared filed it application, have raised concerns with the FCC

regarding the harmful interference risks that LightSquared's network could pose to GPS. Include in the list the entities that filed applications for review of the decision conditionally granting LightSquared's application.

MR. GENACHOWSKI. The following entities and individuals raised concerns regarding interference to GPS on or prior to January 26, 2011, when the FCC's Order was released:

John W. Borst, DAS Corporation
Medwin Dayan, PC Nation
David Stahl, PAVCO Aircraft
James S. Keh, AutoNav 2000 Plus
Travis L. Butts, Tri-N-Run
Tony Parker, Eclipse Aerospace, Inc.
The Institute of Navigation
Jay Steven Allen, Central Missouri Aviation
G. Mark Loreto
Tom Spadafora
Ryan Imagawa, Zoom Systems
Volusia County, Florida
Rick Dyer, Sr.
Mel Beech, Pilot Travel Centers, LLC
Ron Keil, Lapeer Aviation
Jack J. Pelton, Cessna Aircraft Company
Daniel Criswell, Hawker Beechcraft Corp.
United States GPS Industry Council
National Business Aviation Association
Robin Howard, Howard Aviation Inc.
Jerrold Friedman
Universities Space Research Association
Michael Bruno, Sterling Avionics
Frank Lemon, Sterling Avionics
Kent McIntyre, Bevan-Rabell, Inc.
George Baumer, Imagine GPS Inc.
Brenton Wingard, Imagine GPS, Inc.
Drew Roger, The GPS Store, Inc.
Michael Hinderberger, Piper Aircraft Inc.
Matt Anderson, Fleet Feet Sport Madison
Charles Paul, AirNet Systems, Inc.
Michael Schull, Air Net Systems, Inc.
John Dors, Instrument Overhaul Service of San Diego, Inc.
Peter Maurer, Diamond Aircraft Industries, Inc.
Paul Sturge, Diamond Aircraft Industries, Inc.
Martin Volck, Diamond Aircraft GmbH Austria
Paul T. Brey, Cirrus Aircraft
Lawrence Newhart, Endless Mountain Pilots
Joshua Wright, Lafayette Avionics, Inc.

Greg Vail, Bloomington Avionics Inc.
Steve Daley, Gary Gribbles Running Sports
Matt Hagens, Eagle Creek Aviation Services
Qualcomm, Inc.
Chase B. Bohling, The Running Center of St. Louis, Inc.
Motorola, Inc.
AT&T Inc.
CTIA – The Wireless Association
National Telecommunications and Information Administration (in consultation with Federal agencies)
National Public Safety Telecommunications Council
Leica Geosystems, Inc.
Javad GNSS Inc.
Aviation Spectrum Resources, Inc.
General Aviation Manufacturers Association
Novatel, Inc.
Trimble Navigation, Ltd.
Garmin International
Air Transport Association of America

The following entities filed Applications for Review or Petitions for Reconsideration:

Stansell Consulting
U.S. GPS Industry Council (jointly with Garmin International, Inc., Trimble Navigation Limited, and the Air Transport Association of America, Inc.)
Aviation Spectrum Resources, Inc.
Aircraft Owners and Pilots Association
Deere & Company
American Congress on Surveying and Mapping
Lockheed Martin Corporation
General Aviation Manufacturers Association
Alarm Industry Communications Committee

The following additional entities and individuals submitted filings after January 26, 2011:

Edward Saade, Fugro EarthData
CTIA-The Wireless Association
Verizon Wireless
Motorola Solutions, Inc.
New America Foundation, Media Access Project, Free Press, and Public Knowledge (jointly)
National Corn Growers Association
Marcus Spectrum Solutions LLC
John D. Porcari, Deputy Secretary of Transportation, Department of Transportation, jointly with William J. Lynn III, Deputy Secretary of Defense, Department of Defense
American Farm Bureau Federation

National Association of Wheat Growers
Stan Fields
David Standish
Douglas Brunner
Judson Porter
Randy Snarr
Giffen Marr
Patrick McKelvey
William Dicus
Mike Wade
Senator Orrin G. Hatch (forwarding constituent view of Jeremiah Burton)
Senator Amy Klobuchar (forwarding constituent view of James Jarvis and Brenna Proczko)
Senator Herb Kohl (forwarding constituent views of William Lawson)
Senator Patty Murray (forwarding constituent views of Clay Jackson, Jim Albert, and Jonathan Becker)
Senator Charles Grassley
Hon. Eric Cantor (forwarding constituent views of Joseph R. Strohman)
Hon. Anna G. Eshoo
Hon. Lynn Jenkins, Hon. Kevin Yoder, Hon. Mike Pompeo, and Hon. Tim Huelskamp (jointly)

MR. DIAZ-BALART. Please provide the Subcommittee with a summary of the applications for review of the decision conditionally granting LightSquared's application.

MR. GENACHOWSKI. The parties filing Applications for Review and Petitions for Reconsideration are listed in my answer to the previous question. In summary, they raised three similar concerns. First, petitioners and applicants claimed that the January 26, 2011 Order accomplished fundamental changes more akin to an allocation and required a rulemaking instead of a waiver. Second, they argued that the evidence supported a finding that harmful interference precluded the waiver. Third, some petitioners claimed inadequate notice of the proceeding.

MR. DIAZ-BALART. Please provide the Subcommittee with a summary by Department or agency of each federal entity which has raised concerns to the FCC about the GPS interference issue that identifies each of the specific concerns raised.

MR. GENACHOWSKI. NTIA sent a letter to the FCC on January 12, 2011 which presented a consolidated Executive Branch position on the LightSquared waiver request and raised concerns about interference to GPS. Separately, the Deputy Secretaries of the Departments of Defense and Transportation jointly signed a letter to the FCC on March 25, 2011 expressing individual concerns about interference and the process for resolving interference concerns. The letters are brief and both are attached to this response in their entirety.

MR. DIAZ-BALART. Please provide a detailed description of the analysis and testing that will be done, and by whom and using what criteria, to characterize, measure, and determine

precisely the extent of interference between the proposed new wireless internet system and the national GPS system.

MR. GENACHOWSKI. The Order established a working group to analyze a variety of types of GPS devices for their susceptibility to overload interference from LightSquared's terrestrial network of base stations. It consists of more than 100 subject matter experts representing a broad cross-section of GPS stakeholders from industry, wireless providers, engineering firms, public safety and various federal agencies. Based on the April 15 progress report, the working group will test and evaluate nearly 140 devices and the tasks are divided among several sub-teams focused on a particular receiver category. Receiver categories are representative of non-military GPS user equipment including: aviation (10 receivers), cellular (40 devices), general location/navigation (26 receivers), high precision and network (46 receivers), timing (12 receivers) and space-based (4 receivers).

The sub-teams are responsible for determining device selection and prioritization criteria, defining operational scenarios, listing testing conditions and test plan procedures, and recommending appropriate test facilities. The working group sub-teams have finalized or drafted test plans containing pass/fail criteria for the specific receiver types and they are moving forward with a combination of laboratory-based and field-based testing programs. The cellular sub-team will test devices at CTIA authorized test labs and the general location/navigation sub-team has chosen Alcatel/Lucent facilities for testing. The aviation sub-team will rely primarily on FAA funded testing at a commercial facility but FAA will also participate in tests conducted at government facilities. The high precision sub-team and the sub-team evaluating space-based receivers will rely on tests conducted at Navy and NASA facilities, respectively.

Testing began in April and is anticipated to continue through the month of May. LightSquared has provided technical details of equipment planned for its terrestrial broadband deployment including channelization plans, output power, out-of-band emission (OOBE) characteristics and emissions masks. Field testing performed at outdoor test locations will use equipment (transmitter, filters, and antennas) consistent with what LightSquared plans to deploy for commercial operations which provides a more thorough understanding of the radiofrequency environment.

LightSquared is required to submit a final report to the FCC by June 15, 2011, containing both LightSquared's plan for avoiding harmful interference to GPS operations and the respective analyses and recommendation of the parties participating in the working group. LightSquared has filed three progress reports that are available to the public. Another progress report is due May 15, 2011. The final report that is due by June 15, 2011 will be placed in the public record as well and interested parties may comment on it.

MR. DIAZ-BALART. Please provide the specific steps FCC will take to both share the analytical information from this analysis and testing with the Departments of Defense, Homeland Security, Interior, and Transportation and to ensure that they are satisfied that the new wireless internet system poses no risk to the operations and federal missions.

MR. GENACHOWSKI. The January 26, 2011 Order specifically provides that LightSquared may <u>not</u> commence commercial operations pursuant to the waiver until the

Commission determines that the GPS interference issue is resolved. Federal departments participate both directly and indirectly in the working group and they have the opportunity to register any concerns regarding the interference study results. Representatives of federal departments can also raise concerns with NTIA in the Interdepartment Radio Advisory Committee which advises NTIA on radiofrequency spectrum issues relevant to each agency's mission.

FEDERAL COMMUNICATIONS COMMISSION STRUCTURE

MR. GRAVES. This growth at the FCC has occurred during a period in which the U.S. communications sector has been characterized by deregulation, increased competition, investment, and innovation – all of which argue for less, not more, regulation. More regulation skews competition and inhibits investment. Should we not be scaling back the FCC?

MR. GENACHOWSKI. Since 2002, the FCC has seen a large reduction in the number of its full time equivalents (FTEs). In 2002, the Commission had 1,992 FTEs. Today, we have approximately 1,775 FTEs. In that time, despite the shrinking workforce, the Commission's mission has grown in volume and complexity. The increased challenges facing the Commission today call for a workforce with extensive knowledge of and experience in the rapidly growing and increasingly complex communications and technology industries. The Commission will continue to be selective in its hiring and use the budgetary authority granted by Congress to develop and train a workforce that is strong and capable of accomplishing our agency's mission.

MR. GRAVES. Please detail the number of consultants/contractors working for the agency and the amount that the Commission spends annually to pay for their services.

MR. GENACHOWSKI. The Commission has employed a total of 17 consultants this year and to date has paid approximately $282,100 for their services. As of April 9, 2011, the Commission had 16 consultants. In Fiscal Year 2010, the Commission paid approximately $855,271 for 28 consultants. Approximately 80% of the FY2010 consultants supported activities related to the development and drafting of the statutorily-mandated National Broadband Plan.

For Fiscal Year 2010, the Commission maintained approximately 916 contractors associated with more than 67 entities at a total expense of more than $110.6 million. Some of the contract personnel worked in the FCC facilities, and some worked offsite at their employer's locations. In addition to consultants and contractors, the FCC has five employees working with the Commission pursuant to the Intergovernmental Personnel Act mobility program at a cost of approximately $1,018,200 per year.

MR. GRAVES. What are the names of the Commissions 25 largest vendors and how much was paid to them last year?

MR. GENACHOWSKI. I am submitting for the record the attached chart that lists the Commission's top 25 vendors and the amounts paid to them.

[The information follows:]

Top 25 Vendors to Federal Communications Commission During FY 2010

Vendor	Brief Description of Services	FY 2010 Expenditure
GSA OFFICE OF FINANCE	Payment to GSA for leasing of office space.	$43,985,495
COMPUTECH, INC	Provides support service for FCC information systems and websites, including systems supporting auctions activity and financial operations.	$22,094,021
AAC, INC.	Provides the support for the FCC's auction systems, including system integration efforts.	$19,222,038
COMPUTER SCIENCES CORPORATION	Provides support service for FCC licensing and operations systems as well as associated financial systems.	$7,286,567
NATEK, INC.	Provides a wide range of services to the FCC which focus primarily on supporting administrative operations such as the mailroom, warehouse receiving, transportation, housekeeping, parking attendants, and also include financial operations.	$6,734,415
AMBIT GROUP LLC	Provides database infrastructure support, information technology analysis, web services, and 3rd party software support for the FCC.	$6,503,985
CGI, FEDERAL	Core financial system replacement	$4,376,452
COSTQUEST ASSOCIATES, INC	Developed Commission Broadband Plan Economic Model.	$3,920,027
OMNIPLEX WORLD SERVICES CORP	Provides security for the FCC's headquarters.	$3,283,423
GRANT THORNTON LLP	Provides financial project management and change management service support.	$2,782,764
REALTY LEASING & MANAGEMENT CO	Provides space and facility support for the FCC's Gettysburg office.	$2,445,819
SWORD & SHIELD	Provides hardware, software and maintenance services.	$2,124,477
DOI - NATIONAL BUSINESS CENTER	Provider of FCC's core financial management system and supporting systems	$1,971,083
FEDERAL WORKING GROUP, INC.	Provides FCC customer service and auctions support services.	$4,080,024
XEROX CORPORATION	Provides high volume printer and maintenance supplies.	$1,868,620
CARAHSOFT	Provides hardware, software and maintenance services.	$1,699,373
PRINCETON SURVEY RESEARCH	Provided research services in support of the National Broadband Plan.	$1,367,075
MYTHICS	Provides hardware, software and maintenance services.	$1,162,840
GOVERNMENT PRINTING OFFICE	Provides printing services.	$1,043,267
PC MALL GOV	Provides hardware, software and maintenance services.	$1,510,619
TELETECH GOVERNMENT SOLUTIONS	Provided DTV call center support.	$1,156,580
AMYX, INC.	Provides project management support.	$1,123,589
BURSON-MARSTELLER	Provided DTV consumer awareness advertising.	$1,078,139
OPEN SYSTEMS SCIENCES	Provides support for information security.	$1,058,529
WMATA	Provides metro checks.	$1,057,738

MR. GRAVES. Can you speak to the growth of the number of contractors and consultants that the agency has hired in recent years?

MR. GENACHOWSKI. Since 2006, the FCC has hired varied numbers of consultants, based on human capital needs. The FCC hired five consultants in 2006 and maintained a high of 28 in 2010. Currently, the Commission has 16. Of the 28 employed in 2010, 16 were brought on to help the Commission meet its statutory requirement to issue a National Broadband Plan. The Broadband Plan required unprecedented effort and extensive expertise not previously on board at the Commission. To meet the tight timeframes, the FCC used its consultant authority to accelerate the acquisition of skills needed to complete the Plan. We continue to use short term consultants to supplement the expertise and skills available at the Commission for a wide range of work, including our implementation of the Broadband Plan and to supplement our workforce in the areas of public safety and cyber security.

Use of contractors has fluctuated over the years, rising in instances where Congress mandated Commission activity. For example, in Fiscal Year 2009, the FCC had 959 registered contractor personnel plus several thousand grassroots and call center personnel working under FCC contracts to support the massive nation-wide outreach effort required to help transition Americans from analog to digital television (the DTV Transition). In Fiscal Year 2009, the FCC spent more than $154.3 million on contracts, including approximately $52.3 million on the DTV Transition.

In Fiscal Year 2010, the FCC had approximately 916 contractors associated with more than 67 entities at a total expense of approximately $110.6 million. This year, the Commission has approximately 618 contractors, reflecting a significant reduction in the number of contract personnel.

MR. GRAVES. How many senior positions at the Commission are now occupied by consultants rather than FTE's?

MR. GENACHOWSKI. No senior positions, defined as Bureau or Office Chiefs, are currently occupied by consultants. The FCC does, however, have three senior positions occupied by personnel working with the Commission pursuant to the Intergovernmental Personnel Act mobility program, which allows the temporary assignment of personnel between the Federal Government and state and local governments, colleges and universities, Indian tribal governments, federally funded research and development centers, and other eligible organizations. The FCC's current Chief Economist, Chief Technologist and the Chief of the Public Safety and Homeland Security Bureau are all with the FCC pursuant to IPA appointments.

MR. GRAVES. How many FTE's earn more than $100,000 a year? How many earn as much as $125,000?

MR. GENACHOWSKI. As of April 9, 2011, 1,237 of the FCC's on board employees earned more than $100,000. As of April 9, 2011, 930 of the FCC's on board employees earned more than $125,000. The FCC maintains a professional workforce of engineers, economists, attorneys, and technologists largely based at its headquarters.

GOOGLE AND PRIVACY

MR. GRAVES. Google admitted in May 2010 that for three years it had used its Street View mapping process to eavesdrop on the content of the unencrypted consumer WiFi network transmissions. Regulators and law enforcement officials outside the U.S. have revealed that Google picked up sensitive data. The FCC has commenced your own investigation but has yet to come public with any details of that investigation. It is still unclear as to how Google eavesdropped on Americans and what Google has done with the nearly 600 gigabytes of data, which equals 62 million private, personal emails. Do you believe Google eavesdropped on Americans? When does the FCC intend to conclude its investigation of Google "Street View?"

MR. GENACHOWSKI. As I noted in my testimony before the Committee, we are unable to comment on the details of an open investigation. We are, however, actively working to resolve this case as soon as possible.

MR. GRAVES. If the FCC determines that Google did not violate the Communications Act, would the FCC be willing to share its findings with Congress and provide a recommendation for how our laws should be changed to ensure that this sort of conduct is illegal in the future?

MR. GENACHOWSKI. We would certainly welcome the opportunity to explore with the Committee whether and how U.S. laws might be revised to provide stronger privacy protections.

NET NEUTRALITY

MR. GRAVES. In regards to Net Neutrality, When does the FCC expect that the order will be published in the federal registry? The rule was passed in late December before the new Congress began. Why is it taking so long?

MR. GENACHOWSKI. The time between public release of the Open Internet rules last December and their publication in the Federal Register is a consequence of our compliance with the Paperwork Reduction Act of 1995, or "PRA" requirements and the Federal Register's publication regulations.

The PRA, Public Law 104-13, requires the Commission to seek approval from the Office of Management and Budget (OMB) for the two "information collections" announced by the open Internet order. These collections include the transparency rule for broadband providers and the FCC's enforcement procedures for violations of open Internet rules. On February 9, 2011, the Commission published in the Federal Register a notice that began the process of OMB clearance. As provided in the PRA, that notice established a 60-day comment period on the estimated time and expense of complying with the open Internet order's information collection

requirements. Commission staff is currently reviewing a number of public comments that were received on those estimates and determining whether the estimates should be adjusted.

As further required by the PRA, once that review process is complete, the Commission will publish a notice in the Federal Register initiating a 30-day period for public comment on the FCC's PRA submission to OMB. After the close of that comment period, OMB will evaluate the information collection provisions of the open Internet rules under the PRA. Following notice of OMB's clearance, the staff of the Federal Register will publish the Open Internet Report and Order, stating the rules' effective date as determined by the Federal Register publication date.

AT&T/T-MOBILE MERGER

MR. GRAVES. In regards to the recent news regarding the merger between T-Mobile and AT&T, How is the FCC going to approach this acquisition? Are you committed to an objective analysis?

MR. GENACHOWSKI. As the proposed acquisition is currently before the Commission, I cannot comment on the substance of the Commission's review. The parties filed their applications on April 21, 2011, and on April 28, 2011 we issued a public notice establishing a cycle for public comment. I can assure you that the Commission will conduct an objective, thorough, fact-based review.

MR. GRAVES. Because of the crunch on spectrum, is this the model you see happening in the future? – *i.e.*, do you foresee more mergers like this?

MR. GENACHOWSKI. Mergers will not alleviate the spectrum crunch or increase the overall amount of spectrum available for mobile broadband because spectrum is a finite resource and overall consumer demand for spectrum is increasing exponentially. Only solid spectrum management policies and innovative tools like incentive auctions will identify spectrum that can be shared or reallocated for mobile broadband. With regard to this specific transaction, the Commission will carefully study all relevant issues during its review, including the impact of this merger on future competitive activity.

RADIO IN THE DIGITAL AGE

MR. GRAVES. Radio is faced with new competition from satellite and Internet radio services, as well as countless other unregulated technologies which offer alternative sources of audio programming but which are not hampered by artificial limits on their ability to reach audiences. The current local radio ownership rules that were crafted over a decade ago do not adequately take into account the competitive pressure exerted by these sources, because their growth has occurred only in recent years. Yet it was this growth in listener options that led the FCC to approve the merger and ultimate creation of a single satellite radio company. How can the agency stand by while radio suffers the same type of slow death that the newspaper industry has while allowing other platforms to grow and meet market demands?

MR. GENACHOWSKI. I recognize the importance of free broadcast radio services to millions of Americans – especially in times of emergencies. In addition to their role as a lifeline, radio broadcasters provide important news and entertainment services to people nationwide. The Commission remains committed to ensuring that terrestrial broadcast radio retains its important role as a medium of mass communication in the digital age and we have moved aggressively over the past decade to help create a future for terrestrial radio broadcasting. In fact, since its 2002 approval of the "in-band, on-channel" transmission technology – now called "HD radio" – the Commission has established a "light touch" notification-based licensing scheme to facilitate industry adoption and consumer interest in this new radio technology.

At the present time, the Commission is conducting a statutorily-required review of the broadcast media ownership rules to determine whether they continue to be "necessary in the public interest as a result of competition." We initiated the ongoing Quadrennial Review by issuing a Notice of Inquiry (NOI) to gather, among other things, information that will provide us with a comprehensive understanding of the current media marketplace. We also asked for proposals for rules that will best promote our policy goals of competition, localism, and diversity in the context of the current media marketplace.

In the NOI, we specifically noted the declines in audience and revenues affecting the radio industry. We also observed that today consumers of broadcast radio can choose among more than 100 audio channels carried by satellite radio, downloadable podcasts, audio streaming, and other audio entertainment available in cars, on mobile devices, and on computers. To that end, in the NOI, we specifically asked for comments concerning the impact of these developments on the economic viability of broadcasters in order to consider these issues as we determine how to adapt our radio ownership rules for today's media landscape.

Notwithstanding the extraordinarily difficult economic conditions that the broadcast radio industry has endured in recent years, more than 1600 FM stations now operate with "hybrid" analog/digital facilities. Consumers, who have purchased three million digital radio receivers, can receive more than 1300 multicast digital audio programming streams. HD radios are now available from 17 automotive manufacturers covering 85 models and 36 of these vehicles include HD technology as standard equipment. Last year, the Commission also established streamlined procedures to permit most FM stations to increase digital power levels by a factor of four and, in some cases, a factor of ten. This additional flexibility is designed to permit broadcasters to replicate current analog service areas.

MR.GRAVES. Radio is important enough to have a place in the digital age. In addition, given the agency's focus on broadband and its recognition that consumers are likely to turn to Internet sources more and more for their information and entertainment needs, does it really make sense to continue to spend budget money in attempts to justify regulating traditional media?

MR. GENACHOWSKI. As long as free over-the-air, terrestrial radio exists and the Commission is required to allocate and assign spectrum for its use, we will need to expend our budgetary resources to properly carry out the mandates of the *Communications Act*. This budgetary need applies equally to all services that utilize spectrum. We must follow legal

mandates to ensure that this spectrum – an important and valuable national resource – is used in the public interest. Our responsibilities include the development of new spectrum resources, the creation of better efficiencies, and the enforcement of congressional mandates related to indecency and obscenity.

AllViD DEVICES

MR. GRAVES. In regards to the FCC "AllVid" proposal the FCC has come out with, the proposal includes detailed technology requirements that could limit what an AllVid device can do. These mandates and limitations could stifle investment and innovation. Proposals such as these are generally accompanied with adequate proof of a market failure that drives up cost for consumers. Has the FCC conducted an analysis that proves there is a market failure in this marketplace? If so, what is the market failure the Commission's AllVid initiative is intended to address?

MR. GENACHOWSKI. This past year the Commission unanimously adopted a Notice of Inquiry to consider methods for promoting competition in the retail market for smart, set-top video devices that are compatible with all MVPD services. Our goal is to effectuate the intent of Congress set forth in Section 629 of the Act and provide consumers with meaningful options in the set-top video device marketplace, including the existing model of leased equipment from their video provider. Currently, the Media Bureau is evaluating the various proposals submitted by commenters in this proceeding and will consider what, if any, next steps to take

MR. GRAVES. Is it true that under the FCC proposal, consumers would be forced to purchase two devices: namely, an AllVid adapter and a separate AllVid compatible device just to watch television?

MR. GENACHOWSKI. . The AllVid Notice of Inquiry also specifically sought comment on how to avoid the need for duplicative devices, and we continue to refine our thinking in this regard based on the very helpful input we have received from all the affected stakeholders.

FCC PENDING CASES

MR. GRAVES. Mr. Chairman, last year the Commission spent a considerable amount of time and resources on developing a new network neutrality framework. However, at the same time, I understand there are more than 100 fully briefed Applications for Review that have been pending before the Commission for more than one year. In many cases, these pending applications prevent transactions from closing, create economic uncertainty and threaten jobs. Mr. Chairman, can you help me understand how your agency can be delinquent on so many pending cases?

MR. GENACHOWSKI. When I started at the Commission, there were already over 100 Applications for Review that had been pending for more than a year. During my tenure the Commission has actively worked to resolve these matters. The Commission has reduced

backlogs in various areas, resulting in a 30 percent reduction in pending broadcast licensing applications, and an 89 percent reduction in satellite licensing applications.

In my answer to Mrs. Emerson's QFRs, I provided a complete discussion of ongoing efforts to reform the Commission's regulatory processes. I also recently testified concerning these issues before the House Energy and Commerce Committee's Communications and Technology Subcommittee. Our reforms show the Commission's commitment to eliminating burdens on industry while at the same time enhancing work prioritization. For instance, we have tentatively identified 20 data collections for elimination and recently targeted five for actual deletion. We also have eliminated more than double the regulations created, resulting in the deletion of at least 49 specific regulations.

MR. GRAVES. Is this caused by a lack of resources at the Commission or just misguided priorities?

MR. GENACHOWSKI. Applications for review often take a great deal of staff time and thus the Commission must expend considerable resources to evaluate each such application As mentioned in my answers to questions about the FCC's workforce, the Commission also has seen a large reduction in the number of its full time employees since 2002. Despite this shrinking workforce, the Commission's mission has grown in volume and complexity.

While we have made progress in clearing out long pending matters in other areas, I believe we still have more progress to make on our completion rates for applications for review. We will continue to explore procedural mechanisms to address this issue, which has been a longstanding challenge at the FCC. Also, as resources become available from other areas, I will commit workforce operations to resolve outstanding applications.

INTERCARRIER COMPENSATION

MR. WOMACK. The FCC notice of proposed rulemaking on universal service and intercarrier compensation appears to result in drastic changes to mechanisms that rural telecom providers have long relied on to recoup the costs they incur when building networks to reach sparsely populated areas. These support mechanisms enable providers to repay both private and federal loans.

Is the FCC on track to complete the NPRM on universal service and intercarrier compensation by August?

MR. GENACHOWSKI. We intend to move to an Order expeditiously after we have received all comments and data and properly reviewed the record.

On February 8, 2011, the Commission initiated a comprehensive proceeding to streamline and modernize the Universal Service Fund and intercarrier compensation system. Our goal is to make broadband available to all Americans and to accelerate the transition from circuit-switched to Internet protocol networks. In a joint blog post on March 15, 2011, I joined with Commissioners Copps, McDowell, Clyburn, and Baker to announce plans for a series of

public workshops to identify solutions for reform and to promote an open dialogue on these important issues. Over 150 parties filed comments on April 18, 2011 regarding our reform proposals, and the final reply comments are due by May 23, 2011.

MR. WOMACK. Are you concerned that changes to USF and ICC could cause rural telecom providers to default on Rural Utilities Service (RUS) loans?

MR. GENACHOWSKI. We are mindful of the fact that changes to the Universal Service Fund and intercarrier compensation system may affect providers serving rural areas that receive public funding from other governmental agencies such as RUS. Specifically, we requested data from affected firms on that potential impact and have been working with RUS on this issue. A reformed, broadband-focused Universal Service Fund and intercarrier compensation system should complement RUS's efforts to spur broadband build-out in rural America through public-private partnerships.

MR. WOMACK. When considering USF and ICC reforms, what are you doing to ensure a thorough examination of the impacts that these reforms could have on federal lending programs, such as RUS loans?

MR. GENACHOWSKI. As noted in my previous response, we are reviewing data on this issue and working with RUS. I am confident that a reformed, broadband-focused Universal Service Fund and intercarrier compensation system can complement RUS' efforts to spur broadband buildout in rural America through public-private partnerships.

MR. WOMACK. How do you plan to ensure that providers will continue to have the support necessary to repay debt obligations made in reliance upon current rules?

MR. GENACHOWSKI. We are mindful of the fact that changes to the Universal Service Fund and intercarrier compensation system could have an impact on firms' expected future cash flows. We have requested data from affected firms on that potential impact.

MR. WOMACK. In a number of your statements, you refer to the universal service program as wasteful. Yet, it has been determined that the intense and unprecedentedly expensive audits that were pursued by your agency found little, if any, waste, fraud, or abuse in the high-cost program. Given that the audits conducted by your own agency turned up no material concerns with the use of program funds by high-cost recipients, how are these programs wasteful?

MR. GENACHOWSKI. The Commission is looking at instances in which our current rules may not target universal service funding efficiently and may create the wrong incentives for participating carriers. For example, the Universal Service Fund provides substantial funding to companies in some areas where another company provides voice and broadband service to all homes without any public funding—that is, we provide public money in areas where that money may be unnecessary to ensure universal service. These inefficiencies are a form of waste, even when funds are disbursed in accordance with our rules.

BROADBAND

MR. WOMACK. The National Broadband Plan and President Obama's Wireless Initiative place a heavy emphasis on wireless broadband as the solution to ensure that the US is a world leader in high-speed broadband service. However, a recent survey revealed that 70 percent of consumers believe that mobile broadband is slower, less reliable, and more expensive than fixed broadband. Furthermore, last year, 21 percent of smartphone traffic in the United States was offloaded onto terrestrial networks, and there's an expectation that the reliance on wireline networks will increase as data traffic increases and strains wireless networks.

Do you agree that robust wireline capability is needed to make the US a leader in broadband availability and adoption?

MR. GENACHOWSKI. Robust broadband capability – both wireline and wireless – is essential for the nation to become a leader in broadband deployment and adoption. Encouraging deployment of that capability is at the heart of the Commission's mission. Our nation will need to combine wireline and wireless infrastructure in a cost-effective manner to succeed in reaching our broadband goals.

MR. WOMACK. How do we go about ensuring robust wireline networks in rural and remote areas where there aren't many community anchors or business customers to help justify such investments?

MR. GENACHOWSKI. As your question recognizes, areas with low population density that have few community anchors or business customers present a tough business case for the private sector. The costs to build and operate a network in these areas may exceed potential revenues, and we therefore need to ensure that public policies are effectively spurring private investment in broadband, and doing so as cost-effectively as possible.

Accordingly, in February 2011, the Commission initiated the Universal Service/Intercarrier Compensation Transformation – or "Connect America Fund" – rulemaking, to modernize the federal universal service fund (USF) program and intercarrier compensation (ICC) system. Reforming USF and ICC will help make broadband more widely available and affordable in high-cost, rural, and insular areas.

MR. WOMACK. A growing number of rural customers are reporting difficulties receiving long distance calls. The FCC has long emphasized the need for an interconnected public switched network that permits customers to place and receive calls that service providers exchange and complete at the customers' direction. How does your agency plan to address this increasing problem?

MR. GENACHOWSKI. Commission staff has been meeting with representatives of rural carriers concerning this matter. These carriers have noted the importance of the Commission's declaratory ruling making clear that interexchange carriers have an obligation to complete their customers' interexchange calls. To determine whether a party is engaged in

unlawful activity, the Commission requires specific information about the circumstances regarding undelivered calls.

The Commission has asked the rural carriers concerned about this issue to provide any specific information they have regarding whether any parties involved in routing calls may be engaged in an activity that violates a provision of the *Communications Act* or a Commission rule or policy. In addition, individual customers may provide specific information to support an allegation that their carrier is engaging in an unlawful activity. If so, a complaint would be the best way for these customers to seek relief from the Commission.

The Commission also has suggested to the rural carriers that they discuss this issue with the Alliance for Telecommunications Industry Solutions, or "ATIS." ATIS is a world-wide organization whose subject-matter experts resolve issues related to telecommunications network interconnection and interoperability.

SPECTRUM ISSUES

MR. WOMACK. As we continue to review the FCC's spectrum policy and analyze ways we can achieve the full potential of wireless communications, I know that you and your colleagues share my interest in approaching this important issue in a thorough manner and will consider the outcome and effect on all spectrum uses and purposes. With that consideration in mind, I would simply raise that there has been significant emphasis – since the release of the National Broadband Plan – on the utilization of voluntary incentive auctions as the means by which to create greater spectrum availability. Given the focus on the incentive auction approach and the calls on Congress to grant the FCC auction authority, Congress needs to understand your view implementation plan.

As part of the auction process, it is my understanding that there could be a need to ultimately repack existing television stations. Is this correct?

MR. GENACHOWSKI. Yes. To ensure that the spectrum freed up in a voluntary incentive auction is useful for mobile broadband, the Commission may need to assign new frequencies to some television stations.

MR. WOMACK. With regard to broadcasters who elect to continue to provide free local television service, how would they be affected in an approach that includes a repacking of stations?

MR. GENACHOWSKI. Because we do not know in advance how many broadcast stations would decide to voluntarily participate in an incentive auction, it is difficult to predict today how much spectrum would be reallocated to broadband use and how many broadcasters might need to change frequencies as part of the realignment process. To ensure that the spectrum freed up in a voluntary incentive auction is useful for the mobile broadband services, the FCC may need to assign new frequencies to some television stations. We intend to minimize the number of stations that need to change frequencies and fully support reimbursing

broadcasters for any costs incurred in relocating. Our goal is to limit any inconvenience to broadcasters and maintain a strong over-the-air television broadcast service.

MR. WOMACK. What is your response to broadcasters concerns that repacking could create or increase interference?

MR. GENACHOWSKI. We understand that concern, and the Commission is committed to minimizing any interference that would compromise broadcasters' current service areas.

MR. WOMACK. What is your response to concerns that repacking could reduce a broadcaster's service area?

MR. GENACHOWSKI. We want to work with broadcasters to minimize any loss of service area as a result of realignment. Our goal is to limit any inconvenience to broadcasters and maintain a strong over-the-air television broadcast service.

MR. WOMACK. Does the Commission have a sense of cost for stations to be repacked?

MR. GENACHOWSKI. We are in the process of estimating the costs associated with realignment. We have also proposed that Congress allow the Commission to fully reimburse any costs incurred in relocating from auction proceeds.

INNOVATIONS IN BROADCASTING

MR. WOMACK. In the early stages of the National Broadband Plan, you indicated a number of commercial stations had already communicated their willingness to exit the broadcasting business. However, in a number of meetings I have had with local broadcasters, not a single person has indicated a willingness to remove them from the business. On the contrary, I have heard stories of innovation for HD, hyper local multi-cast programming, and mobile DTV.

Will recommendations of the National Broadband Plan and subsequent FCC rulemakings undermine broadcasters' ability to continue to innovate?

MR. GENACHOWSKI. No. Under our voluntary incentive auction proposal, no broadcaster would be required to give up spectrum involuntarily. Those stations that want to continue to broadcast on all or part of their current 6 MHz channel would be able to do so.

MR. WOMACK. Is it true that local television on my iPad or iPhone will be free of charge?

MR. GENACHOWSKI. The Commission is not involved in establishing the terms for iPad or iPhone applications. Broadcasters and Apple would set the terms and conditions that would govern consumer access to broadcast television programming on these devices.

MR. WOMACK. Is it in the public interest to hamper this free innovative service to my constituents?

MR. GENACHOWSKI. We believe our voluntary incentive auction proposal will not hamper any free innovative services available to the public because no broadcaster would be required to participate in the auction. Moreover, voluntary incentive auctions would provide a capital infusion for licensees that choose to participate with some or all of their spectrum, strengthening their economic position and their ability to offer innovative new services.

LIGHTSQUARED – GPS

MR. YODER. The Subcommittee understands that besides the GPS interference issue, there are potential interference issues with the federal INMARSAT system as well as the emergency communications equipment on aircraft owned by any nation which has international flights. Please provide an explanation of these issues.

MR. GENACHOWSKI. The INMARSAT system is a privately-owned satellite system licensed by the United Kingdom. The customers for its service include U.S. Government agencies and international airlines. In December 2007, Inmarsat and LightSquared (through its predecessor in interest SkyTerra) concluded an agreement that provided a framework for resolving long-standing difficulties concerning coordination of the L-Band frequencies on which Inmarsat and LightSquared operate. The agreement contemplates that over time both companies will make changes to their operations in order to significantly improve the efficiency of spectrum use. The changes will involve, in some circumstances, changes to customer equipment, for example by deploying receivers with improved resilience to interference.

The FCC discussed the agreement in an Order dated March 26, 2010, in which it modified SkyTerra's authority for an ancillary terrestrial component. In addition, Inmarsat indicated, in a letter submitted in the LightSquared proceeding dated January 28, 2011, that work is ongoing, in coordination with its U.S. Government customers, to address the implementation of the coordination agreement and any interference issues it may present. Inmarsat indicated that it "is committed to ensuring its customer base is satisfied" with the operating experience provided by its system.

Regarding concerns about the impact of LightSquared's proposed operations on emergency communications equipment on aircraft used for international flights, LightSquared is required to present the Commission and NTIA, no later than six months prior to commencement of commercial operation, with a detailed written demonstration of how operations will comply with the priority and preemption requirements for mobile systems operating in spectrum shared with aeronautical mobile satellite, en-route service.

MR. YODER. Please provide the Subcommittee with a complete list of the entities and individuals that, since LightSquared filed its application, have raised concerns with the FCC regarding the harmful interference risks that LightSquared's network could pose to GPS. Include in the list the parties that filed applications for review of the decision conditionally granting LightSquared's application.

MR. GENACHOWSKI. The following entities and individuals raised concerns regarding interference to GPS on or prior to January 26, 2011, when the FCC's Order was released:

John W. Borst, DAS Corporation
Medwin Dayan, PC Nation
David Stahl, PAVCO Aircraft
James S. Keh, AutoNav 2000 Plus
Travis L. Butts, Tri-N-Run
Tony Parker, Eclipse Aerospace, Inc.
The Institute of Navigation
Jay Steven Allen, Central Missouri Aviation
G. Mark Loreto
Tom Spadafora
Ryan Imagawa, Zoom Systems
Volusia County, Florida
Rick Dyer, Sr.
Mel Beech, Pilot Travel Centers, LLC
Ron Keil, Lapeer Aviation
Jack J. Pelton, Cessna Aircraft Company
Daniel Criswell, Hawker Beechcraft Corp.
United States GPS Industry Council
National Business Aviation Association
Robin Howard, Howard Aviation Inc.
Jerrold Friedman
Universities Space Research Association
Michael Bruno, Sterling Avionics
Frank Lemon, Sterling Avionics
Kent McIntyre, Bevan-Rabell, Inc.
George Baumer, Imagine GPS Inc.
Brenton Wingard, Imagine GPS, Inc.
Drew Roger, The GPS Store, Inc.
Michael Hinderberger, Piper Aircraft Inc.
Matt Anderson, Fleet Feet Sport Madison
Charles Paul, AirNet Systems, Inc.
Michael Schull, Air Net Systems, Inc.
John Dors, Instrument Overhaul Service of San Diego, Inc.
Peter Maurer, Diamond Aircraft Industries, Inc.
Paul Sturge, Diamond Aircraft Industries, Inc.
Martin Volck, Diamond Aircraft GmbH Austria
Paul T. Brey, Cirrus Aircraft
Lawrence Newhart, Endless Mountain Pilots
Joshua Wright, Lafayette Avionics, Inc.
Greg Vail, Bloomington Avionics Inc.
Steve Daley, Gary Gribbles Running Sports
Matt Hagens, Eagle Creek Aviation Services

Qualcomm, Inc.
Chase B. Bohling, The Running Center of St. Louis, Inc.
Motorola, Inc.
AT&T Inc.
CTIA – The Wireless Association
National Telecommunications and Information Administration (in consultation with Federal agencies)
National Public Safety Telecommunications Council
Leica Geosystems, Inc.
Javad GNSS Inc.
Aviation Spectrum Resources, Inc.
General Aviation Manufacturers Association
Novatel, Inc.
Trimble Navigation, Ltd.
Garmin International
Air Transport Association of America

The following entities filed Applications for Review or Petitions for Reconsideration:

Stansell Consulting
U.S. GPS Industry Council (jointly with Garmin International, Inc., Trimble Navigation Limited, and the Air Transport Association of America, Inc.)
Aviation Spectrum Resources, Inc.
Aircraft Owners and Pilots Association
Deere & Company
American Congress on Surveying and Mapping
Lockheed Martin Corporation
General Aviation Manufacturers Association
Alarm Industry Communications Committee

The following additional entities and individuals submitted filings after January 26, 2011:

Edward Saade, Fugro EarthData
CTIA-The Wireless Association
Verizon Wireless
Motorola Solutions, Inc.
New America Foundation, Media Access Project, Free Press, and Public Knowledge (jointly)
National Corn Growers Association
Marcus Spectrum Solutions LLC
John D. Porcari, Deputy Secretary of Transportation, Department of Transportation, jointly with William J. Lynn III, Deputy Secretary of Defense, Department of Defense
American Farm Bureau Federation
National Association of Wheat Growers
Stan Fields
David Standish
Douglas Brunner

Judson Porter
Randy Snarr
Giffen Marr
Patrick McKelvey
William Dicus
Mike Wade
Senator Orrin G. Hatch (forwarding constituent view of Jeremiah Burton)
Senator Amy Klobuchar (forwarding constituent view of James Jarvis and Brenna Proczko)
Senator Herb Kohl (forwarding constituent views of William Lawson)
Senator Patty Murray (forwarding constituent views of Clay Jackson, Jim Albert, and Jonathan Becker)
Senator Charles Grassley
Hon. Eric Cantor (forwarding constituent views of Joseph R. Strohman)
Hon. Anna G. Eshoo
Hon. Lynn Jenkins, Hon. Kevin Yoder, Hon. Mike Pompeo, and Hon. Tim Huelskamp (jointly)

MR. YODER. Please provide the Subcommittee with a summary of the post-grant filings seeking review of the decision conditionally granting LightSquared's application (applications for review and petition for reconsideration).

MR. GENACHOWSKI. The parties filing Applications for Review and Petitions for Reconsideration are listed in my answer to the previous question. In summary, they raised three similar concerns. First, petitioners and applicants claimed that the January 26, 2011 Order accomplished fundamental changes more akin to an allocation and required a rulemaking instead of a waiver. Second, they argued that the evidence supported a finding that harmful interference precluded the waiver. Third, some petitioners claimed inadequate notice of the proceeding.

MR. YODER. Provide a summary by Department or agency of each federal entity which has raised concerns to the FCC about the GPS interference issue identifying each of the specific concerns raised;

MR. GENACHOWSKI. NTIA sent a letter to the FCC on January 12, 2011 which presented a consolidated Executive Branch position on the LightSquared waiver request and raised concerns about interference to GPS. Separately, the Deputy Secretaries of the Departments of Defense and Transportation jointly signed a letter to the FCC on March 25, 2011 expressing individual concerns about interference and the process for resolving interference concerns. The letters are brief and both are attached to this response in their entirety.

MR. YODER. Provide a summary by Department or agency of each federal entity which raised concerns about the GPS interference issue to the NTIA, which then passed those concerns on to the FCC, identifying each of the specific concerns raised.

MR. GENACHOWSKI. Federal departments provided NTIA with their individual comments and positions on the LightSquared waiver request. In its correspondence to the FCC dated January 12, 2011, NTIA indicated that it received letters from the Space-Based Position

Navigation and Timing National Coordination Office, the Office of the Assistant Secretary of Defense – provided as an attachment in the NTIA letter, the National Aeronautics and Space Administration, the Office of the Secretary of the Department of Transportation, the Office of the Secretary of the Department of Interior and the Federal Aviation Administration. The January 12, 2011 letter is brief and it is attached to this response in its entirety.

MR. YODER. Provide a summary of the communications between NTIA and the FCC, since LightSquared filed its application, in which NTIA discussed the application, noted any harmful risks presented by LightSquared's proposal, or passed on such concerns from any other federal government entity;

MR. GENACHOWSKI. NTIA represents the interests of the Executive Branch agencies on radiofrequency spectrum matters. It authorizes federal use of the radiofrequency spectrum while the FCC authorizes non-federal use of the spectrum. Under a Memorandum of Understanding, the FCC and NTIA have agreed to cooperate and give notice of all proposed actions that could potentially cause interference to authorized operations.

FCC and NTIA staff routinely discuss spectrum management matters according to the agencies' joint jurisdiction over radiofrequency spectrum. From the time LightSquared filed its waiver application to the time NTIA filed its official response on January 12, 2011, representing the consolidated Executive Branch position on the LightSquared waiver request, NTIA staff discussed the waiver request with FCC staff. Topics discussed included the potential impact of LightSquared services on Global Positioning System (GPS) and Global Navigation Satellite System (GNSS) receivers, Aeronautical Mobile-Satellite (Route) Service (AMS(R)S) (used during en-route oceanic flights and for maritime emergency communications as part of the Global Maritime Distress and Safety System (GMDSS)), and MSS earth stations using Inmarsat commercial services.

Communications between the FCC and NTIA on the waiver request have been consistent with the agencies' joint jurisdiction over spectrum matters and within the terms of the MOU between the FCC and NTIA.

MR. YODER. Provide a detailed description of the analysis and testing that will be done, and by whom and using what criteria, to characterize, measure, and determine precisely the extent of interference between the proposed new wireless broadband system and the national GPS system.

MR. GENACHOWSKI. The January 26, 2011 Order established a working group to analyze a variety of types of GPS devices for their susceptibility to overload interference from LightSquared's terrestrial network of base stations. It consists of more than 100 subject matter experts representing a broad cross-section of GPS stakeholders from industry, wireless providers, engineering firms, public safety and various federal agencies. The working group will test and evaluate nearly 140 devices and the tasks are divided among several sub-teams focused on a particular receiver category. Receiver categories are representative of non-military GPS user equipment including: aviation (10 receivers), cellular (40 devices), general location/navigation (26 receivers), high precision and network (46 receivers), timing (12 receivers) and space-based (4 receivers).

The sub-teams are responsible for determining device selection and prioritization criteria, defining operational scenarios, listing testing conditions and test plan procedures, and recommending appropriate test facilities. The working group sub-teams have finalized or drafted test plans containing pass/fail criteria for the specific receiver types and they are moving forward with a combination of laboratory-based and field-based testing programs. The cellular sub-team will test devices at CTIA authorized test labs and the general location/navigation sub-team has chosen Alcatel/Lucent facilities for testing. The aviation sub-team will rely primarily on FAA funded testing at a commercial facility but FAA will also participate in tests conducted at government facilities. The high precision sub-team and the sub-team evaluating space-based receivers will rely on tests conducted at Navy and NASA facilities, respectively.

Testing began in April and is anticipated to continue through the month of May. LightSquared has provided technical details of equipment planned for its terrestrial broadband deployment including channelization plans, output power, out-of-band emission (OOBE) characteristics and emissions masks. Field testing performed at outdoor test locations will use equipment (transmitter, filters, and antennas) consistent with what LightSquared plans to deploy for commercial operations which provides a more thorough understanding of the radiofrequency environment.

LightSquared is required to submit a final report to the FCC by June 15, 2011, containing both LightSquared's plan for avoiding harmful interference to GPS operations and the respective analyses and recommendation of the parties participating in the working group. LightSquared has filed four progress reports that are available to the public. The final report that is due by June 15, 2011 will be placed in the public record as well and interested parties may comment on it.

MR. YODER. State the specific steps the FCC will take to both share the analytical information from this analysis and testing with the Departments of Defense, Homeland Security, Interior, and Transportation and to ensure that they are satisfied that the new wireless internet system poses no risk to the operations and federal missions.

MR. GENACHOWSKI. The Commission's Order specifically provides that LightSquared may not commence commercial operations pursuant to the waiver until the Commission determines that the GPS interference issue is resolved. Federal departments participate both directly and indirectly in the working group and they have the opportunity to register any concerns regarding the interference study results. Representatives of federal departments can also raise concerns with NTIA in the Interdepartment Radio Advisory Committee which advises NTIA on radiofrequency spectrum issues relevant to each agency's mission.

MR. YODER. Even though the International Bureau conditioned LightSquared's commencement of commercial operation on completion of the working group process, the Subcommittee understands that LightSquared may have already commenced "noncommercial" operations in certain locales. Please provide information on FCC authorizations issued to LightSquared to allow these operations and any information that you have on the operations.

MR. GENACHOWSKI. The working group is moving forward with a combination of laboratory-based and field-based testing programs. Field tests managed by Air Force were conducted in mid-April at Holloman AFB in New Mexico. After successfully coordinating with NTIA, the FCC staff granted LightSquared an experimental special temporary authority to participate in the Holloman tests. The Holloman field tests were representative of a rural operational scenario.

The working group has also indicated its plans to evaluate the effect of LightSquared operations on GPS receivers in a suburban and urban operational scenario. Additional experimental STAs would need to be issued for a representative suburban and urban locale. The FCC will seek NTIA concurrence on any experimental STA request for additional test locations under established inter-agency coordination processes.

MR. YODER. Any LightSquared interference with GPS will put at risk the FAA's NextGen program, that agency's wide ranging transformation of the entire national air transport system. The FAA says that, without NextGen, there will be gridlock in the skies and that, by 2022, the failure to implement the program would cost the U.S. economy $22 billion annually in lost economic activity, a figure that grows to over $40 billion by 2033. When the International Bureau granted LightSquared's waiver, did it consider the risk to NextGen and the severe loss of future economic activity that would cause?

MR. GENACHOWSKI. As I have mentioned previously, LightSquared may not commence commercial operations pursuant to the waiver until the Commission determines that the GPS interference issue is resolved The safeguards included in the LightSquared waiver are designed to ensure proper coordination with other important systems, including NextGen. In so doing, we can realize broad economic benefits, resulting not only from systems like NextGen, but also from the substantial economic benefits that would flow from increased availability of spectrum for mobile broadband. Sound policy in this area will enable small and large businesses to reap the benefits of spectrum, resulting in greater investment and more U.S. jobs. Consumers will also benefit greatly, as mobile services continue to become more integral to our lives – as shown in the fact that smartphones now outsell PCs.

USF REFORM

MR. VISCLOSKY. Earlier this year, the Federal Communications Commission issued a notice of proposed rulemaking regarding reform of the Universal Service Fund (USF) for broadband deployment nationwide. As the USF is funded by consumers, what specific actions will the FCC take to ensure that any reforms of the USF maintain its efficiency and accountability?

MR. GENACHOWSKI. The Notice of Proposed Rulemaking sought comments on adopting performance goals and measures for the program, improving internal controls to ensure greater accountability for fund recipients, and modifying program rules to encourage efficiency. The Commission received comments in the proceeding on April 18, 2011 and reply comments are due May 23, 2011.

The Commission also has improved the universal service fund audit process and oversight over the Universal Service Administrative Company to strengthen accountability and effectiveness. Specifically, the FCC Office of the Managing Director, working with the Office of Management and Budget, has replaced the old audit program with an improved program designed to fulfill the following objectives: cover all programs and contributors; tailor audit findings to type and scope to program risk elements, size of disbursement, audit timing and other factors; keep costs reasonable in relation to efficiencies, control costs, reduce unnecessary burdens on beneficiaries, and maintain pool of trained auditors; and retain capability and capacity for targeted and risk-based audits to be conducted as recommended by the FCC, law enforcement, or USAC.

The Commission expects that this new program will also be substantially less costly, estimated at less than $28 million versus previous program costs of $87 million. The procedures also will present a truer picture of the extent of any improper payments on a more timely basis.

Consistent with the objectives of the Improper Payments Information Act, the Commission has also implemented the Payment Quality Assurance or "PQA" Program to strengthen beneficiary compliance with FCC rules and ensure the USF is making "every effort to confirm the right recipient is receiving the right payment for the right reason at the right time."

In addition, the Commission has provided the following directives over the past year to improve audit oversight, strengthen internal controls, and keep administrative costs reasonable for the USF program:

- In October 2010, the Commission directed USAC to develop a systematic process for assessing internal controls that considers audit findings and is supported by documented procedures and policies.
- In December 2010, the Commission directed USAC to improve existing internal controls for protecting against improper payments when distributing support under all four universal service programs.
- In December 2010, in response to a recommendation from GAO, the FCC directed USAC to conduct a robust risk assessment of the E-rate program, which considers, among other things, the top five findings from the last five rounds of E-rate audits and their impact on meeting program objectives. In addition, the FCC directed USAC to implement a series of measures to strengthen internal controls.
- In January 2011, in response to a recommendation from GAO, the FCC directed USAC to conduct a robust risk assessment of the Low Income Program and implement a series of measures to strengthen internal controls.
- In February 2011, in response to the December 2010 USAC Final Report and Statistical Analysis of the 2007-08 High Cost Program Beneficiary Audits, to further identify and reduce improper payments, the FCC instructed USAC, for each of findings concerning improper payments, to examine, identify, explain, and categorize the cause(s) of each error and to make recommendations to prevent these errors from re-occurring.]

TUESDAY, MARCH 15, 2011.

SECURITIES AND EXCHANGE COMMISSION

WITNESS

MARY L. SCHAPIRO, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mrs. EMERSON. The hearing will come to order. I would like to welcome our witness, Chairwoman Schapiro, and I thank you so much for being here today and for the testimony you will be giving related to the Securities and Exchange Commission. The SEC has a complicated mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, while at the same time not over-regulating our markets and hindering economic recovery.

As you know, this committee is committed to reducing non-security discretionary spending to fiscal year 2008 levels, and so far we have had a strong hearing schedule and I intend to continue this theme of strong oversight throughout the rest of the year. While the SEC is funded by fees, Congressional oversight over your budget is an important check on agency activities. Since 2001 in the wake of Enron, this committee has increased the SEC's budget by over 160 percent. Few if any other agencies have received such a large increase. In fiscal year 2001, the SEC's budget was $423 million; today it is $1.1 billion. The fiscal year 2012 request proposes a significant increase, including a 20 percent increase in staff.

Before we decide to provide the SEC with even more resources, several concerns need to be addressed such as the SEC's internal financial reporting, leasing practices, and the ability to ensure investors that another Madoff or Stanford Ponzi scheme will be caught and brought to justice before investors are severely affected. Capital formation and investment are critical parts of our economy and we must be sure that this agency is protecting investors while at the same time not precluding investment. This committee must be vigilant in our oversight of agencies like the SEC that play a critical role in the U.S. economy. Chairman Schapiro, you have a very, very challenging job and we do appreciate all the hard work you and your staff do and look forward to your testimony. I would now like to recognize my friend, Ranking Member Joe Serrano.

Mr. SERRANO. Thank you. Thank you, Madam Chair. And I also would like to welcome you to today's hearings. You have been involved in reforming the internal operations of the SEC and I look forward to learning more about your efforts during this hearing about that reform. You have been given many new responsibilities under the recently passed Dodd-Frank Act. These new responsibilities are vital to protect consumers and shareholders and to ensure that past abuses are not repeated. Unfortunately, you now have to

implement your many new mandates without the necessary resources. I look forward to discussing this problem with you in greater detail today.

We are also aware of your need to increase staffing, make significant information technology investments so that you can better fulfill your extensive new responsibilities. These are real needs that we need to work with you on addressing in a timely way. We are all in agreement that we need a strong SEC to protect us from investment scandals and another meltdown of the securities markets. We cannot afford to repeat our past mistakes, but now need a robust and well-run SEC so that we can apply past lessons to future challenges. During today's hearings, I hope to learn more about your reform efforts at the SEC and about the progress you are making.

In closing, let me just make a comment. I know that the Chairwoman spoke about the fact that there is a great desire to cut back to 2008 levels. And certainly we on this side understand that that is going to happen in one way or another, maybe not to the extent that we have seen expressed so far, but there will be serious cuts across the federal government. It would seem to me that this is a dangerous place to cut if we are not going to provide proper oversight. I have been in public office 37 years. I cannot tell you, except for once, did I ever hear a state or federal agency come before me and say, We do not need money. We have enough. That was the SEC some years ago before you that actually came to us and said, No, no, that is fine, Mr. Serrano. We do not need any money. Translation, We do not want any oversight. And that is what happened.

And so on one hand, I understand the need to cut. On the other hand, I fear that this is a place not to cut. One last point. I realize that there are a lot of people out there who do not like Obamacare, and by the way, I was the first one who said, Let us call it Obamacare because at the end of the day, there will be Social Security, Medicare, and Obamacare, and the other side would have given him his legacy. And so I am proud to call it Obamacare. I understand that that is an issue. But there is also a move afoot not to fund Dodd-Frank. And so we have this law that everybody agreed had to be passed in order to deal with this meltdown and all the schemes and all the scandals, and now we are not going to fund it and that would be a tragedy. So I hope that in the desire to cut, we come to some conclusion that there are some things we need to fund and fund properly. And I welcome you today. And I thank you, Madam Chair.

Mrs. EMERSON. Thanks, Mr. Serrano. I now recognize Chairman Schapiro for her opening. If you would try to keep your remarks to about five minutes, we will have more time for questions. Thanks so much.

Ms. SCHAPIRO. Chairwoman Emerson, Ranking Member Serrano, thank you for the opportunity to testify in support of the President's fiscal year 2012 budget request for the United States Securities and Exchange Commission. The $1.4 billion that the President is requesting will allow us to adequately staff the agency to fulfill our core mission of protecting investors, expand our information technology system so we can realize operational efficiencies, better

keep pace with increasingly sophisticated financial market participants, and carry out our new responsibilities over hedge funds, derivatives, and credit rating agencies.

As you know, we have worked tirelessly to make the SEC a more vigilant, agile, and responsive agency over the past two years, and we continue moving forward on multiple fronts designed to enhance our effectiveness and ensure robust oversight of the financial markets.

In addition, we have embarked on a vigorous rule-making agenda, addressing critical issues including equity market structure, money market fund resiliency, asset-backed securities, consolidated audit trail, and municipal securities disclosure. I believe we have made a great number of necessary changes and accomplished a great deal, but this year we find ourselves at a critical juncture. That is because Congress has challenged us not only to continue our reform efforts and to carry out our core responsibilities, but also to fulfill the significant new responsibilities under the Dodd-Frank Act.

As you know, separate and apart from that legislation, the SEC is responsible for essential financial market activities such as pursuing securities fraud, reviewing public company disclosures, inspecting the activities of investment advisers and investment companies and broker-dealers, and ensuring fair and efficient markets. And because of the new legislation we are taking on considerable new responsibilities. For oversight of the over-the-counter derivatives market and hedge fund advisers, registration of municipal advisers and security-based swap market participants; enhanced supervision of credit rating agencies, heightened regulation of asset-backed securities, and the creation of a new whistleblower program.

Over the past decade, the SEC has faced significant challenges maintaining staffing levels sufficient to carry out its existing mission. For instance, from 2005 to 2007 the SEC experienced three years of frozen or reduced budgets forcing a 10 percent reduction in the agency's staff. Similarly the agency's investment in new or enhanced IT systems declined approximately 50 percent between 2005 and 2009.

At the same time, the size and complexity of the securities markets were growing at a rapid pace. Indeed, during the past decade, trading volume more than doubled, listed equity market volume alone now averages approximately 8.5 billion shares a day. The number of investment advisers grew by 50 percent and the assets they managed increased to $38 trillion. Today the SEC has responsibility for approximately 35,000 entities, including direct oversight of more than 11,000 investment advisers, 7,000 mutual funds, and 5,000 broker-dealers with more than 160,000 branch offices.

We also review the disclosures and financial statements of approximately 10,000 reporting companies. And we oversee transfer agents, national securities exchanges, clearing agencies, and credit rating agencies. Indeed, we oversee some financial firms that regularly spend many times more just on their technology operations than the SEC's entire budget.

A budget of $1.4 billion would allow us to hire the experts and acquire the technology we need to effectively carry out our core responsibilities and to begin implementation of Dodd-Frank.

Of the 2012 requested amount, we estimated that $123 million will be allocated to begin implementing the provisions of the new law. This funding request also will support information technology investments of $78 million, including vital new technology initiatives ranging from data management and integration, to internal accounting and financial reporting. It will permit the agency to develop risk-analysis tools to help us triage and analyze tips, complaints, and referrals. And it will permit us to complete a digital forensics lab that enforcement staff will use to recreate data of computer hard drives and cell phones capturing evidence of sophisticated frauds.

Finally, it is important to note that the SEC's fiscal year 2012 funding request will be fully offset by matching collections of fees on securities transactions. Beginning with fiscal year 2012, the SEC is required to adjust fee rates so the amount collected will match the total amount appropriated for the agency by Congress. Because of this mechanism, SEC funding will be deficit neutral.

I thank the subcommittee for your support and I look forward to working with you to improve the agency's performance of its core mission, to implement our new responsibilities, and to continue protecting investors. And, I am, of course, happy to answer any questions.

[The statement of Ms. Schapiro follows:]

Testimony before the Subcommittee on Financial Services and General Government

Committee on Appropriations
U.S. House of Representatives

by Chairman Mary Schapiro
U.S. Securities and Exchange Commission

March 15, 2011

Chairwoman Emerson, Ranking Member Serrano, Members of the Subcommittee:

Thank you for the opportunity to testify in support of the President's FY 2012 budget request for the U.S. Securities and Exchange Commission (SEC).[1] I welcome this opportunity to answer your questions and provide you with additional information on how the SEC would make effective use of the $1.407 billion that is requested for the coming fiscal year.[2]

Over the past two years, we have worked tirelessly to make the SEC more vigilant, agile, and responsive, and are moving on multiple fronts to enhance the agency's effectiveness and provide robust oversight of the financial markets. We have new senior leadership in all key positions and have embarked on a vigorous rulemaking agenda, addressing areas such as equity market structure, investment adviser custody controls, money market fund resiliency, asset-backed securities, large trader reporting, pay-to-play, and municipal securities disclosure.

In addition to carrying out our longstanding core responsibilities, last year's enactment of the Dodd-Frank Act has added significantly to the SEC's workload. In the short term, it requires the agency to promulgate more than 100 new rules, create five new offices, and produce more than 20 studies and reports. The law assigns the SEC considerable new responsibilities that will have a significant long-term impact on the agency's workload, including oversight of the over-the-counter (OTC) derivatives market and hedge fund advisers; registration of municipal advisors and security-based swap market participants; enhanced supervision of nationally recognized statistical rating organizations (NRSROs) and clearing agencies; heightened regulation of asset-backed securities (ABS); and creation of a new whistleblower program.

My testimony will provide an overview of the agency's actions and initiatives over the past year. I will then discuss the FY 2012 budget request and the activities that these resources would make possible.

New Leadership, Organizational Reform, and Expertise

Without a doubt, the most critical element to our success in improving the Commission's operations is the agency's talented staff. Over the past two years, we have installed new

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[1] A copy of the SEC's FY2012 Budget Congressional Justification can be found on our website at http://www.sec.gov/about/secfy12congbudgjust.pdf.

[2] The views expressed in this testimony are those of the Chairman of the Securities and Exchange Commission and do not necessarily represent the views of the President or the full Commission.

management across the major divisions and offices of the Commission. These new senior managers are playing a vital role in our efforts to transform the agency.

During my first year, we brought in new leadership to run the four largest operating units—the Division of Enforcement, the Office of Compliance Inspections and Examinations (OCIE), the Division of Corporation Finance, and the Division of Trading and Markets. We also created a new Division of Risk, Strategy, and Financial Innovation to re-focus the agency's attention on—and response to—new products, trading practices, and risks.

This past year, we brought on board a new director to oversee the Division of Investment Management, and hired deputy directors in the Divisions of Trading and Markets and Corporation Finance. We also brought on board key leaders to help improve internal operations. This includes the creation of a new Chief Operating Officer position; the hiring of a new Chief Financial Officer to oversee the agency's budget, accounting, and financial reporting; the hiring of a new Chief Information Officer to oversee the agency's information technology program; and the hiring of the agency's first Chief Compliance Officer. At all levels we have focused on hiring individuals with key skill sets that reflect the rapidly changing markets under our supervision.

We're continuing to make significant progress in reforming how the SEC operates. Since 2009, the agency has carried out a comprehensive review and restructuring of its two largest programs—enforcement and examinations—to ensure effective performance. The Enforcement Division has streamlined its procedures to bring cases more swiftly, removed a layer of management, created national specialized units, and added new staff with new skills to pursue complex fraud and market abuses. More recently, the SEC's examinations unit restructured its exam program after a top-to-bottom review, becoming more risk-based in its approach, enhancing staff training, and installing better systems to support examiners.

Also during the past year, to the extent permitted by available resources, we worked to improve training and education of agency staff, to establish a deeper reservoir of experts throughout the agency, and to modernize information technology, including a centralized system for tips and complaints, enforcement and examination management systems, risk analysis tools, and financial management systems.

Enforcing the Law

Enforcement of the securities laws is the foundation of the SEC's mission. Swift and vigorous proceedings directed at those who have broken the law are at the heart of the agency's efforts to protect investors.

In the past year, the SEC has continued our structural reforms of the enforcement program. We have created five national specialized investigative groups dedicated to high-priority areas of enforcement; adopted a flatter organizational structure to permit more staff to be allocated to front-line investigations; and created a new Office of Market Intelligence to serve as the hub for the effective handling of tips, complaints, and referrals.

The Dodd-Frank Act substantially expands the agency's authority to compensate whistleblowers who provide the SEC with high-quality information about violations of the federal securities laws. Last November, the Commission proposed rules mapping out the procedure for would-be whistleblowers to provide information to the agency. The proposed rules describe how eligible whistleblowers can qualify for an award through a transparent process that provides them an opportunity to assert their claim to an award. Pending the adoption of final rules, Enforcement staff has been reviewing and tracking whistleblower complaints submitted to the Commission.

We also have added a series of additional measures to encourage corporate insiders and others to come forward with evidence of wrongdoing. These new cooperation initiatives establish incentives for individuals and companies to fully and truthfully cooperate and assist with SEC investigations and enforcement actions. This program will encourage "insiders" with knowledge of wrongdoing to come forward early, thus allowing us to shut down fraudulent schemes earlier than would otherwise be possible.

These reforms, which were intended to maximize our use of resources and permit the agency to move more swiftly and strategically, are already showing improvements. Over the past calendar year, court-ordered disgorgements are up 20 percent, while the amount of monetary penalties has almost tripled. Of course, numbers alone don't fully capture the complexity, range, or importance of our enforcement accomplishments. During the past year, the Commission:

- brought significant actions involving issues arising from the financial crisis, including actions against the former Chief Executive Officer (CEO) and other executives of Countrywide Financial, Citigroup and its former Chief Financial Officer (CFO) and Head of Investor Relations, Morgan Keegan, Goldman Sachs, State Street Bank, former executives of New Century Financial and IndyMac Bancorp, Brookstreet Securities, and ICP Asset Management and its President;
- obtained multi-million dollar settlements with Tyson Foods, Alcatel-Lucent, Technip, and General Electric for violations of the Foreign Corrupt Practices Act (FCPA).
- filed our first case against a state involving municipal securities;
- brought accounting fraud cases against Dell, Diebold, and DHB Industries;
- brought a significant case alleging inappropriate use of confidential customer information by a proprietary trading desk at Merrill Lynch and an action against AXA Rosenberg in the challenging and rapidly evolving area of computer-based quantitative investment management;
- filed a variety of cases to halt Ponzi scheme operators and perpetrators of offering frauds, including those brought in conjunction with the Financial Fraud Enforcement Task Force's Operation Broken Trust sweep – indeed, in each of the past two fiscal years we've filed more than twice as many Ponzi cases as we filed in fiscal 2008;
- brought actions alleging illegal trading on confidential information obtained from technology company employees moonlighting as expert network consultants and illegal trading by major hedge funds based on illegal tips; and
- brought an action alleging a $1.5 billion mortgage securities fraud scheme to defraud the U.S. Treasury's Troubled Asset Relief Program (TARP).

Strengthening Oversight

Strong regulation is essential to the fair, orderly, and efficient operation of markets. A vigorous examination program not only reduces the opportunities for wrongdoing and fraud, but also provides early warning about emerging trends and potential weaknesses in compliance programs.

This past year, the SEC reorganized the agency's national examination program in response to rapidly-changing Wall Street practices and lessons learned from the Madoff and Stanford frauds. The agency strengthened the national exam program to provide greater consistency and efficiencies across our eleven regions and to focus more sharply on identifying the higher risk firms that it targets for examination. We also implemented new policies requiring examiners to routinely verify the existence of client assets with third party custodians, counterparties, and customers. Additionally, the exam unit now assembles individual specialists with the appropriate skill-sets for the firm they are examining or the issues on which they are focusing. Finally, the SEC has also worked to enhance the training of examiners and bring on board specialists in risk management, trading, and complex structured products.

These reforms are helping to deliver results in the exam program's work to evaluate risks, inform policy, and identify potential wrongdoing. In fact, in January 2011 alone, the Enforcement Division brought three significant cases stemming directly from exams. And going forward, the national exam program will continue to conduct sweeps in critical areas from trading practices to market manipulation to structured products.

Improving Market Structure

No discussion of the SEC's actions over the past year would be complete without a discussion of May 6, 2010—the day our markets dropped more than 500 points in a matter of minutes, only to bounce back minutes later. That event reinforced the importance of our ongoing review of market structure, which we had launched months earlier with a concept release inviting comment on regulation of the changing financial markets.

The U.S. equity market structure has changed dramatically in recent years. A decade ago, most of the volume in stocks was executed manually, whether on the floor of an exchange or over the telephone between traders. Now nearly all orders are executed by fully automated systems at great speed. The fastest exchanges and trading venues are now able to accept, execute, and send a response to orders in less than one thousandth of a second.

Speed is not the only thing that has changed. As little as five years ago, the great majority of U.S. equities capitalization was traded on a listing market – the New York Stock Exchange (NYSE) – that executed nearly 80 percent or more of volume in those stocks. Today, the NYSE executes approximately 22 percent of the volume in its listed stocks. The remaining volume is split among 15 public exchanges, more than 30 dark pools, 3 electronic communication networks (ECNs), and more than 200 internalizing broker-dealers. Currently, more than 30 percent of the volume in U.S.-listed equities is executed in venues that do not display their liquidity or make it generally available to the public, reflecting an increase over the last year.

The evolution of trading technologies has dramatically increased the speed, capacity, and sophistication of the trading functions that are available to market participants. The new electronic market structure has opened the door for entirely new types of professional market participants. Today, proprietary trading firms play a dominant role by providing liquidity through the use of highly sophisticated trading systems capable of submitting many thousands of orders in a single second. These high-frequency trading firms can generate more than a million trades in a single day and now account for more than 50 percent of equity market volume.

Over the past year, the SEC has engaged in a dedicated effort to study and learn from the experiences of May 6, with the aim of taking action to preserve the benefits of the current structure while minimizing its downsides. The agency worked with FINRA and the exchanges to develop rules that trigger circuit breakers for certain individual stocks, clarify up front how and when erroneous trades would be broken, and effectively prohibit "stub quotes" in the U.S. equity markets. We adopted a rule that prohibits broker-dealers from providing their clients with unfiltered access to exchanges, and proposed the creation of a large trader reporting system that would enhance our ability to identify large market participants, collect information on their trades, and analyze their trading activity.

We also proposed a new rule that would require the creation of a consolidated audit trail that would enable regulators to track information about trading orders received and executed across the securities markets. Today, there is no standardized, automated system to collect data across the various trading venues, products, and market participants. Each market has its own individual and often incomplete data collection system, and as a result, regulators tracking suspicious activity or reconstructing an unusual event must obtain and merge an immense volume of disparate data from a number of different markets. And even then, the data does not always reveal who traded which security, and when. To obtain individual trader information, the SEC must make a series of manual requests that can take days or even weeks to fulfill. In brief, the Commission's tools for collecting data and surveilling our markets are wholly inadequate to the task of overseeing the largest equity markets in the world.

Key Rulemaking

Over the past year, the Commission has pursued an active rulemaking agenda aimed at making our financial markets more secure, providing investors with more and better information, finding ways to make securities markets less volatile and more transparent, and promoting effective corporate governance. Even before passage of the Dodd-Frank Act, the SEC was in the midst of a productive period of rulemaking on diverse topics. Among the key ongoing and recently completed rulemakings are the following:

- ***Municipal securities:*** The Commission adopted rules that provide market participants with more meaningful and timely information regarding the health of municipal securities. In addition, as discussed below, we adopted rules to curtail pay to play practices by investment advisers seeking to manage public pensions.

- ***Proxy enhancements:*** The Commission adopted rules to facilitate exercise of shareholders' traditional state law right to nominate directors to corporate boards. We also improved

disclosure relating to risk and compensation and revised the e-proxy rules so that additional materials could be provided to shareholders with the company's notice. And, we issued a concept release requesting public input on the mechanics of proxy voting and shareholder communications.

- ***Investment adviser disclosure:*** In order to ensure that investors receive clear and accurate information from their advisers, the Commission adopted rules requiring advisers to provide clients with brochures that plainly disclose their business practices, fees, conflicts of interests, and disciplinary information.

- ***Mutual funds fees and marketing:*** The Commission proposed rules to create a more equitable framework for mutual fund marketing fees, known as 12b-1 fees. We proposed rules to help clarify the meaning of a date in a target date fund's name, as well as enhance information in fund advertising and marketing materials.

- ***Target date funds:*** The Commission proposed rules that are intended to provide enhanced information to investors concerning target date retirement funds and reduce the potential for investors to be confused or misled regarding these funds.

- ***Money market funds:*** The Commission took action to permit investors, for the first time, to access detailed information that money market funds now file with the agency, including their "shadow NAV" (net asset value). While the SEC uses this information in its real-time oversight of money market funds, public disclosure can provide investors and market analysts with useful insight for their evaluation of funds. We also tightened the quality standards that apply to the funds' investments and are working with our regulatory colleagues to assess the various options for making sure these funds are as safe and resilient in the face of market stresses as investors are led to believe.

- ***Asset-backed securities:*** The Commission proposed rules that would revise the disclosure, reporting and offering process for ABS to better protect investors in the securitization market.

- ***Market access:*** The Commission took an important step to promote market stability by adopting a new market access rule. Broker-dealers that access the markets themselves or offer market access to customers will be required to put in place appropriate pre-trade risk management controls and supervisory procedures. The rule effectively prohibits broker-dealers from providing customers with "unfiltered" access to an exchange or alternative trading system. The rule should prevent broker-dealers from engaging in practices that threaten the financial condition of other market participants and clearing organizations, as well as the integrity of trading on the securities markets.

- ***Pay to Play:*** The Commission adopted in June of last year a new rule to address so-called "pay to play" practices in which investment advisers make campaign contributions to elected officials in order to influence the award of contracts to manage public pension plan assets and other government investment accounts. The rule, adopted in response to a growing number of reports of such activities across the country, is intended to combat pay to play

In addition to these items, enactment of the Dodd-Frank Act added significant new work to the Commission's agenda, including more than 100 rulemaking provisions applicable to the SEC. To date, the Commission has issued twenty-eight proposed rule releases, seven final rule releases, and two interim final rule releases in connection with the Dodd-Frank Act. We have received thousands of public comments, held hundreds of meetings with market participants, completed five studies, and hosted five roundtables. Key rulemakings under the Dodd-Frank Act include regulations for the supervision of OTC derivatives, private fund advisers, asset-backed securities, credit rating agencies, corporate governance, rewards for whistleblowers, and specialized disclosure provisions related to conflict minerals, mine safety, and resource extraction.

SEC Resources

This year finds the SEC at an especially critical juncture in its history. Not only does the Dodd-Frank Act create significant additional work for the SEC, both in the short and long term, but the agency must also continue to carry out its longstanding core responsibilities. These responsibilities—pursuing securities fraud, reviewing public company disclosures and financial statements, inspecting the activities of investment advisers and broker-dealers, and ensuring fair and efficient markets—remain essential to investor confidence and trust in financial institutions and markets.

Over the past decade, the SEC has faced significant challenges in maintaining a staffing level and budget sufficient to carry out its core mission. The SEC experienced three years of frozen or reduced budgets from FY 2005 to 2007 that forced a reduction of 10 percent of the agency's staff. Similarly, the agency's investments in new or enhanced information technology (IT) systems declined about 50 percent from FY 2005 to 2009.

As a result of increased funding levels in FY 2009 and FY 2010, current SEC staffing levels are just now returning to the level of FY 2005, despite the enormous growth in the size and complexity of the securities markets since then. During the past decade, for example, trading volume has more than doubled, the number of investment advisers has grown by 50 percent, and the assets they manage have increased to $38 trillion. Six years ago, the SEC's funding was sufficient to provide nineteen examiners for each trillion dollars in investment adviser assets under management. Today, that figure stands at twelve examiners per trillion dollars. A number of financial firms spend many times more each year on their technology budgets alone than the SEC spends on all of its operations.

Today, the SEC has responsibility for approximately 35,000 entities, including direct oversight of 11,800 investment advisers, 7,500 mutual funds, and more than 5,000 broker-dealers with more than 160,000 branch offices. We also review the disclosures and financial statements of approximately 10,000 reporting companies. The SEC also oversees approximately 500 transfer agents, 15 national securities exchanges, 9 clearing agencies, 10 NRSROs, as well as the Public Company Accounting Oversight Board (PCAOB), Financial Industry Regulatory Authority

(FINRA), Municipal Securities Rulemaking Board (MSRB), and the Securities Investor Protection Corporation (SIPC).

In addition to our traditional market oversight and investor protection responsibilities, the enactment of the Dodd-Frank Act has added significant new responsibilities to the SEC's workload. These new responsibilities include a parallel set of responsibilities to oversee the over-the-counter derivatives market, including direct regulation of participants such as security-based swaps dealers, venues such as swap execution facilities, warehouses such as swap data repositories, and clearing agencies set up as long-term central counterparties. In a similar fashion, under the Dodd-Frank Act the SEC has been given responsibilities for hedge fund advisers that are similar to those that the agency has long overseen with respect to traditional asset managers. These hedge fund advisors include those that trade with highly complex instruments and strategies. Additionally, the Commission has new responsibility for registration of municipal advisors, enhanced supervision of NRSROs, heightened regulation of asset-backed securities, and the creation of a new whistleblower program.

FY 2012 Request

The SEC is requesting $1.407 billion for FY 2012, an increase of $264 million over the continuing resolution level under which we are currently operating. If enacted, this request would permit us to hire an additional 780 positions (612 FTE) over projected FY 2011 levels.

It is important to note that the SEC's FY 2012 funding request would be fully offset by matching collections of fees on securities transactions. Currently, the transaction fees collected by the SEC are approximately two cents per $1,000 of transactions. Under the Dodd-Frank Act, beginning with FY 2012, the SEC is required to adjust fee rates so that the amount collected will match the total amount appropriated for the agency by Congress. Under this mechanism, SEC funding will be deficit-neutral, as any increase or decrease in the SEC's budget would result in a corresponding rise or fall in offsetting fee collections.

The FY 2012 request is designed to provide the SEC with the resources required to achieve several high-priority goals: to adequately staff the agency to fulfill its core mission; to continue to implement the requirements of the Dodd-Frank Act; and to expand the agency's IT systems and management infrastructure to serve the needs of a more modern and complex organization. For purposes of my testimony today, I would like to summarize the request in each of these priority areas:

- ***Reinvigorating Core SEC Programs:*** 40 percent (312) of the new positions requested for FY 2012 would be used to strengthen and support core SEC operations, including protecting investors, maintaining orderly and efficient markets, and facilitating capital formation. As mentioned before, SEC staffing levels are just now returning to FY 2005 levels, even as the agency's responsibilities have grown along with the size and complexity of the securities markets. To help restore core capabilities, this budget request would permit us to add forty-nine positions to the enforcement program that would grow the five new specialized investigative units, bolster the agency's litigation program, and expand the new Office of Market Intelligence which conducts risk assessment and handles thousands of tips,

complaints, and referrals. In our examination program, this request would allow us to add fifty-five personnel to augment risk assessment, monitoring, and surveillance functions and to conduct additional adviser and fund inspections. The request would also permit thirty-seven staff to be added to the Division of Corporation Finance primarily to conduct more frequent disclosure reviews of the largest companies, fifteen additional staff to the Division of Investment Management primarily to enhance oversight of money market funds and specialized products, and eleven new positions to be added to the Division of Risk, Strategy, and Financial Innovation to better equip the agency to identify and address emerging risks and long-term issues of critical importance.

- ***Implementing the Dodd-Frank Act:*** 60 percent (468 positions) of the new positions requested for FY 2012 would be used to implement the Dodd-Frank Act. Many of these new positions would be used to hire experts in derivatives, hedge funds, data analytics, credit ratings, and other new or expanded responsibility areas, so that the agency may acquire the deeper expertise and knowledge needed to perform effective oversight. These new positions would support 157 new positions focused on the derivatives markets; 102 focused on hedge fund advisers; 43 to expand investigations of tips received from whistleblowers; 35 focused on municipal securities and examinations of newly registered municipal advisors; 33 focused on clearing agencies, including annual reviews of those determined to be systemically important; and 26 focused on NSRSOs principally to perform the annual examinations required by the Act. The agency also would invest in technology to facilitate the registration of additional entities and capture and analyze data on the new markets.

  The total FY 2012 costs to implement the Dodd-Frank Act through these new positions and technology investments will be approximately $123 million. In addition to the new positions requested in FY 2012, we also anticipate that an additional 296 positions and additional technology investments will be required in FY 2013 for full implementation of the Dodd-Frank Act.

- ***Investing in Information Technology:*** The SEC's budget request for FY 2012 will support information technology investments of $78 million, an increase of $23 million over FY 2011. This level of funding would support vital new technology initiatives including data management and integration, document management, EDGAR modernization, market data, internal accounting and financial reporting, infrastructure functions, and improved project management. This funding will permit the agency to develop risk analysis tools to assist with triage and analysis of tips, complaints, and referrals and to complete a digital forensics lab that enforcement staff can use to recreate data from computer hard drives and cell phones to capture evidence of sophisticated frauds. The budget request would also permit the hiring of additional staff in the Office of Information Technology, including experienced business analysts and certified project managers to oversee IT projects and staff to address financial statement and information technology deficiencies identified by the Government Accountability Office (GAO).

- ***Improving the Agency's Management Infrastructure:*** The SEC's FY 2012 request would permit the SEC to make further improvements to the agency's basic internal operations and to bring administrative and support services capabilities into alignment with the requirements

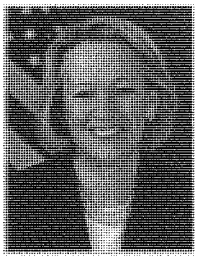
of today's SEC, and ensure that the agency manages its resources wisely and efficiently. The budget request would permit the strengthening of the newly-established Office of the Chief Operating Officer, including the development of a more robust operational risk management program and the build-out of a data management program. The budget request also contemplates an appropriate expansion of the agency's administrative support functions, including the Offices of Financial Management, Human Resources, Administrative Services, and FOIA and Records Management. The request also includes the necessary space rent and other non-compensation expenses necessary to support the level of staffing requested for FY 2012. Additionally, the SEC is devoting significant management attention to improving program and management controls, including in response to audits and assessments by the Office of the Inspector General, GAO, and management's own internal assessments.

- ***Addressing Material Weaknesses in Internal Controls***: In November 2010, the SEC completed its Performance and Accountability Report, the equivalent of a company's annual report. A GAO audit found that the financial statements and notes included in the report were presented fairly and in conformity with U.S. GAAP. It also, however, identified two material weaknesses in internal controls over financial reporting: one in information systems, and a second in financial reporting and accounting processes. The root causes of these weaknesses are gaps in the security and functionality of the agency's financial system, resulting from years of underinvesting in financial system technologies.

  These material weaknesses are unacceptable. Rather than try and solve each particular deficiency in piecemeal fashion, the agency has committed to investing the time and resources to implement a long-term, comprehensive solution. To avoid the development risks of creating new technology and systems, the SEC is switching to a Shared Service Provider approach, migrating the agency's financial system to the Department of Transportation. Other agencies, including GAO, have migrated to DoT, and they have had very positive results, with clean audits free of material weaknesses. This will be a significant undertaking, which, assuming adequate funding, will culminate in the cutover to the new system in April 2012.

Conclusion

Thank you, again, for your support for the agency's mission, and for allowing me to be here today to present the President's budget request. I am happy to answer any questions that you might have.



SEC Chairman Mary L. Schapiro

Mary L. Schapiro is the 29th Chairman of the U.S. Securities and Exchange Commission. Chairman Schapiro was appointed by President Barack Obama on January 20, 2009, unanimously confirmed by the U.S. Senate, and sworn in on January 27, 2009. She is the first woman to serve as the agency's permanent Chairman.

Chairman Schapiro's priorities at the SEC include reinvigorating a financial regulatory system that must protect investors and vigorously enforce the rules; and working to deepen the SEC's commitment to transparency, accountability, and disclosure while always keeping the needs and concerns of investors front and center.

Prior to becoming SEC Chairman, she was CEO of the Financial Industry Regulatory Authority (FINRA) — the largest non-governmental regulator for all securities firms doing business with the U.S. public. Chairman Schapiro joined the organization in 1996 as President of NASD Regulation, and was named Vice Chairman in 2002. In 2006, she was named NASD's Chairman and CEO. The following year, she led the organization's consolidation with NYSE Member Regulation to form FINRA.

Chairman Schapiro previously served as a Commissioner of the SEC from December 1988 to October 1994. She was appointed by President Ronald Reagan, reappointed by President George H.W. Bush in 1989, and named Acting Chairman by President Bill Clinton in 1993. She left the SEC when President Clinton appointed her Chairman of the Commodity Futures Trading Commission, where she served until 1996.

Chairman Schapiro is an active member of the International Organization of Securities Commissions (IOSCO). She was Chairman of the IOSCO SRO Consultative Committee from 2002 to 2006.

A 1977 graduate of Franklin and Marshall College in Lancaster, Pa., Chairman Schapiro earned a Juris Doctor degree (with honors) from George Washington University in 1980. Chairman Schapiro was named the Financial Women's Association Public Sector Woman of the Year in 2000. She received a Visionary Award from the National Council on Economic Education (NCEE) in 2008, honoring her as a "champion of economic empowerment."

Mrs. EMERSON. Thank you so much Chairman Schapiro. I am going to try to keep my questions to five minutes just because we seem to have a lot of folks here today.

Our party is really trying to get a grip on spending and is very committed to reducing spending. While the SEC's appropriation is offset by collections, we still need to look at all agencies in our efforts to reduce funding for ineffective programs and the like, no matter what their funding source is.

So could you explain to all of us on the subcommittee here, number one, how would a reduction of the SEC's appropriation to fiscal year 2008 levels affect the SEC? Do you believe that tax payer dollars are effectively being spent at the SEC? And what recommendations can you offer for more efficient and effective use of tax payer funds within your organization?

Ms. SCHAPIRO. Sure. With respect to returning to 2008 levels, that year we had a $906 million appropriation. So it is about a $241 million funding gap. The way we would go about that would be to take the maximum non-compensation cuts that we can, including travel, expert witnesses, and information technology. Although, I have to say that I am not really in favor of cutting information technology to the bone. I think it is really critical for us to be successful in what we do. But then it would require that we likely have significant furlough or RIFS, or potentially office closings.

The way we view it is after accounting for our normal attrition, going back to 2008 levels in 2012, assuming we do not go back this year, which would have, somewhat, more drastic consequences. About 740 FTE would have to be reduced. So in terms of a RIF, that would be something like a 1,000 positions. And if it were to be done through furloughs something like 50 days for the entire agency to be furloughed. It would have a dramatic impact on our ability to pursue our enforcement cases, to continue even our internal reform efforts, but also to survey the markets during this particularly volatile time, given our very complex market structure.

We would reduce even further the number of examinations that we are doing of regulated entities now. We are only examining nine percent of the investment advisers; I would expect to see that cut very dramatically.

So it would have serious consequences, I believe, for our core programs, putting aside Dodd-Frank, for which of course, we would have virtually nothing for the implementation of.

Mrs. EMERSON. So what can you recommend? I know that you are doing your best to put efficiencies into practice. Are there other measures that you can take? Forget about the money piece of it, but are there other measures you can take with the budget that you have today to get done all of the responsibilities that you have been entrusted with.

Ms. SCHAPIRO. There are things. We can go through an initiative, and in fact we will because it is part of the Boston Consulting Group report that was just issued last week, to rethink our priorities and, perhaps, reprioritize in some areas. But we are already making some hard choices. We would be making very hard choices. And we would be stopping doing things I think are really critical to investor protection and their confidence in the integrity of our

market. So if we have investment advisers with $38 trillion of assets under management and we are only inspecting nine percent of them, know we would have many fewer inspected and we would have significantly more assets that are at risk.

But we can reprioritize in some areas; some things we cannot. Congress has decreed that we do certain things, and of course, we must try to do those. But even within reprioritization, we would be leaving some very, very big gaps in the regulation of the financial markets at a time when, I think, investors really question the integrity of financial intermediaries and even the integrity of our market structure after events like May 6.

We can also continue to try to leverage more. One of my themes since I came on board two years ago has been to try to leverage private sector efforts. For example, in order to verify that the assets that an investment adviser says that they have in custody are, in fact there, we did a rule that says that investment advisers who custody with an affiliated broker-dealer have to get a surprise audit by a registered accounting firm. And that is a way for us to leverage third-parties to try to do more and take a little bit off our shoulders. The whistle-blower program: it is about leveraging third-parties to bring us high-value information so that we may be able to bring securities fraud cases and stop ongoing frauds.

Mrs. EMERSON. You mentioned gaps. What gaps do you expect would not be filled?

Ms. SCHAPIRO. Well I think if we were to go back to 2008 levels and potentially lose 1,000 positions from our staff of 3,800, we would have to give up significant examination responsibilities. Our two largest divisions are examination and enforcement; between them about 2,000 people. We cannot bring all the cases now that are out there. But we are bringing about 700 cases a year; that would be significantly reduced. Our ability to examine broker-dealers, credit rating agencies, investment advisers, mutual funds, where the vast majority of Americans have their personal savings. Our ability to monitor the exchanges and keep up with new phenomena, like high-frequency trading, would be severely impacted.

Mrs. EMERSON. Thank you. Mr. Serrano.

Mr. SERRANO. Thank you, Madam Chair. I will also try to keep it to as close to five minutes as possible, because we do have a lot of folks here that should participate. Again, Ms. Schapiro, the big issue here, to me, is whether or not Congress will fund Dodd-Frank. So, my question to you is, assuming for a second that some folks get their way and we do not, we cripple the effects of Dodd-Frank. Is the law still strong enough to take effect, to keep us from not falling into the same situation we fell into last time? In this country, we have a unique way of having some folks either rewrite history or forget. It will not be long, I assure you, before people will forget what caused this mess a few years ago. And so, no one will be asking any questions. If we cripple Dodd-Frank, if we do not fund it, is the law on the books strong enough to have an impact, or will we run the risk again of not supervising, not analyzing, and therefore having the same kinds of schemes and situations again.

Ms. SCHAPIRO. Under our existing capability, we will get lots of the rules written for Dodd-Frank. We will not make the deadlines, for sure, on many of them. But for over-the-counter derivatives, for

example, which is the largest area of concern, we will get the rules written. But I really believe and I think we can look back on history and see evidence of this, an inability to inspect for compliance with the rules and to enforce the rules, ultimately means that no matter how strong the law is, no matter how strong the rules are, we will have non-compliance, because there is no penalty for non-compliance. Compliance has costs associated with it. Some firms will continue to do a good job and be compliant and I think some clearly will not, if there is no mechanism for enforcing compliance.

When we look at programs like the Consolidated Supervised Entities Program that was started by the agency in the mid–2000s and disbanded by my predecessor, which was a voluntary program for regulation of the largest investment banks. One of the flaws in it, and there were many, was that it was a voluntary program. It was not really a good means for the SEC to enforce compliance, with the requirements of that program. As we know now, all of those investment banks are either gone or they have been converted to bank holding companies under supervision of the Federal Reserve. So, I think history tells us that it is important that we have the capability to follow up on compliance and enforcement.

Mr. SERRANO. What is really interesting about this, and this is a total personal statement, is that we do have in this country right now two groups who are disagreeing with each other on cuts and how to handle these cuts. But interestingly enough, from what I have seen, on the side of those who want cutting, their constituents do not want another meltdown on Wall Street. And on the side of those who may cut with caution, also do not want a meltdown. So, if there is one issue that most groups agree on, it is that we cannot have that kind of lack of supervision again and lack of oversight.

So let me just ask you one last question. A lot is said about bringing the levels down, back to 2008. But I think we need to know, that from 2005 to 2007 frozen or reduced budgets cut a number of employees and the SEC is just now approaching the levels for 2005. Given all that has happened between 2005 and today in the financial world, how did a reduced workforce affect the SEC over the past several years? I am talking now about that period when we were reducing rather than increasing.

Ms. SCHAPIRO. Of course, I was not at the agency at that time, but I think that is when you saw the agency go from examining, for example, with respect to investment advisers, a significant portion of the population, down to very low numbers, in the single digits of the investment adviser population. We saw dramatic cutbacks in technology spending, which I think has been one of the things that has most surprised me in the time that I have been at the agency. I was at the agency from 1988–1994, under President Reagan and then President Bush, and served as a commissioner. When I came back, in 2009, I was really shocked to see that the quality of the technology had hardly improved in that period of time. I think, given the size of our markets, the complexity and their global reach, the agency being unable to do a lot of its work through the use of technology and analytics is very crippling and leaves us in a position to not be able to do the kind of job that the American people have a right to expect from us. So, I would say during that period, examination resources were particularly re-

duced and the capability to keep up with these very complex financial institutions was definitely hurt.

Mr. SERRANO. Thank you.

Mrs. EMERSON. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you Madam Chairwoman. How are you doing? The SEC's Proposal for Municipal Advisors appears to cast a really wide net as to who has to register. In addition to the appointed members of [inaudible] boards, et cetera. It looks the SEC believes that the requirement applies to traditional bank products, including deposits and loans. So if all those bank employees and appointed officials have to register, I am not sure how the SEC expects to monitor and examine all those activities and how it would not distract from your other critical mandates.

Two questions on that, do you really think it is the best use of Commission resources to try to regulate bank activities that are already regulated by the bank regulators who are more familiar with those banks, and their activities, and how they do business, number one. And number two is, would not it just lead to banks being subjected to yet another layer, another set of regulators with the SEC imposing a regulatory scheme, a regime that is completely different than the one they are already subjected to under banking regulations already in existence?

Ms. SCHAPIRO. Congressman, let me agree with you that we do not have the luxury or the resources or the desire to duplicate what other regulators are doing. And that I think also goes back to the leverage point. Where can we rely on our fellow regulators to pick up the slack? I will say on the muni adviser rule that we have gotten lots of comment, and the rule proposal is out for comment right now, and that we have cast the net in defining municipal adviser a little bit broadly. The statutory language is quite broad, but we are taking very seriously the comment letters, particularly with respect to the difference between appointed members of a public pension fund or a municipal hospital versus elected members and employees, and why was there a distinction made? And I appreciate that issue very much, and I think more was read into what we said than we intended in that regard, but we are looking very carefully at whether we may have cast the net too widely and taking the comments very, very seriously.

Mr. DIAZ-BALART. I appreciate that, and I am glad to hear that you are still looking at that because I think it does lead to a lot of concerns.

Ms. SCHAPIRO. Oh, absolutely, hundreds of comment letters yes, and from real people with real concerns because they volunteer their time on a school board.

Mr. DIAZ-BALART. Well, it is also—well, it might even hinder your ability to do what you have to do, your core mission. So, anyways, I am glad you are looking at that. The 500 shareholder registration threshold, which I guess I just learned after a little bit of research, I guess under 1934 act has not been updated since the 1960s and for obviously a substantial number of community banks, it is either a restraint or it really hurts their ability to loan. And it is tough on them for raising capital, et cetera. Either way, it acts as a restriction on lending and I think particularly for community banks, in particular it could hurt the economic recovery, so when

does the SEC expect to act to raise the threshold and will the SEC also act to raise a level of shareholders at which registered community banks can actually deregister?

Ms. SCHAPIRO. The second issue I would like to get back to you on, I do not know the answer. We have been looking at the 500 shareholder limit because it has obviously become very current in the last couple of months with the increasing trading activity of unregistered shares and it has been brought very much to light. I have asked the staff to come back to me with a recommendation with respect to the 500 shareholder limit.

You are right it has been in law since the 1960s, the goal was, of course, to make sure that when a company had a certain number shareholders and a certain amount of following, it was providing public disclosure and information for all of those shareholders about the finances of the company so investors could make reasonable, well-informed decisions. It may be that this is one of those areas where it is due for our looking at it again. It is in the statute. Although how we interpret the 500 shareholder limit is in our rules so we have some flexibility with respect to that and we are looking at that. I would be happy to come back to you as we get closer.

Mr. DIAZ-BALART. Please. And if I may Madam Chairwoman, one last question, and you have heard this one before. The issue of the Stanford Ponzi Scheme, there are a lot of victims, and many in Florida, South Florida, that are eagerly awaiting an SEC decision on their SIPC eligibility so that they can potentially recoup some of their lost funds. And as you know in Florida where we have a lot of retirees it has been a huge issue. So, would you make the 16-month-old request for that determination a priority?

Ms. SCHAPIRO. Congressman it is a priority. We have been working with the Stanford Victim's Group and in fact, have not made a final decision because they asked us to keep the record open to provide us with additional information. I understand that late in January of this year we received significant new information from them, we are reviewing it right now and we will make it a priority.

Mr. DIAZ-BALART. So you will be taking into account the recently released Stanford Group Forensic Accounting Reports which show that Stanford funds were stolen and not used to purchase securities. So you will have that?

Ms. SCHAPIRO. We will take everything into account and speaking personally, I would love to find a way for this to work out well for the victims. But the law is our constraint and SIPC has quite different perspectives as well.

Mr. DIAZ-BALART. Madam Chairwoman I have a number of other questions but I will submit those for the record. Thank you very much.

Mrs. EMERSON. Thank you Mr. Diaz-Balart. Ms Lee.

Ms. LEE. Thank you Madam Chair, good morning. First let me just say your leadership in strengthening the SEC has really been vital in maintaining strong and fair markets and in stabilizing the overall economy following the financial crises. And quite frankly, I think that $1.4 billion really is not quite enough to ensure that the SEC has the resources and skills and technology that you need to complete your mission given the size, the massive size, and the constantly increasing complexity of our markets. So let me ask you

a couple of questions as it relates first of all, to fines and fees that you have levied. Can you give us a sense of how much in fines and fees were levied by the SEC?

Ms. SCHAPIRO. Sure. If we use 2010 as a benchmark, we had penalties ordered of just over $1 billion. That money goes to the Treasury, although some of that is actually returned to investors, but the bulk of that goes to the Treasury. We also assessed fees of $1.5 billion in 2010, all of which goes to the Treasury, so about $2.5 billion in fines and fees, an additional $1.8 in disgorgement does not go to the Treasury but goes back to harmed investors, was distributed in 2010. So, I think we are bargain.

Ms. LEE. So the taxpayer, definitely, we are getting our money's worth in terms of return on investment in the SEC.

Ms. SCHAPIRO. I believe so. I know, as hard as we have worked over the last two years, with our new leadership team, we have more to do, there are efficiencies to find. We have a tiger team that is constantly going through and looking for pools of money that can be reallocated or used more effectively. But in terms of fees and fines, the SEC pays a very significant amount of money.

Ms. LEE. And I suspect, I do not know but if your budget were cut, the assessment and the levying and the fines and fees probably would be reduced.

Ms. SCHAPIRO. If we do fewer enforcement cases, there will be fewer fines, and under the 2012 provisions, our fees are automatically adjusted to meet out appropriated amount.

Ms. LEE. Let me ask you as it relates to the Dodd-Frank requirement of the SEC to set up and Office of Minority and Women Inclusion to be responsible for all agency matters relating to minority owned businesses, diversity in management, employment and business activities. Can you give us an update on that and how closely are you working with the SBA and all other Department of Commerce to adopt the best possible practices and policies to implement and maximize the impact of this office?

Ms. SCHAPIRO. Congresswoman we have posted the position for the head of that office. We did a nationwide posting. We have gotten 250 resumes. We are in the process of waiting for the re-programming authorization in order to actually set the office up, and in the meantime we have the functions, not all of them, but largely being done by existing staff. Once re-programming has been decided, we will go ahead and hire the head of that office. I would like that person to be involved in setting up our processes and procedures, and then depending upon budgetary resources, we will either hire additional people or we will move people from other parts of the agency into the function.

Ms. LEE. Could you keep the subcommittee updated on the status? It is something that some of us are very interested.

Ms. SCHAPIRO. Absolutely, I would be happy to.

Ms. LEE. Thank you, and finally let me just ask you, in terms of some of the regulatory controls under Dodd-Frank as it relates to executive compensation; what impact have these new reforms been on executive pay and have companies changed their way of paying employees in terms of the connections between pay and performance across the financial services sector?

Ms. SCHAPIRO. Well there are a couple of different threads under Dodd-Frank. We just proposed rules, we and the FDIC, but we need to wait for the other financial regulators to join us on executive compensation clawback and deferral of compensation at the largest financial institutions, so those rules are not in effect yet. We have also done rules at the SEC that require enhanced disclosure with respect to executive compensation. Those pre-dated Dodd-Frank and went into effect last year and I think we saw generally better, more clear disclosure about compensation philosophy, so forth. And then the major Dodd-Frank piece of this is the Say on Pay Proposals which we will start to see play out over this proxy season, which is really just going to begin in the next month or so. So we have not yet seen how Say on Pay is impacting compensation programs yet.

Ms. LEE. Yes, disclosure is one aspect of it which is fine. Again I am not sure if Dodd-Frank requires some actual regulation.

Ms. SCHAPIRO. It requires that companies give their shareholders the opportunity to have an advisory vote on compensation and those are rules that are out now. And it requires that for the largest financial institutions, that all of the financial regulators jointly propose rules that would ensure that companies do not exacerbate or engage in excessive risk-taking through compensation programs that reward, essentially, risk-taking. We and the FDIC have done those rules for comment; the other regulators are following along.

Ms. LEE. Madam Chair, let me just make one point for the record. I have legislation that I think would be a heck of a lot stronger in this environment, I know it will not pass but, I do not believe that taxpayers should pay for executive compensation pay over a 25 to 1 ratio. No more than 25 times what the average employee, or the lowest employee makes, to get a tax deduction from the federal government. And I do not think the public realizes that they do get tax deductions, these companies, by paying these employees this money.

Ms. SCHAPIRO. And that is the third piece of Dodd-Frank, you have reminded me. There is a requirement; we have not done these rules yet. They are very complex to write. It requires that companies calculate a pay ratio for median employee total compensation versus the CEO's total compensation. And by all that, included with every filing that the company does, and so we are working on those rules. As I say, there is complexity in the way the statute is written that we are trying to work through to do those rules.

Ms. LEE. Thank you very much, Madam Chair.

Mrs. EMERSON. You are welcome. Mr. Graves.

Mr. GRAVES. Thank you, Madam Chair. Thanks for joining us this morning, and there seems to be some discussion about the Dodd-Frank legislation, and I guess I want to talk about that a little bit as well. I know there is a fine line between consumer protection and personal responsibility, and that is certainly a difficult challenge for you. And as we just think about the Dodd-Frank law, and oftentimes I guess I will say government overreaches, it does want to jump in there and provide too much protection or save the taxpayer from decisions that they are making; and Dodd-Frank, in my opinion, and I think in many others, is one of those overreaching pieces of legislation. And as we think about, I know there

are a lot of rules and things that have to be implemented from the commission, can you help us understand how long that might take to fully implement it?

And partly because we know with uncertainty even in what we are doing here as policymakers, there is uncertainty in the marketplace, and it is holding up investment and cash is on the sideline. So maybe you could help us understand how long you think it will take to fully implement it. And then, in your opinion, when it is fully implemented, what impact does that have on the financial markets and maybe folks not investing where they may have previously.

Ms. SCHAPIRO. I am happy to. As you know, Congressman, there are lots of statutory deadlines in Dodd-Frank that require us to go very quickly. I think in part, this is motivated by a desire to have certainty about what the regulatory framework would look like, particularly around areas like over the counter derivatives where there was no regulation at all; hedge funds to a lesser extent and so forth. So we have been working very hard to try to meet the statutory deadlines where we can, but where we have found the statutory deadline runs headlong into our ability to really do a good job in proposing a rule and really having sufficient consultation with industry and market participants and investors, we have taken the time to do that because we think that is really important; more important to get it right than to get it fast. We appreciate the need for the certainty that the ultimate regulatory regime, particularly for derivatives, will create for industry as institutions and individuals determine if they want to run a swap data repository; do they want to have a swaps execution facility; do they want to be clearing agencies; do they want to participate in this market as it is regulated?

We have done lots of consultations, as I said, we have gotten thousands of comment letters, and we have tried to propose our rules in a sequence that makes sense for industry in order to comment on them. We are also going to ask the industry how much time, once rules are finalized, do they need to implement them. What kind of technology do you need to build to be a major swap participant and be connected to the markets that are clearing and trading? And then try to build in reasonable amounts of time for people to get ready and to make the rules effective in a sequence also that makes sense.

So I cannot predict for you how long that will take. Most of these rules have to be done by July 21 of this year; many of them will be, but not all of them. And then we will have the implementation periods that will largely be driven by the practical realities of the industry being ready. And so I would imagine it could take some significant time beyond there.

But they will have legal certainty once the rules are done about what is the world going to look like; do we want to be in this world, do we not? How do we structure our business to work in this?

Mr. GRAVES. So it could be the next 12, 24 months of uncertainty, quite frankly, I guess.

Ms. SCHAPIRO. I think 12 months of uncertainty; but again, uncertainty on some levels, but not uncertainty on other levels be-

cause there is some statutory certainty, also, specificity about a number of these things as well.

Mr. GRAVES. Then what is your sense of money staying on the sidelines as a result of the new rules and regulations? You mentioned it is going to take a significant amount of investment in order to comply, potentially, by somebody who is in the marketplace with investment in new technology.

Ms. SCHAPIRO. You know, I do not have a number for you, certainly, from our meetings, we meet with lots and lots of industry participants. There is interest in being engaged in this market, and so I think there may well be some less spending right now until it is clear what the rules will require, what the technology will require in terms of reporting, for example. I think that once there is clarity, people will be in this marketplace, and they will want to participate in it.

What I see causing more money, frankly, to stay on the sidelines are events like May 6, which scared people when we had that dramatic 500 point drop in the Dow in a matter of minutes; it really frightened people. The money is coming back now, but from that period until very recently, we had net outflows from equity mutual funds virtually every week. So retail investors were nervous, but even institutional investors were nervous about the frailty and the fragility of our market structure after that period. And then, of course, world events are causing a great deal of uncertainty.

Mr. GRAVES. Madam Chair, can I ask one more question?

Mrs. EMERSON. Certainly.

Mr. GRAVES. I would like to just get your opinion. Knowing where the debt is, the government, what we have as debt, and the tremendous load that that is, it is my understanding that when investors are investing in U.S. treasuries or notes, the bonds and such, that is taking money outside of the private sector. And right now, with $14 trillion of debt, the majority of that, what 65 percent of that or more, being the public debt, or what we would define as public debt, what impact is that having on the marketplace when we as a federal government are demanding so much in dollars to be invested in us? And there is only a finite amount no matter how fast they want to print it, there is still a limited amount. And yet it is not in the private sector being invested in new buildings or employees or products.

Ms. SCHAPIRO. Well, the stock market has been reasonably healthy; I should not probably say that and jinx things. And I think that suggests that the markets are available for equity capital raising, we have not had a lot of IPOs yet, although that is picking up again. I think it is a better question for an economist than for me, but I think the way the SEC enters into that equation is to do our best to ensure that investors have the information they need so they can make the rational choice between a treasury security and a share of common stock and feel comfortable that they know everything there is to know about that company. They will take their risks, prices will go up, prices will go down, but they have all the information that they need, and the market structure will facilitate their selling that stock after they bought it and they want to get out of it at a reasonable price; at a price that is reasonably related to the market.

So to me, that is how I view our role in this. It is not so much to mediate between the competitive forces for where investors put their precious capital, but making sure that if it is in the equity markets, it is a stable marketplace and people have the information.

Mr. GRAVES. And I appreciate that you cannot really give an opinion. I know you are right about the various markets there. I guess I am of the opinion, and I am sure many in this Congress are, that we would rather be in the private sector in the common stock and preferred stock and such.

Ms. SCHAPIRO. I believe in our equity market. One reason I believe the SEC is such an important piece of the economic framework is our equity markets are absolutely critical to the future of our economy. If companies cannot raise money and investors are not confident about putting in their money, we will not create jobs, we will not grow.

Mr. GRAVES. Great, thank you, Commissioner.

Mrs. EMERSON. Thank you. I am going to go off Dodd-Frank for a little bit and just get back to some budget issues because we really do need to cover those. There is one thing that I want to follow up with you on: the request for increased personnel related to Dodd-Frank. You have asked for a 20 percent staff increase, and given the short amount of time that we have, you know, for the rest of this fiscal year, and trying to figure out how we are going to fund the government until September 30, this seems impossible. But given that, and looking at fiscal year 2012: do you have the capacity to actually hire that many people?

Ms. SCHAPIRO. I believe we do. Actually we have strengthened our human resources function and Congress has given us some expanded hiring authorities that allow us to move more quickly than we have historically. We need to actually move aggressively utilize those. And we have, although I understand OPM has some disagreements with how aggressively we can utilize them. I do think it is a big number. There is no question. The total would be 780 new positions, 584 FTE, so it is not a small number. But I think they are spread out over many different divisions and departments which gives us, also, the capability to have hiring managers in a position to get that number of people on board.

I will also say that we have wonderful opportunities to hire right now. We have not been hiring except very selectively during this continuing resolution to fill very specific positions. But when we do go out we are able to get people with tremendous backgrounds in algorithmic trading or hedge funds or credit rating agency expertise. It has been really incredible to me to see the kind of talent we can bring on and have, again, very selectively during the CR. So I think we can do it. We also have a new chief operating officer who is very committed to the improvements of our systems and our capability to move people through the system.

Mrs. EMERSON. You mentioned Boston Consulting and the report that they did. Going back to the staffing question, it summarized that you currently have 19 offices reporting directly to you and if we increase that with Dodd-Frank, it will be 24. Now I have worked in the private sector and I have had a lot of people report to me, but I have never had that many people. That would be, for

me, personally, a very tough juggling act. So I just want to ask if that, for you, is the most efficient way to operate. And perhaps it might be worth looking at having a deputy or two to help run all those people. So please talk about that a little bit.

Ms. SCHAPIRO. Sure. I mean look, it is a big number. There is no question about it. Now, some of them are very small offices. The Office of the Chief Accountant is quite small, the Office of International Affairs is quite small. We have the five major divisions and the Examination Office which are very large. But it is a lot and I will say that it would be wonderful to have a little more flexibility than Dodd-Frank gave us with respect to the four new offices that will report to me, to perhaps have them report somewhat differently. Most all those functions that are contained in those offices are already being done elsewhere in the agency and reporting to different people. It would just bring them under me. And frankly, the intent was a good one. It was so they would have high level of visibility and support but, in fact, because it does give me a very large span of control they may not actually get more visibility and more support as a result.

But we are working through all the Boston Consulting group recommendations and looking at where we can do some rationalizing of offices. So for example, we are going to put under the chief operating officer all the functions of the executive director's office. So those will not report to me separately, they will report to the chief operating officer. And there are some other opportunities, I think, to streamline this a little bit.

Mrs. EMERSON. I mean, you have a big job and you do need sleep occasionally. Efficiencies work. I know sometimes it is hard to do that and of course if Congress then requires people to report to you as opposed to you actually designing the most effective way to run your organization, I can imagine that can be difficult. I think we all should know better than to tell you precisely how to do something as long as you achieve the goals that are set out. With that, I am going to let Mr. Serrano ask questions.

Mr. SERRANO. I was interested that you had people report to you but not that many. Now we report to 700,000.

Mrs. EMERSON. Well there is that so I guess I probably had about 25 people doing really different things. So technically they could have all reported to me at one time. But it was just easier to split it up with three people, so only three people had to direct report because I could not have managed. I was a lot younger then and I actually could not multi-task much better than I can now.

Mr. SERRANO. Without a blackberry. Here is a concern, you spoke about IT and it almost sounded like you were willing to cut it but not to the bare bone. Maybe I did not hear you correctly, my concern there is that Wall Street firms and their lawyers are well prepared in that department and they certainly can outgun the SEC any time they wish even without some cuts. So what did you mean to tell us and how far are you willing to go?

Ms. SCHAPIRO. I only meant that if we have to go back to 2008 levels we will have to make tradeoffs between our personnel costs and our IT costs. Over 70 percent of our budget is personnel and IT costs. So in order to go back to 2008 levels, those are the two levers we have to pull to make really big differences and find that

$240 million in savings. I meant only to say that we have not made choices yet about how we would calibrate furloughs or RIFF's versus IT cuts, but I would not want to take IT down to nothing, even under those circumstances because it is just way too important for us to be able to do our job. We do regulate firms that sometimes spend as much as $2 billion a year, $3 billion a year on their telecom and information technology costs compared to our relatively modest spending.

Mr. SERRANO. Something like the Cardinals and the Yankees. You guys invest on pitching, we invest on hitting.

Mrs. EMERSON. Well none of our pitchers are quite available at the rate we are going now.

Mr. SERRANO. There are injuries, as the SEC can tell you. So on that issue, you have to understand that we never miss one hearing opportunity to mention baseball.

Ms. SCHAPIRO. I know that.

Mr. SERRANO. It is what keeps us sane. But Boston beat the Yankees, yes I am depressed. So we talk about IT and yes we need to support it and so on, but give us specifics. How will increased information technology help the SEC perform oversight of the complex markets that we have?

Ms. SCHAPIRO. Sure, I am happy to do that. There are the systems that help us to do our jobs better internally. Case tracking systems and the capacity for our economists and our people who do market surveillance to have the analytics to review trading information and look for trends and patterns that are problematic. There are systems like the new TCR system, which I know this committee talked with our inspector general about, which helps us to bring in all of the tips and complaints and referrals that we receive in the agency, centralize them into one repository and allow everybody who is working on a particular matter to search that data to find what might be relevant to the case that they are working or the matter they are working on. And then to actually risk rank those tips and make sure the most important ones are being worked on first.

And then there are systems like EDGAR which is how public companies get all their filing information to the SEC and the public accesses that data to understand what companies are saying in their 10–Ks and their 10–Qs. And we use that data to do our surveillance of public company disclosure. And there are systems like SEC.gov, which gets 18.5 million visitors a day. It has not been upgraded since it was launched in 1996, I believe. Yet it is a really critical tool for the public to access the SEC and the information that we have in the form of investor alerts, rulemakings, pronouncements, speeches, interpretations, everything that we are doing, and so that is a system where we really need to do a lot of work. And then we have systems that are critical to the integrity of the SEC's operations and the Chairwoman mentioned this earlier, our financial capabilities. We had in our audit two material weaknesses in our controls over financial reporting, largely because of a lack of investment in our internal financial management technology over many, many years. It is completely unacceptable for the SEC to be in that position. We have made a decision to outsource that function to a federal shared service provider, the

Department of Transportation, but it will cost us money. It will cost us $13 million in 2012 to complete that migration to the Department of Transportation, but hopefully we will clear our internal weaknesses and have clean audit reports going forward.

So, there are lots of different systems, whether it is Edgar Modernization for the corporate filings, SEC.gov, our case management and data management, internal systems or our financial reporting systems; they all help us do our job much better. And, of course, under Dodd-Frank, we are now going to have to register swap market participants, and municipal advisers and others and we need to build out the technology to do that.

Mr. SERRANO. Let me ask you a question. During the height of the crisis, there were a lot of folks unemployed on Wall Street and not necessarily the bigger shots but some middle management folks. Did any of those folks come over to the SEC? And if so, was it similar to when you see Fox or CNN say, And we have this issue we are dealing with today and we have an expert here who was once involved on the wrong side of the issue and he will tell us how to do it or not do it. I mean, I am not a lawyer so I do not know if I am getting into any difficulties here or getting you into any difficulties. Did any folks come over?

Ms. SCHAPIRO. Oh, absolutely. About 50 percent of our workforce has prior experience in the securities markets, and we have been the beneficiary of Wall Street's lean times, quite honestly. During the last two years in particular where we were in a position to do hiring, we were able to bring in people with great expertise and talent, and one of the criticisms of the SEC has been that we are too far from Wall Street and we have not kept up. These people help us keep up.

Mr. SERRANO. Thank you.

Mrs. EMERSON. What really makes me nervous is all the flash trading, the algorithmic trading et cetera. Obviously you do not have a computer system that can monitor that. I do not know that you can monitor it anyway because it is too split second, but how much would it cost to upgrade your system to even be able to track this?

Ms. SCHAPIRO. You know, we cannot and we probably should not be able to track this. But somebody has to be able to track this, so what we have done is we have proposed a consolidated audit trail that would require all of the markets, that are already surveiling their piece of the pie separately, to come to us with a plan and I hope we will finalize this rule in the next couple of months. Come to us with a national market system plan that would create a consolidated audit trail that would in fact give us an order by order, microsecond by microsecond audit trail for every transaction in the securities markets and ultimately we would like to be able to expand it to include the derivatives markets as well.

After May 6, it took us four months to be able to reconstruct the market trading so we could reassure people that what had happened in our markets on that date, that it was not a cyber attack, it was not just a mistake, it was what it turned out to be in our report. And so this consolidated audit trail system will actually have to be paid for by the industry and the SEC will have complete access to the information. Now we will need tools with which to use

that data, and to be able to look for improper trading, to be able to reconstruct trading after a serious market event, but we have actually pushed to the private sector in a sense, the responsibility of self regulatory organizations, the responsibility to actually build the data repository and build the system that will have a genuine audit trail for the first time in the U.S. equity markets.

Mrs. EMERSON. I am glad to hear that.

Mr. SERRANO. I did not catch or understand why you said that you probably should not be involved?

Ms. SCHAPIRO. Well we have to be involved, and we will set all the requirements and we will be deeply involved in what this looks like because it has to satisfy our standards for what market surveillance would look like. I meant only in the sense that in a time when there is not a lot of funding around if we can leverage third parties, leverage self regulatory organizations I believe that is a better approach for us. They will also have talent, expertise, and capability to oversee the extraordinary detail that will go into the building of a consolidated audit trail system. And of course it has to link all of their markets, so I think there is a logic to having the industry do this, but under very close oversight of the SEC.

Mr. SERRANO. Thank you.

Mrs. EMERSON. Since they already have the machines doing it anyway. Time for Mr. Graves.

Mr. GRAVES. That is fine. You know, it seems like on every subcommittee, each agency comes before us and they all have great presentations, and yours has been fantastic as well and I appreciate that, and each time though it is asking for additional resources and because there are critical missions I know you are trying to accomplish and I think we all know the resources are limited and so we are looking for the efficient and effective ways to govern right now and I guess that is code words for less spending and being responsible to the tax payers. And I know, Chairwoman asked you about the 2008 levels, and that is a serious discussion I think we are all having right now. And so when it is brought up I know you do not take it lightly in any way, and I know it would not be devastating according to the words you used.

Has the commission gone through an analysis of how it might be able to reach those levels in a comprehensive way, and not so just, you know, off the top of the head so much but as a agency they are comprehensively looked at and seen how they might do it? Or with any recommendations as to what we might do as a Congress to repeal authorizations or something that may no longer be necessary that you see as still burdensome, that we have overcome that error or whatever it might but just sort of a comprehensive approach to how we might reach 2008.

Ms. SCHAPIRO. Well as you can imagine, we have been doing lots of contingency planning over the last few months, but we have not sat down and said if we have to lose 1,000 positions from the SEC we will definitively choose not to do the following five things and the positions associated with those. What we have done is we have asked all of our division directors to prioritize those functions that are absolutely most critical and there are some we think we could stop doing and nobody would really notice. Or we could push again, to self regulatory organizations or to other third parties.

But I cannot tell you that we have made the granular decisions yet, as well as how it would impact our technology investment going forward as well. Because for us, we do not do a lot of contracting, we do not do a lot of programs that can be shut down in the way that many Cabinet agencies do for example. For us it is going to always be a tradeoff between people and technology. There are efficiencies still to be gained at the SEC, I absolutely believe that and we are working hard to do that. But I do not believe there is a lot of money being spent on non productive functions. We will make very, very hard choices that I think have the potential to impact investor confidence in whether our markets are sufficiently regulated.

Mr. GRAVES. And I think we as a committee would really like to work with you on that. You know, unfortunately, we will be put in the position to make some of those decisions for you if we are not given some of those recommendations as well, because regardless of any input we get from the various agencies the resources are still limited and there is only so much that we can apply toward your purpose and mission. So I would certainly encourage you to work with us and look for those opportunities in which maybe you are performing a task that is no longer necessary, that is still something that is going on and is required to be funded because law says you must carry out that task. But maybe you do not see that its purpose is necessary.

Ms. SCHAPIRO. And there are some of those. I mean, just to give you a quick example, under Dodd-Frank, we are required to examine every credit rating agency once a year. That is without regard to the risk that they might be presenting to the financial system, or to investors, or to companies. And our view would be it would be better for us to do our risk analytics and decide, yes, this one needs to be examined every year, but this one, maybe every three years, is good enough. So there are some small examples, I do not think they are huge, but there are some small examples where the constraints of the law might be loosened in a way that would give us more flexibility to deploy our resources.

Mr. GRAVES. Right. Well, thank you. Thank you, Chairman.

Mrs. EMERSON. I want to bring up an issue that I know is not pleasant. But it has to do with rent, and leasing, and inefficiencies that might exist within the SEC's office that performs leasing for you all. Obviously, I am referring to the Constitution Center lease, and the fact that, as a result of us passing Dodd-Frank, and the anticipation that funds would be forthcoming, I assume, you all went out and leased 900,000 square feet of space at Constitution Center. And yet it was not filled. And then there were other facilities that were not as well. And so, talk to us a little bit about how you are revamping this whole process, because there is nothing that is more frustrating to us than to know that there are 300 workstations somewhere, with all the equipment, and no people, and no budget to pay for it.

Ms. SCHAPIRO. Well, that is not the case right now. There are not 300 workstations with no people. But, as you know, Dodd-Frank authorized doubling of the SEC's budget over five years, and gave us very, very significant new responsibilities. And we have to have people to do those responsibilities. We also have to plan for our

space needs in advance because the time it takes to fit out a building, and particularly to install technology and telecomm, is not something we can turn on a dime to do.

We did lease the space when it became clear that we might not have a budget; we very quickly released 600,000 square feet to self-funded agencies, FHFA and the OCC. So I think we have done the very responsible thing there. We still have the 300,000 square feet, and we are, obviously, assessing our needs, and when we have clarity around the budget going forward, we will do what we need to do to continue to shed that space if that is what is required. But we moved aggressively because we had huge responsibilities coming, and an expectation from the authorization.

Mrs. EMERSON. Do you go through GSA for leases?

Ms. SCHAPIRO. Currently we do not. And I should say more broadly to your question, as you know, the Inspector General is looking at our leasing functions, and I am looking forward to his recommendations for improving that area. And again, I would mention, we have a new chief operating officer, who is experienced, not just in technology; he came from Capital One, but also with respect to issues like this. And I think we will be able to implement the IG's recommendations and move forward.

Mrs. EMERSON. Do you know how much one square foot costs at Constitution Center?

Ms. SCHAPIRO. I do not know off the top of my head; I would be happy to provide that information to you.

Mrs. EMERSON. I would appreciate it, because prices all over D.C. are crazy. But I had a meeting with somebody who happens to be in office management, or development, I do not know what you call it, but they own the buildings and they rent them out. And he told me that the average is somewhere in the $58 range, but it can go up to $94 if you are in a prime location. So I am just curious, and if you all would get back to me on that.

Ms. SCHAPIRO. More than happy to do that.

Mrs. EMERSON. I would appreciate it. And I understand, on the one hand, the need to anticipate. On the other hand, perhaps you had more faith in us than we had in ourselves for getting things done in a quick fashion.

On the issue of financial reporting, the GAO report issued in November of 2010 said, in essence, that since 2004 you all had continually struggled with issuing clean financial statements. I know you addressed that, just for a moment before; and so given the fact that you do sophisticated monitoring of financial markets, it is a little embarrassing.

Ms. SCHAPIRO. It is more than a little embarrassing. It is not the right result for the SEC, and I actually announced it to a very large conference of auditors and accountants, that this was the result of our annual audit, because I think it is very important that we own up to it, and own up to the fact that over many years there was no investment in our financial management systems. They grew with lots of workarounds, and bolted on systems, that overtime, just became unsustainable.

So the decision we have made, and I really believe it is the right decision, because this is not going to be a core area of focus for us, is to outsource this to a federal shared service provider. We will

use Department of Transportation; that the GAO uses as well. And we made the decision, we have a new CFO, and a new Chief Information Officer as well, and we collectively made the decision that rather than take on the risks of trying to build a new system ourselves, and deploy that, that we should go with something that is basically tried and true. And I think it is the right decision.

Mrs. EMERSON. So, how does the financial part of that work? The Department of Transportation charges you for that service, and it is a kind of interchange between agencies?

Ms. SCHAPIRO. Yes. My understanding is that it will cost us about $5 million a year, annually, after we have made the switch over to DOT, which should happen by April of next year; so within the next year. The costs are $13 million in 2012 and $12 million in 2013, so it is not an inexpensive undertaking. But at the end of the day we will have a financial management system that works and remediates our internal weaknesses. I fear we could spend a lot of money to try to recreate the wheel, and maybe at the end of the day, not have a system that is tried and true.

Mrs. EMERSON. And could cost you easily that much.

Ms. SCHAPIRO. Exactly.

Mrs. EMERSON. Okay. I think that, you know, sometimes it is why we invent the wheel, if you will.

Ms. SCHAPIRO. Right. Exactly. To me it was the responsible thing to do, for the taxpayers.

Mrs. EMERSON. Yes, I mean, so DOT actually has the system and then you would just replicate it.

Ms. SCHAPIRO. They run the systems for multiple agencies.

Mrs. EMERSON. Oh, I see. Okay.

Ms. SCHAPIRO. They do it for GAO, they do it for CFTC; they have been designated by OMB as the service provider to other agencies, of financial management systems.

Mrs. EMERSON. Okay. Thank you. Mr. Serrano.

Mr. SERRANO. I will submit the rest for the record. Part of what the SEC provides to the financial markets is confidence that a powerful watchdog is providing the proper amount of oversight to the market. With the proposed H.R.–1 Bill, and this series of two to three week continuing resolutions, is the SEC able to provide that level of confidence in such an uncertain legislative climate?

Ms. SCHAPIRO. I think that, you know, H.R.–1, while certainly not having as dramatic an impact as going back to 2008, would still impact the agency's ability to fulfill even its core functions. Operating as we are now, on the CR, we are not hiring, even though there are good people available for us to hire. We have cut back our investments in technology; we have spread them out over more years. We have cut back our examiners' ability to travel. And, you know, importantly, we are really, feeling the impact on our capability to engage, for example, with industry, or with foreign regulators, at a time when Dodd-Frank coordination is so critical with foreign regulators. We cannot spend the money to send people back and forth to Europe and to Asia, to really be working on coordinated rule sets.

So, I think if we were to go back to the numbers in H.R.–1 we would see, obviously, even more tightening of the belt: fewer enforcement cases, fewer examinations, less travel, and less tech-

nology investment. We are impacted now, that would clearly impact us more.

Mr. SERRANO. When we had the Inspector General here, the Inspector General remarked during his testimony that the SEC is in a much better position now than it was when he became Inspector General in 2007. So you are to be commended for that turnaround. What are your next goals for the agency, except in addition to staying alive?

Ms. SCHAPIRO. Staying alive is good. You know, we have an entirely new leadership team across the entire agency. And they are incredibly talented people. They are working collaboratively together and we have to continue to instill in our culture that investors come first and collaboration, cooperation with our colleagues internally, and in other agencies, and continue to make that part of our DNA. We have to always continue to be willing to remember the lessons of the past. We talk about Madoff a lot at the SEC, because we need to remember that the agency's failures cause tremendous harm. We need to continue to embrace those lessons of the past failures.

And so my goal is that we become more agile, that we continue to recruit different kinds of skill sets and different kinds of talent to the agency, so that we are better able to connect the dots and understand what is going on on Wall Street, and throughout the financial markets that might impact investors. We could prevent more harm, which would be a wonderful legacy, and not just redress the harms after they have been exposed. So we have a lot of work ahead of us, a lot to do, but we have an incredibly engaged senior leadership team now. And I am pretty optimistic that we are going to continue to make real strides.

Mr. SERRANO. I should leave it there, for my part, but let me ask you a question: Do we know everything that we should know about the people, the groups, that were harmed by Madoff? It even reached the baseball team in New York. Where does it end?

Ms. SCHAPIRO. I think there is quite a lot of information out there as a result of the efforts by the SIPC trustee, and of course the SEC and the Justice Department have brought multiple cases in this regard. So I think it has been pretty transparent.

Mr. SERRANO. All right. Thank you so much.

Mrs. EMERSON. I have a bunch more questions and I know Mr. Womack wants to get back here. Oh, he is not going to make it, after all? Okay, well I know he will have some questions to submit for the record. Will you just go over, for Mr. Serrano and I, and for the record here, talk a little bit about all of the rule-making that you have to do as a result of Dodd-Frank. Explain, a little bit, those rules that you have to coordinate with the Commodity Futures Trading Commission, and how that whole process will work. Because I know that there is some frustration on the part of colleagues that the SEC is taking too long to do the rule-making, or implement the rules, but, quite frankly, I believe in your philosophy that you have got to get it right and that is more important than hurrying.

Just explain, because the complexity of it is enormous, as is the impact if you get it wrong, which I think would have a very negative impact on the market.

Ms. SCHAPIRO. Sure. Well, we have some rules that we are doing jointly with the CFTC. But all the rules in the over the counter derivative space are at least in close consultation and collaboration. And I think both of us believe that, to the extent market participants are going to be both in their world of OTC derivatives and our world of OTC derivatives, we need to make the rules as synchronous as possible and as consistent as possible, because we do not want institutions to incur unreasonable costs trying to comply with two sets of regulatory requirements. So we have worked very, very closely together. We have coordinated very, very closely. Many of the rules we have proposed are essentially the same.

But there are a bit in number where we have taken a different approach than the CFTC, in part based on the nature of the small piece of the OTC derivatives market we have responsibility for, the securities base swap market is different, for example, than the interest rate swap market, which is enormous and very liquid.

And some of the differences really come from the fact that we just have different historical statutes and philosophies about things.

We have gone out for comment on more than a dozen rules. We have reopened some comment periods, in fact, where we have gotten interesting comment letters, or there are other approaches. We have sought cross comments in our rule proposals. So if we have proposed something, we have asked. Did you think the CFTC has done it better? Yes, no, why? What would you do differently?

And we have had many, many meetings, and we in fact held four round tables together where we brought industry in to talk through the different rule sets. As we come to final proposals we will need, I think, to work very hard to try to get these rules to be the same as much as we possibly can. And that is the challenge that is before us right now. And, then we need to also phase them in in the same way so that industry is meeting one set of deadlines, not two different sets of deadlines.

Mrs. EMERSON. Are there some things that we in Congress need to do to help clarify some of the requests or requirements that we imposed, I mean, within the rule-making process. Obviously, you are the expert at what you do, we are not necessarily the experts at what you do; and therefore, something that sounds like a good idea might not, in reality, be workable. Are there things that we can help you with this?

Ms. SCHAPIRO. I was going to say, we are getting a record number of comment letters from members of Congress, at least in my experience, over the last couple of months, explaining what was intended, or what was meant by particular provisions in Dodd-Frank; and that is actually extremely helpful to us. But I think we are trying to work things through the rule-making process as best we can.

Where there are issues, or where we think there really is a necessity, potentially, for change, and I can think of one in the OTC derivatives area. There is a requirement that foreign regulators have to indemnify a swap data repository for information that it receives. Most foreign regulators cannot indemnify; we certainly could not indemnify a foreign swap data repository if we needed information from them. And we are going to see if we can work this through, somehow, through exemptive and other actions, but if not,

we may well come back and say, this is a provision that will make it very hard for us to work collegially with foreign regulators. And it may also put them in the position of forcing us through the same hoop in getting information that we might need from their repositories, so that is just an example where we may well come back.

Mrs. EMERSON. Speaking of foreign regulators, I mean, obviously, so much of what you do, is at a global level and the global marketplace needs to more or less be on the same page. Are you finding good cooperation with your counterparts?

Ms. SCHAPIRO. There is great cooperation, I would say. Of everybody, I would say the United States is leading in the derivatives space, less so in compensation and some other areas. But it is very, very important for us to stay very closely tied to what foreign regulators are doing, because we do not want to create artificial opportunities for regulatory arbitrage, or see industries move from one jurisdiction to another simply because one regulator is far ahead of the others.

To date, the G20 countries are talking about the same kinds of rules and the same kinds of protections built into their regulatory system for derivatives as we are, so we remain very confident at this point, but we will be watching closely. And, as well, that will go to the implementation periods.

Mrs. EMERSON. Mr. Serrano. I may just ask a couple more.

Mr. SERRANO. Ask as many as you want.

Mrs. EMERSON. I know, I know, but I do not want to keep everybody, especially if Mr. Womack is not coming back. I do have a very short question, and then I am going to ask something else that is just something that is more annoying than anything else, perhaps, and it has to do with the Facebook private sales. Only because that would have been one stock that would have been fun to buy one share for my grandchildren, just because it would be a fun thing to do.

And I know that a lot of Americans were upset that Goldman chose not to allow American investors to buy stock in Facebook's stock offerings. Some have argued that regulations have forced the capital formation process offshore. In this case, Goldman actually marketed sale of shares to savvy, large scale investors, not smaller, less sophisticated investors like me. And so, while they were able to collect fees at Goldman, American investors were not able to invest in an American company. I mean, how do you all balance protecting investors while at the same time not depriving them of opportunities to invest?

Ms. SCHAPIRO. Well you know, the basic requirement is that securities have to be registered to be sold publicly, and there needs to be financial reporting, unless there is an exemption from that requirement. And Goldman proceeded, I believe, on the basis that this would be a private offering to large players without a general solicitation. And then when the media frenzy erupted, their concern was they might not be able to satisfy the requirement that this was not a general solicitation.

So in light of that, I have asked the staff to come back to me with some recommendations on whether we need to look at the requirements of our exemptions. When these exemptions were written, nobody thought about media frenzy being the sort of thing that

would tip the balance into whether you were engaged in a general solicitation or a truly private offering. And so we are looking at this issue very closely. We recognize the frustration that people felt. On the other hand, we do have to balance it with the need for people to have current, reliable financial information if they are going to buy shares of companies.

Mrs. EMERSON. And I do agree. It is just that it was frustrating.

Ms. SCHAPIRO. Understood.

Mrs. EMERSON. Let me just ask you about municipal securities. Primarily because I know that you have been, we all have been, looking into the issue of the safety and transparency of the muni bond market, and that you conducted a number of field hearings on the issue last year. So, if you could answer these few questions. First, how does the SEC propose to balance the importance of this financial instrument for cities and States with the importance of protecting investors? And while you do not have direct authority to require financial disclosures before municipal securities are issued, how does the SEC monitor these securities currently?

It is worrisome, given all of the stress we are seeing today in States and in cities, with regard to pensions and financial obligations. So it does concern me that we may be potentially selling these bonds with the possibility that a town or a city might go bankrupt. I realize that traditionally nobody thought that that would happen, but, as I said, with pensions not fully funded, this becomes a little problematic. So I would just like to hear your thoughts on that.

Ms. SCHAPIRO. Well, as you point out, we do not have the ability to tell municipal issuers what they have to disclose or when they have to disclose it. We do get a reasonable amount of disclosure out by putting burdens on the broker-dealers who are going to sell the municipal securities to make certain information available. We have actually increased that in my two years at the SEC to require that even more information be made available. But we are reaching the limits of the authority that we were exercising over broker-dealers to do that.

So, as you point out, we started a series of field hearings last year under Commissioner Walter's leadership, to try to bring issuers, investors, commentators, academics, everybody together, around the country, to talk about the issues with respect to the municipal securities market, and what could the SEC do that would get the balance right and protect investors in this, frankly, $3 trillion market, which is really, largely an individual investor-held market. And we had to suspend those because we didn't have the travel budget, but I am hoping that we will pick those up again later this year. And we did get a couple of them in, and they have been enormously valuable. And we have also been inviting people to Washington to come and talk with us about it.

We have also done a lot in enforcement. We created a specialized group in our enforcement reorganization to focus on municipal issues. That group brought the first case against the State of New Jersey for inadequate disclosure. And they have a number of investigations going on around the country. One of the things we have seen from our enforcement actions is that it is having the effect on other state and municipal issuers to go back and look at the quality

of their disclosure, the timeliness of their disclosure, the accuracy, the fullsomeness, to see if they can make improvements. And that is a great result from an enforcement case. We didn't levy a fine or anything, we didn't want to burden the taxpayers of New Jersey, but we wanted to make the point that you have to be truthful and you have to be honest in the disclosure that you do.

My view would be that we get through the bulk of Dodd-Frank. We'd like to come back to Congress and talk about whether there should be some more direct authority at the SEC with respect to the content of disclosure by municipal insurers. And the way we monitor it is largely through the MSRB, which is a self-regulatory organization that we leverage that runs the database for municipal disclosure.

Mrs. EMERSON. This will be my last question, and then I'll submit the rest of mine for the record. Because you referred to credit ratings agencies and perhaps the need to keep your hands off them, per-se, that is not how you said it, but that was the gist I got. But on the other hand, many people have said that part of the whole financial meltdown was due to the fact that the credit ratings agencies, or companies, were too invested with some of their clients, and not vigilant enough, if you will. And so, I am curious why they have not, in the past, been subject to the same expert liability standards that accountants and lawyers who make statements on security prospects would have been subject to.

Ms. SCHAPIRO. My point earlier was not that we should not be regulating them. I believe we should and that we have new tools under Dodd-Frank. Just that the statutory requirement that we analyze, examining every single one of them every year might be a little bit inflexible.

Mrs. EMERSON. OK, I misunderstood. Thank you.

Ms. SCHAPIRO. But the provision 436G in Dodd-Frank that would repeal the statutory provision that shielded them from expert liability is one we are wrestling with right now, because we do not want it to create issues, particularly for the asset backed securities market. I do not really know the historical reasons why credit ratings agencies did not consent and face expert liability. I would be happy to get back to you on that. I am just not recalling.

Mrs. EMERSON. Perhaps we should ask the authorizing committee to give us the answers to that, or look into that. I would appreciate that. That is certainly problematic to some extent.

Ms. SCHAPIRO. Well, the issue we face now is that they are refusing to consent, so that the ratings cannot be included in the registration statement, and that makes it very difficult to sell the securities in the public market. And so, we are trying to get the balance right. But we are going to move forward on that provision.

Mrs. EMERSON. Thank you, I think it is pretty necessary to do that. Joe, do you have any closing comments?

Mr. SERRANO. Yes. Please do not cut them. I know. That is a Congressional decision.

Mrs. EMERSON. Over my pay grade.

Mr. SERRANO. Just, my closing comments is that I really believe that they need every opportunity, the Commission does, to carry out its function, and put in place Dodd-Frank, and in the process

we will all be better for it. If not, then we just wasted a lot of years and didn't learn anything from the last meltdown.

Mrs. EMERSON. Mr. Yoder is here, and so, let's filibuster a couple of minutes and talk about baseball teams so he can get organized to ask his one question. So, is St. Louis ahead of the Yankees in the standings?

Mr. SERRANO. I didn't even know St. Louis was still in the league.

Mrs. EMERSON. Oh, Joe. Well, listen, are you going to opening day?

Mr. SERRANO. No.

Mrs. EMERSON. I am going to try to. Let me just let Mr. Yoder go ahead, and thanks for getting here.

Mr. YODER. Thank you, Madam Chair, and I actually was distracted by your conversation, because I actually wanted to join you in that conversation.

Mrs. EMERSON. Because he is a Royals fan.

Mr. YODER. A long-suffering Royals fan.

Mr. SERRANO. But you gave up David DeJesus, right?

Mr. YODER. We are a farm team for a lot of the other national teams.

Mrs. EMERSON. Let me just say that you really do have a great farm team, though, I think. I mean, they are terrific. They are terrific. But it just seems like they are better than the division.

Mr. YODER. That is true. That is true. Last time we won our division, I believe was in 1994, when the strike ended the season early.

Mr. SERRANO. If I am not mistaken, you guys had the first baseball academy, right?

Mr. YODER. I'll take credit for that. I am not sure.

Mr. SERRANO. A thousand years ago. And you know who went there? Bill Richardson.

Mrs. EMERSON. Really? How come he never played on the Congressional baseball team?

Mr. SERRANO. He did. He was a great hitter. Could not run.

Mr. YODER. Thank you, Madam Chair. Ms. Schapiro, I appreciate you being here today, and I apologize for coming in here towards the end, but I did have a couple of questions for you. One is for very specific and it is related to complex minerals.

Ms. SCHAPIRO. Conflict.

Mr. YODER. I am sorry, conflict minerals. Pardon me. And I have had some concern raised, and I am apologizing if this has already been discussed, by a company in my district related to what they believe is a very difficult and onerous provision that would require them to have to understand the history of a mineral that has gone through so many different entities, that they feel it would be impossible for them to use it at the very trail-end. And the question they have that they wanted me to ask you is related to a potential de minimis provision. Could you maybe discuss that a little bit? And I might have a follow-up question.

Ms. SCHAPIRO. Sure. We have a proposal out for comment right now on conflict minerals, and this relates to certain enumerated minerals in the statute that come from the Democratic Republic of the Congo, or the surrounding area. Our rule proposal is out, which would set forth the requirements for companies that use these par-

ticular minerals in their products to do due diligence about the source of the minerals, and provide a due diligence report if they are not conflict-free, or they cannot determine whether or not they are, and have an audit of that report. I do not believe, and I would like to get back to you on this specifically, that the statute has a de minimis exception in it, and I do not honestly recall whether we made any proposal or asked for any comment with regard to a de minimis exception, but my recollection is that it is not contained in the statute.

Mr. YODER. Well, I appreciate that. I just want to share with you some concern from American companies that are having to compete globally. And we all share the same interests here in creating jobs in the United States, and I know you do as well, and I just want to make sure you are aware that there are some companies that use a very, very small amount of these minerals, a very de minimis amount, and that it would be extremely arduous and difficult for them, and a high cost would make them less competitive and affect their ability to create jobs and get the economy back on track.

Ms. SCHAPIRO. And you should know that we have met with many companies to talk because these are all important minerals. It includes gold, coltan, and a number of others that are really critical to the manufacture of electronics, as well as jewelry and other things. So, we have met with many companies, and we have gathered very broadly their input, and we will take it very seriously. And I would be happy to come back to you with further thoughts on that.

Mr. YODER. Would you, please? And particularly with electronics, where you might be using a minuscule amount, but the effort that it would take to understand that whole process, I think, is overly burdensome for some of these companies.

And then I just had a couple general questions that small businesses ask me all the time, related to the fees they pay to the federal government and various agencies, and I wonder if you would comment on the status of all the different fees that businesses are paying to the SEC. And are there ways in which we can alleviate some of those to help the pressure on business owners? And then the other question would be related to just general regulations and the President's call for each agency to go through and review, and modify, and change regulations such that they are not burdensome and onerous. And we talked about one, the conflict minerals one. What is your agency doing specifically in that regard?

Ms. SCHAPIRO. The executive order does not actually apply to the independent agencies like the SEC. But that said, we have said that while we do much of what is already sought in the executive order: the cost-benefit analysis, trying to make accommodations for smaller businesses where we can with delayed implementation periods, or delayed compliance dates, and so forth, or exemptions. We are very active, and have been, over the last couple of years, looking at that, as well. But we have said that we want to go back. We are about to form a small business advisory committee. I have asked our commission to approve our doing that and going back and looking at rules that have been on the books for a long time to see whether there is small business relief that the SEC can make possible. So, for example, on regulation A offerings one of the

ideas on the table is raising the limit, so more money can be raised with fewer requirements. We actually have come up with many ideas that we hope to address with our advisory committee once it has been put into place. So, while the executive order does not apply to us, we are trying to act as though it does because we think it is just a good practice.

With respect to fees paid to the SEC by small companies, there are of course some fees related to securities registration, when you go public or your offer stock, but I am not aware of other fees. Again, I would be happy to supplement the record with that. But unlike other agencies, we do not have a lot of programs that I think would generate fee payments to the SEC.

Mr. YODER. Do you generate your resources, then, from tax dollars, or are you entirely fee-based?

Ms. SCHAPIRO. Well, we are fully appropriated by Congress, obviously, since we are all sitting here, but the SEC's budget is covered by a transaction fee that is paid by the self-regulatory organizations to the SEC, and that is generally, I believe, passed on, ultimately, to customers. It is a fee on every stock trade, as opposed to a fee directly on businesses. And it is two cents per $1,000.

Mr. YODER. And I have not had a chance to review your comments, but what is the SEC doing in terms of reducing expenditures, and trying to find ways to become more efficient in this economy in which resources are obviously very scarce?

Ms. SCHAPIRO. Well, living under a continuing resolution, after two years of growth, we have had to significantly cut back on a number of activities, and try to reprioritize as best we can with the dollars that we have. We have a team under the leadership of our chief operating officer that has been going through and looking for all the places we are spending money less efficiently or less effectively than we think we could, trying to redeploy those resources to higher and better uses throughout the agency. We are also trying to leverage the efforts of third parties where we can, whether that is accounting firms, or whistle-blowers, or self-regulatory organizations.

Mr. YODER. Do you have examples on where you have made reductions?

Ms. SCHAPIRO. Sure.

Mr. YODER. Anything you want to highlight for the committee?

Ms. SCHAPIRO. This year we zeroed-out bonuses. We cut travel by 10 percent. We have delayed our technology spending by a significant amount. I would be happy to provide the actual dollar numbers, but we have reduced our security guards; we have reduced our overtime pay; we have reduced the use of expert witnesses even in our own enforcement cases, and consultants; we have eliminated the summer intern program; we have eliminated the student loan repayment program. A number of efforts we have taken.

Mr. YODER. Okay. Well, I appreciate that. I hope you continue to go down that road. And certainly, I want to follow-up with you again on that conflict minerals issue.

Ms. SCHAPIRO. I am sorry. I said we eliminated the summer intern program. I think that is targeted. I do not know that we have actually done that, so let me get back to you.

Mr. YODER. Well, keep doing what you can do to reduce spending and keep costs low for business owners, and certainly, as well, on the regulatory side. As you take comment, it is my hope that you will keep an eye towards helping our innovators and entrepreneurs in the country be as successful as possible, and that our regulations are such that they do not create onerous burdens that make our U.S. companies less competitive in the global marketplace. So thank you for your comments. Madam Chair, I yield back. Thank you for the time.

Mrs. EMERSON. Thanks, Mr. Yoder. Chairman Schapiro, I really want to thank you for being here today, and thank you for undertaking the enormous job that you have that is probably quite intimidating to most people. And you do a very good job at it. And I know that you have had many, many messes to clean up, and you are going about doing it in the right way. And I also appreciate the fact that you are making efficiencies in some things, and I also understand the great need for you to be funded to the maximum extent possible in other areas, because of the nature of the work that you do.

I may challenge my good friend, Mr. Serrano, on your statement that, I believe you said that the financial crisis was in fact perhaps mostly caused by lack of regulation and oversight. I think there were many, many things involved that led to it, and that was not necessarily the primary thing, but I feel good that the Chairman has undertaken a good review of the many burdens that they have to oversee and to regulate. It is tough, and it is a big burden, on the one hand. We will do our very best to ensure that you have the tools necessary to do your job, because our markets are absolutely critical, and I do not want you all to short-thrift that IT system, particularly because technology changes so rapidly. So we will keep our fingers crossed and do the best we can. Thank you so much for being here.

Ms. SCHAPIRO. Thank you so much.

Mr. SERRANO. Thank you.

[The information follows:]

Financial Services and General Government Subcommittee
Hearing on the Securities and Exchange Commission FY 2012 Budget

Questions for the Record Submitted by Chairwoman Jo Ann Emerson

FINANCIAL REPORTING

According to the GAO report issued in November 2010, since 2004 the SEC has continually struggled with issuing clean financial statements. This seems fairly embarrassing for the agency tasked with monitoring financial markets.

Q1&2. Why has the SEC had problem with its financial reporting? What do you believe are the factors contributing to this problem within the SEC?

What, if anything, has the SEC done to change its financial reporting methods so that they are accurate?

A 1&2. As you know, the SEC's auditor, the Government Accountability Office (GAO), found that in FY 2010 the SEC's financial statements were presented fairly, in all material respects, in conformity with U.S. Generally Accepted Accounting Principles (GAAP). GAO also found that the SEC had two material weaknesses in internal controls over financial reporting: one in information systems, and a second in financial reporting and accounting processes.

With respect to information systems, GAO pointed out a number of SEC self-identified deficiencies in the design and operation of information security and other system controls. The deficiency areas included patch management, control of system user access, segregation of computer-related duties, timely remediation of self-identified system security deficiencies, and the implementation of a robust change management process that can prevent unapproved and unauthorized changes to the SEC's financial systems.

The second material weakness, in financial reporting and accounting processes, results from the combination of five deficiency areas:

1. Financial reporting processes, some of which are manual because of gaps in the core financial system and therefore inherently vulnerable and prone to error;
2. Accounting for budgetary obligations, particularly with respect to deobligations of prior year amounts;
3. Filing fees, because of backlogs related to the verification of the accuracy of filing fee payments and the return of inactive registrant deposits;
4. Disgorgements and penalties, primarily because of delays in recording changes in disgorgements and penalties resulting from follow-on court orders and because of the need to properly account for checks received late in an accounting period; and
5. The lack of Required Supplementary Information in the SEC's draft financial statements.

Remediation of the agency's two material weaknesses is a top priority for the SEC. Under the leadership of our recently-hired Chief Operating Officer, Chief Financial Officer, Chief Information Officer, and Chief Accounting Officer, the agency has launched a series of initiatives to address the agency's deficiencies in internal control.

These two material weaknesses both are closely connected to gaps in the security and the functionality of our financial systems. Although we are taking a number of steps to address these gaps this fiscal year, we believe that putting our internal controls on a solid footing over the long term primarily requires significant investment in our financial systems. That is why the centerpiece of our remediation strategy is to migrate our core financial system and transaction processing to a Federal Shared Service Provider, the Department of Transportation's Enterprise Services Center (ESC). Through this multi-year initiative, the SEC will fill gaps in the functionality of the current system, eliminate many manual processes that are inherently prone to error, and enhance financial and management reporting. The SEC has now signed an Interagency Agreement with the Department of Transportation for the implementation of the new system, with a cutover planned for April 2012.

While the SEC focuses attention and resources on ensuring a successful system migration, the agency also is working this fiscal year on a number of steps aimed to address deficiencies identified in the GAO's report. These efforts include:

- Updating security patches on SEC systems, strengthening user access controls, and remediating self-identified security deficiencies;
- Enhancing the agency's internal control monitoring program;
- Conducting a comprehensive assessment of the spreadsheets and databases used by the agency, and tightening controls over those applications based on risk;
- Strengthening our process for de-obligating funds from completed contracts, and ensuring we incorporate appropriate accounting adjustments for these amounts;
- Reducing backlogs of inactive registrant deposit accounts, and of filing fees paid by registrants in need of review;
- Tightening controls over the recording of subsequent orders, post-judgment interest, and deposits in transit related to disgorgements and penalties;
- Instituting a number of reforms to our processes for handling miscellaneous obligating documents; and
- Performing an assessment to ensure that the SEC's financial statements and notes comply with all relevant requirements, including with respect to items like Required Supplementary Information.

The SEC is committed to investing the time and resources to put its internal controls over financial reporting on a strong, sustainable path, so that these material weaknesses are eliminated and do not recur.

DODD-FRANK: CHANGES TO CREDIT RATINGS

As I understand, there is currently a "no-action" relief order from the SEC stating that the SEC will not bring enforcement actions against issuers who did not disclose ratings in prospectuses, thus removing the expert liability threat for ratings agencies. This stay has been extended past the original six month timeframe.

Q3. Why have credit rating agencies in the past not been subject to the same "expert liability" standards as accountants and lawyers who make statements on security prospectuses?

A3. The Commission has considered whether rating agencies should be subject to expert liability on several occasions in the past. The question raised complex issues, as described below.

Section 7 of the Securities Act provides that "[i]f any accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or valuation for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement." These persons are referred to as experts for purposes of the securities laws. Registrants are required to file the consents of experts as exhibits to their registration statements and those experts are subject to liability under Section 11 of the Securities Act.

In 1977, the Commission published a concept release announcing that it was considering a change in policy to permit disclosure of credit ratings in documents filed with the Commission. In that release the Commission solicited comment on whether a nationally recognized statistical ratings organization (NRSRO) is the type of person from whom a consent would be required under Section 7 of the Securities Act (thereby also subjecting it to liability under Section 11). That release contained a list of questions regarding the Commission's then-current policy of discouraging the disclosure of credit ratings and whether the Commission should change that policy or retain it. According to the 1981 release ultimately announcing the Commission's change in position, commentators on the 1977 release generally were opposed to subjecting NRSROs to liability under Section 11 and argued, among other things, that it would interfere with the substance and timing of the registration process, that it would result in changes to the way credit ratings were issued, and that it would result in increased costs and uncertainty over the scope of liability. The NRSROs in existence in 1977 indicated that they would not provide consents to be named in the registration statement. The 1981 release also indicated that commentators were concerned that requiring consent and subjecting NRSROs to Section 11 liability would affect their independence if they were "participants" in the offering and would lessen the quality of ratings because NRSROs likely would rely only on objective, quantifiable information. The commentators in favor of subjecting NRSROs to liability under Section 11 cited the incentive that NRSROs would take more care in determining ratings.

In 1981, the Commission announced the shift in policy to permit, but not require, disclosure of credit ratings in registration statements. In addition, the Commission proposed Securities Act Rule 436(g) to provide that a security rating assigned to a class of debt securities, a class of convertible debt securities, or a class of preferred stock by an NRSRO would not be considered a part of the registration statement prepared or certified by a person within the meaning of Section 7 and Section 11 of the Securities Act. In proposing Rule 436(g), the Commission noted that if NRSROs refused to provide consents, then disclosure of credit ratings would not be provided even if permitted by the Commission. As a result, the Commission proposed Rule 436(g) in order to make its new policy position on the disclosure of credit ratings meaningful. The Commission also cited the fact that NRSROs already were subject to substantial liability under the antifraud provisions of the securities laws. When Rule 436(g) was adopted in 1982, the Commission stated its belief that exempting NRSROs from liability under Section 11 of the Securities Act was appropriate and cited the rationale provided in the proposing release that practical problems would arise in obtaining the consents and that NRSROs were subject to the antifraud provisions of the securities laws.

Over the years the Commission has reconsidered Rule 436(g). In 1994, the Commission proposed to require disclosure about credit ratings in registration statements. This release solicited comment on whether there should continue to be a distinction between NRSROs and credit rating agencies that are not NRSROs for purposes of Rule 436(g) (Rule 436(g) only provided relief to rating agencies that were NRSROs). The release also sought comment on whether Rule 436(g) should be expanded to include credit rating agencies that are not NRSROs or whether the rule should be rescinded. Commentators generally were opposed to subjecting NRSROs and other credit rating agencies to liability under Section 11 of the Securities Act. Among other things, the commentators argued that: ratings published by NRSROs "are expressions of opinion about risk, not statements," and even if the security defaults in an individual case, it would not necessarily be an indication that the opinion was wrong; Section 11 liability would violate the NRSROs' First Amendment rights; and Section 11 liability could eliminate the disclosure of security ratings in prospectuses. The Commission did not act on the proposals in the 1994 release.

In July 2008, the Commission proposed to amend Rule 436(g) to extend the exemption to ratings provided by any credit rating agency rather than only to ratings provided by NRSROs. The Commission cited its belief that, among other things, amending Rule 436(g) would foster competition between credit rating agencies. Only three commentators addressed the proposed amendment to Rule 436(g). One commentator opposed it because credit rating agencies that are not NRSROs are not subject to Commission oversight. Another commentator supported extending the exemption in Rule 436(g) to credit rating agencies that are not NRSROs. That commentator did not believe references to ratings should be considered "expertized." The commentator also cited the costs that registrants have to incur absent the amendment of Rule 436(g) to obtain a consent from a credit rating agency that was not an NRSRO. In addition, the commentator discussed the possibility that a rating obtained from a credit rating agency that was not an NRSRO would be omitted, thus offering investors an incomplete view of the ratings for a particular security. A third commentator objected to requiring disclosure of credit rating agency information without the consent of the relevant credit rating agency but did not cite any concerns about liability. The Commission did not adopt the proposal.

In April 2009, the Commission hosted a roundtable regarding the oversight of credit rating agencies. In connection with the roundtable, the Commission also solicited comment on the topics to be covered at the roundtable, including the appropriate oversight and liability for NRSROs and credit rating agencies that are not NRSROs. One commentator suggested that the Commission reconsider the exemption from liability for NRSROs. That commentator also expressed skepticism regarding the First Amendment arguments asserted by NRSROs against being held liable for their credit ratings because credit rating agencies have become involved in the structuring of complex securities and have abandoned their former practice of rating most or all securities whether or not they have been hired to do so. In addition, another commentator commissioned a white paper in connection with the roundtable discussion. The paper argues that in order to make NRSROs more accountable, they must be subject to a credible threat of liability. Some commentators expressed concern regarding any liability that would allow for second-guessing of judgments made by credit rating agencies.

In October 2009, the Commission proposed rule amendments to require disclosure of information regarding credit ratings used by registrants in connection with a registered offering of securities so that investors would better understand the credit rating and its limitations. The proposal would require additional disclosure that would inform investors about potential conflicts of interest that could affect the credit rating. In addition, the proposed amendments would require disclosure of preliminary credit ratings in certain circumstances, such as ratings shopping, so that investors have enhanced information about the credit ratings process that may bear on the quality or reliability of the rating. The Commission also issued a concept release at the same time, seeking comment on whether Rule 436(g) should be rescinded. The history of Rule 436(g) is discussed in more detail in Concept Release on Possible Rescission of Rule 436(g) Under the Securities Act of 1933, Release No. 33-9071 (October 7, 2009), available at http://www.sec.gov/rules/concept/2009/33-9071.pdf. As you know, Section 939G of the Dodd-Frank Act rescinded Rule 436(g).

Q4. How is the SEC regulating credit rating agencies?

A4. The Credit Rating Agency Reform Act of 2006 provided exclusive authority to the Commission to implement registration, recordkeeping, financial reporting and oversight rules with respect to credit rating agencies registered as nationally recognized statistical rating organizations (NRSROs). The Commission issued final rules establishing a registration and oversight program for NRSROs in June 2007 and has since adopted two sets of amendments to those rules.

Since the passage of the Reform Act and the implementation of the June 2007 final rules, the Commission has used its authority to examine the adequacy of the NRSROs' public disclosures, their recordkeeping, their procedures to prevent the misuse of material nonpublic information, how they manage their conflicts of interest, and their approaches to preventing unfair, abusive, or coercive practices. In July 2008, the Commission released findings from extensive 10-month examinations of three major credit rating agencies that uncovered significant

weaknesses in ratings practices. These findings informed the Commission's subsequent rulemakings in February and November of 2009.

The Dodd-Frank Act augmented the Commission's oversight authority and mandated that the SEC adopt rules in a number of areas with respect to NRSROs. The Commission has begun the process of implementing these mandates with the adoption of a new rule in January 2011 requiring NRSROs to provide a description of the representations, warranties, and enforcement mechanisms available to investors in an offering of asset-backed securities – as well as how those representations, warranties, and enforcement mechanisms differ from those of similar offerings. On May 18, 2011, the Commission proposed new rules and amendments to existing rules that would implement the balance of the Dodd-Frank Act's NRSRO rulemaking mandates. The proposals would enhance the Commission's existing rules governing ratings and rating agencies by, among other things, requiring NRSROs to:

- report on internal controls,
- protect against conflicts of interest,
- establish professional standards for credit analysts,
- provide public disclosure about the credit rating and methodology used to determine the credit rating, when publishing a rating, and
- enhance their public disclosures about the performance of their credit ratings.

MUNICIPAL SECURITIES

Municipal securities are important instruments for cities and states to raise money, as well as historically safe investment vehicles for investors on the secondary market. The economic recession and cities and states' obligations have made municipal bond yields rise, even on bonds that are highly rated. I know that the SEC has been looking into the issue of the safety and transparency of the muni bond market and that you all conducted a number of field hearings on this issue last year.

Q5. How does the SEC propose to balance the importance of this financial instrument for cities and states with the importance of protecting investors?

A5. The Commission recognizes the importance of the municipal securities market in providing needed capital to states and local governments to fund a variety of public projects, cash flow and other governmental needs. As the agency charged with administering the federal securities laws and overseeing the U.S. securities markets, the Commission has an obligation to protect investors in the municipal markets from fraud, including misleading disclosures. Although state and local governments have certain unique attributes by virtue of their political nature, insofar as they are issuers of securities, they are subject to the proscription against false and misleading disclosures.

However, the Commission's authority in the municipal securities market is limited. Although we have jurisdiction to regulate broker-dealers who engage in municipal securities transactions, to register municipal advisors, and to enforce the antifraud provisions of the federal securities

laws, we have no regulatory authority over issuers of municipal securities. As a result, the Commission cannot establish by regulation standards for disclosures for municipal bond offerings or for periodic reporting by issuers, nor may it require the use of generally accepted accounting principles.

The Commission is currently conducting a review of the municipal securities market, examining a wide range of issues including disclosure and transparency, financial reporting and accounting, and investor protection and education. Commissioner Elisse Walter, along with fellow Commissioners and staff from across the agency, is leading this effort. Ultimately, the Commission staff will prepare a report concerning the state of the municipal securities market, including recommendations for further action, such as legislation, rulemaking, and changes in industry practice.

As part of this review, the Commission conducted field hearings in San Francisco and Washington, D.C. Plans for additional field hearings were suspended during the recent continuing resolution due to budgetary constraints. However, protecting investors in the municipal securities market is a critical function of the Commission, and the staff is continuing its efforts to gather information about the market in other ways, including meetings and conference calls with interested parties.

Q6. While the SEC does not have direct authority to require financial disclosures before municipal securities are issued, how does the SEC monitor these securities currently?

A6. The Office of Municipal Securities, which is currently located in the Division of Trading and Markets, advises the Commission on policy matters relating to the municipal bond market and provides technical assistance in the development and implementation of major Commission initiatives in the municipal securities area. In addition, the Office assists the Division of Enforcement and other Offices and Divisions on a wide array municipal securities matters. The Office works closely with the municipal securities industry to educate state and local officials and conduit borrowers about risk management issues and foster a thorough understanding of the Commission's policies. In addition, the Office reviews and processes rule filings of the Municipal Securities Rulemaking Board (MSRB) and acts as the Commission's liaison with the MSRB, FINRA, and a variety of industry groups on municipal securities issues.

The Commission's Office of Compliance, Inspection and Examinations also examines brokers, dealers and municipal securities dealers who engage in transactions in municipal securities, and is in the process of developing an examination program for municipal advisors. The Division of Enforcement, in part through a special unit dedicated to enforcement matters concerning municipal securities and public pension funds, conducts investigations into possible violations of the federal securities laws in the municipal securities market, and prosecutes the Commission's civil suits in the federal courts as well as in administrative proceedings.

Because municipal securities are not subject to the registration requirements or periodic reporting requirements of the federal securities laws applicable to public companies, the Commission does not directly monitor the content of disclosures prepared or provided by municipal issuers on an ongoing basis. However, municipal issuers and other municipal securities market participants

are subject to the antifraud provisions of the federal securities laws in connection with disclosures made to investors. Further, the Commission has adopted Exchange Act Rule 15c2-12, which, among other things, provides that any broker, dealer, or municipal securities dealer acting as an underwriter in a primary offering of municipal securities may not purchase or sell securities in such an offering unless it has reasonably determined that an issuer of municipal securities, or an obligated person for whom financial or operating data is presented in the final official statement has entered into in a written agreement in which it has agreed to provide certain annual financial information, including annual financial statements, and notices of certain events to the MSRB's EMMA system. The EMMA system makes this information available to the public at no charge at www.emma.msrb.org.

Q7. Concern has been expressed over credit rating agencies ratings of municipal bonds. What are your thoughts on this?

A7. I am aware of the concerns expressed over credit ratings of municipal bonds and their comparability with ratings of other instruments, including the extent to which any differences may raise issues for investors. Under Section 939(h) of the Dodd-Frank Act, the SEC is required to study the feasibility and desirability of: (1) standardizing credit ratings terminology, so that all credit rating agencies issue credit ratings using identical terms; (2) standardizing the market stress conditions under which ratings are evaluated; (3) requiring a quantitative correspondence between credit ratings and a range of default probabilities and loss expectations under standardized conditions of economic stress; and (4) standardizing credit rating terminology across asset classes, so that named ratings correspond to a standard range of default probabilities and expected losses independent of asset class and issuing entity. The standardization of rating terminology across asset classes is of particular importance for municipal securities, which some rating agencies held to a different standard than corporate debt securities. Some have argued that applying different standards increased the cost of capital to certain state and local governments. Others, however, have argued that using the same rating scale lessens the ability of investors in municipal securities to distinguish among issuers at the same level of granularity as was previously available. The Commission is required to submit to Congress a report containing the findings of the study and its recommendations, if any.

On December 17, 2010, the Commission requested comments on the issues set forth in Section 939(h). The comment period ended on February 7, 2011, and the Commission staff is carefully reviewing the input received in preparing a report for submission to Congress this year.

Q8. There has been some fraud in the municipal securities market related to bid-rigging schemes, like the one Bank of America settled at the end of last year, and pay-to-play issues, like the one in Jefferson County, Alabama. What is the SEC doing to better police this area of the market?

A8. The Commission has had concerns with respect to, and brought cases involving, bid-rigging schemes and pay-to-play issues in the municipal securities market for decades. As part of the Division of Enforcement's restructuring in early 2010, we created a specialized Municipal Securities and Public Pensions Unit to focus on this marketplace. From its founding, one of the five primary areas of focus for this specialized unit has been pay-to-play and kickback schemes.

The Commission filed a securities fraud case against, among others, Birmingham Mayor Larry Langford in April 2008, over seven months before he was indicted by the U.S. Attorney's Office for essentially the same conduct. The Commission followed that action with a significant enforcement action in November 2009 against JP Morgan, the broker-dealer that paid Mayor Langford in connection with the bribery scheme. Moreover, the Commission brought the primary federal case against Banc of America Securities in December 2010 for repeatedly paying undisclosed gratuitous payments and kickbacks to various bidding agents and affirmatively misrepresenting that certain bidding processes were proper. In that enforcement action, we collected more than $36 million in disgorgement that was redistributed to victimized municipalities. Similarly, the Commission settled an injunctive action against UBS Financial Services, Inc. in May 2011 for similar fraudulent conduct, collecting over $47 million in disgorgement, prejudgment interest, and civil money penalties that was redistributed to approximately 100 injured municipalities in 36 states. We continue to vigorously pursue evidence in numerous ongoing investigations involving the municipal securities market and pay-to-play schemes.

In addition to enforcement actions, the Municipal Securities and Public Pensions Unit is engaged in a number of initiatives aimed at proactively assessing marketplace risks. The Unit collects data on the more than 10 million trades involving municipal securities that occur each year. Depending on budgetary constraints, the Unit intends to develop data analytics to allow it to mine this trading information for patterns of suspicious activity. Unit staff from across the country also are in contact with state regulators and our federal law enforcement partners to encourage close coordination on parallel investigations involving municipal securities.

WHISTLEBLOWERS/TIPS

Many companies have expressed concerns that the SEC's whistleblower program would create a perverse incentive for company employees to bypass internal reporting in favor of going directly to the SEC to collect bounties on their information. This has lead to concern that shareholders might be affected should employees wait to disclose information to the SEC instead of internally, first. Some companies also believe that the SEC's whistleblower program may take away from their efforts to foster an open and ethical environment.

Q9. I understand the SEC is looking into ways to avoid this problem. Some companies have suggested requiring internal reporting first before contacting the SEC. Can you give us your thoughts on this suggestion?

A9. It is important to note that the Commission is in the midst of its rulemaking process, including consideration of the many comments we received by a wide variety of interested persons and entities. Thus, the rules have not been finalized yet. That being said, we are fully embracing this new statutory authority and expect that our new program will accomplish Congress's goals in granting it to us.

Whistleblowers can be an invaluable source of information to uncover securities fraud and better protect investors. Although there is great value in whistleblowers reporting matters internally when appropriate, there are numerous instances when such reporting is not appropriate, and I believe it is important – consistent with the statute's language and our mission to protect investors – to ensure that whistleblowers can bring us their evidence of securities violations expeditiously.

When we proposed our rules, we attempted to achieve a balance that preserved the important role that internal compliance programs play while remaining true to the statute's purpose of encouraging whistleblowers to come forward. With that in mind, we included provisions in the proposed rules intended to encourage, but not require, employees to continue to report potential violations through existing company processes, in addition to making a whistleblower submission. For example, the rules provide that an employee who reports information through appropriate company procedures would be treated as a whistleblower under the SEC's program as of the date the employee reported internally as long as he or she provides the same information to the SEC within 90 days. By taking advantage of this provision, employees would be able to report internally first while preserving their "place in line" for a possible award from the SEC. Additionally, the proposed rules provide that the Commission can consider, as a basis for paying a higher percentage award, whether a whistleblower first reported the violation through effective company compliance programs. We will consider additional ideas in this area that have come up during the public comment process.

I believe we can adopt rules which achieve a balance that preserves the important role that internal compliance programs can play while remaining consistent with the statute's purpose of encouraging whistleblowers to come forward.

NY STOCK EXCHANGE/FRANKFURT STOCK EXCHANGE MERGER

Last month the New York Stock Exchange and the Frankfurt Stock Exchange agreed to merge. In its wake, London and Toronto stock exchanges have announced their mergers, as well as the announcement by the SGX, the operator of Singapore's exchange, that it is planning to buy the Australian stock exchange.

Q10. What are your thoughts on the merger between NYSE and the Frankfurt exchange?

A10. The regulatory approvals required from the SEC in connection with the transaction are anticipated to be similar to those required in connection with other exchange combinations, such as those between NYSE and Euronext, Nasdaq and OMX, and Eurex and ISE. For example, in reviewing previous exchange mergers, the Commission has carefully examined the proposed governance and ownership structure to ensure that the U.S. exchanges have provided in their rules for certain protections designed to strengthen the ability of the exchange and the Commission to effectively carry out their respective regulatory responsibilities under the federal securities laws. The Commission's review historically has not differed materially in cases where the holding company is controlled by foreign persons (*e.g.*, the Eurex acquisition of ISE).

Commission staff is coordinating with our European counterparts as the transaction develops and we conduct our respective regulatory reviews.

Q11. Is this a good thing for American investors?

A11. Because the Commission will be called upon to review the proposed transaction, I am not in position to comment at this time on the specific benefits or costs that may result from a proposed merger I believe, however, that one of the cornerstones for protecting the interests of U.S. investors is to ensure the maintenance and protection of open and transparent financial marketplaces that comply with all applicable securities laws, rules and regulations. These policy goals are central to the Commission's review of the proposed merger.

Q12. Does the SEC have any concerns related to these mergers?

A12. The Commission is focused on protecting U.S. investors and, to this end, will be considering (as it has in the case of previous cross-border mergers involving securities exchanges) whether the appropriate controls and agreements are in place to ensure that U.S. exchanges will be operated, monitored, and regulated in an open and transparent manner in accordance with all applicable securities laws, rules and regulations.

REGISTRATION ISSUES FOR FUNDS THAT INVEST IN SMALL BUSINESS

On January 26th the SEC proposed a rule to govern the registration and reporting of private fund investment advisers. For the first time small investment funds would be required to register with the SEC and implement compliance programs by July 2011, possibly at a cost off hundreds of thousands of dollars. These new costs would prove most harmful to funds that invest in small businesses. It is my opinion that the funds which invest in small business are not systemic risks to our economic system and not the reason behind these new requirements.

Q13. Given the demands on SEC's resources, shouldn't the focus of new compliance requirements be focused on those entities that pose real systemic risks?

A13. With the adoption of the Dodd-Frank Act, Congress made a number of significant changes to the Advisers Act, including changes that will require many private fund advisers to register with the Commission. However, because of new exemptions also provided in the Dodd-Frank Act, small and mid-sized advisers generally will not register with the Commission. In addition, advisers solely to venture capital funds -- which generally invest in smaller, start-up businesses -- as well as advisers solely to private funds with less than $150 million in assets in the United States, will not be required to register with the Commission or implement compliance programs. Under the terms of the Dodd-Frank Act, however, these advisers will report basic information about themselves and the private funds they manage.

Those advisers that are registered must comply with requirements that are intended to protect investors and ensure that advisers make appropriate disclosures to their clients. These

compliance requirements are designed to balance the benefit of investor protection with the cost to advisers. Historically, many small entities have been registered with the Commission and have been able to operate as small businesses under the rules applicable to investment advisers. For instance, approximately half of the advisers currently registered with the commission report less than $150 million in assets under management, suggesting that small and mid-sized advisers have a record of successfully operating under these compliance requirements

In the Dodd-Frank Act, Congress directed the Commission to collect systemic risk information from private fund advisers in order to support the work of the Financial Stability Oversight Council. The Commission's recent proposal for private fund systemic risk reporting on Form PF is intended to implement this reporting requirement. Under the proposal, most private fund advisers would report only basic information and only once a year. The full range of reporting only applies to the largest advisers – those with over $1 billion in private fund assets under management.

Q14. Are you considering delaying implementation for these funds by at least a year help to minimize the cost of compliance for small business investors?

A14. Given the time needed for private fund advisers to register and come fully into compliance with the obligations applicable to them once they are registered, I expect that the Commission will consider extending the date by which these advisers must register and come into compliance with the obligations of a registered adviser until the first quarter of 2012. See letter dated April 8, 2011 from the SEC staff to NASAA regarding the timing of registration. (http://www.sec.gov/rules/proposed/2010/ia-3110-letter-to-nasaa.pdf)

Questions for the Record Submitted by Ranking Member Serrano

SEC RESOURCES

Q15. As stated in your testimony, the SEC has Responsibility for approximately 35,000 entities, including direct oversight of 11,800 investment advisers, 7,500 mutual funds, and more than 5,000 broker-dealers with more than 160,000 branch offices. Six years ago, the SEC's funding was sufficient to provide nineteen examiners for each trillion dollars in investment advisor assets. Today, there are 12 examiners per trillion dollars. As staffing declined and markets grew more complex, how did the SEC allocate scarce resources?

A15. The SEC has long faced the challenge of how best to allocate scarce resources to oversee its registrant population. Over the last twenty years, the securities markets have grown tremendously in size and complexity, with the average value of securities transaction per day rising by about 2,500% and the value of investment advisor assets growing by about 3,070%. Yet, although the SEC's workforce grew over this period, it did not nearly keep pace..

This mismatch between the changes in the markets and in the SEC has been exacerbated since 2005. As the question points out, the markets' size and complexity exploded since 2005. Yet,

the SEC's workforce and technology investments had to be cut back significantly between 2005 and 2007 and are only now returning to 2005 levels. To compound the issue, last year the SEC received vast new or enhanced responsibilities to oversee hedge fund advisers, derivatives, municipal advisors, and credit rating agencies, without the additional staff to handle these responsibilities.

To help address this disparity, the SEC has worked on a variety of fronts to reform its operations and better focus its resources on the areas of greatest risk to investors. For example, in September 2009, the agency created a new Division of Risk, Strategy, and Financial Innovation to bring together economic, financial, and legal experts to analyze new products, trading practices, and risks. The agency also has completed a comprehensive review and restructuring of the enforcement and examinations programs. As a result, the Division of Enforcement has streamlined its procedures to bring cases more quickly; removed a layer of management to permit more staff to be allocated to front-line investigations; created five national specialized investigative units dedicated to high-priority areas of enforcement; and created a new Office of Market Intelligence to serve as the hub for the effective handling of tips, complaints, and referrals (TCR). The Office of Compliance Inspections and Examinations reorganized the agency's national examination program to provide greater consistency and efficiencies across the eleven regions and sharpen the staff's focus on identifying the higher risk firms that it targets for examination. The agency also has invested in modernizing information technology tools, such as the new TCR system and risk analysis tools, to better leverage resources.

The President's Request for FY 2012 of $1.407 billion is critical in two respects. First, the request would allow the agency to add 780 more staff positions, to begin addressing the disparities described above between the SEC's workforce and technology systems and the wide array of registrants the agency must oversee. Second, the request would permit the agency to hire specialized skill sets, continue structural reforms, bolster training, and invest in technologies that will better enable the SEC to focus its resources on the areas of greatest risk.

Q16. This subcommittee worked very hard between 2007 and 2010 to provide the resources that the SEC needs to perform its important mission. How were those resources used? Please tell us what your staffing levels have been from 2005 to present.

A16: We greatly appreciate the subcommittee's strong support in recent years for increasing resources for the SEC. First, with your support, the SEC was able to rebuild its staff from the 10% cut of the 2005-2007 period, bringing its workforce back to its 2005 levels. Specifically, from FY 2007 through FY 2010, the agency restored about 280 FTE, of which about 100 were for our enforcement and examinations programs, another 40 were for Corporation Finance, and nearly 50 were for the Divisions of Investment Management and Trading and Markets.

To summarize, our agency-wide staffing levels from FY 2005 to present have been as follows:

	FY 2005 Actual	FY 2006 Actual	FY 2007 Actual	FY 2008 Actual	FY 2009 Actual	FY 2010 Actual	FY 2011 CR Est.
Total FTE	3,851	3,695	3,465	3,511	3,656	3,748	3,848
Permanent FTE for Major Programs							
Enforcement Program	1,232	1,157	1,111	1,148	1,179	1,173	1,236
Examination Program	851	880	817	790	820	854	854
Corporation Finance	495	471	430	441	464	470	465
Trading and Markets	171	166	157	167	177	191	214
Investment Management*	154	149	145	149	154	157	157

*Excludes FTE associated with the Public Utility Holding Company Act (PUHCA), which was repealed by Congress in 2006.

Q17. Why has staffing been slow, despite these resources?

A17. The staffing process at the SEC is governed by a complex set of federal rules and regulations which can create significant delays in the hiring process. Recently, the Office of Personnel Management (OPM) changed its interpretation of the SEC's hiring authorities which will likely only make this process move more slowly. Another factor that has inhibited hiring is that the SEC has been funded under continuing resolutions for significant periods of the recent fiscal years, which has impacted our ability to recruit and create a consistent pipeline of talent. We have had to cut short our hiring efforts as budget uncertainties arise and critical talent has been lost in the "stop and start" funding environment. In addition, to move more efficiently, investment is needed in the support infrastructure within the Office of Human Resources (OHR). We had planned to address this issue in 2011 but those plans were on hold during the CR.

DODD-FRANK IMPLEMENTATION

Dodd-Frank Act puts a new level of responsibility on the SEC. The agency is required to promulgate more than 100 new rules, create five new offices, and produce more than 20 studies and reports. In addition, the SEC will now be responsible for oversight of the over-the-counter derivatives market and hedge fund advisors, as well as increased regulation of asset-backed securities. You don't have to be a financial expert to recognize that these entities played a big part in our financial meltdown and subsequent recession. Regardless of how some people feel about the Dodd-Frank Act, it is the law and the SEC is bound to implement it.

Q19. I appreciate your straightforward presentation of the costs of implementing Dodd-Frank. Your testimony states that $123 million in staffing and information technology costs are requested in the FY12 budget. To my mind, $123 million is a small price to pay for greater regulation of the entities that ultimately cost the taxpayer trillions in damage to our economy. If we do not make the investment in greater oversight of these entities, are we leaving ourselves vulnerable to another economic decline?

A19. Yes, I believe the Dodd-Frank rules we are working to promulgate will help to fill a number of significant regulatory gaps. For example, in 2000, over-the-counter derivatives were excluded from regulatory oversight by the Commodity Futures Modernization Act. Partly as a result, regulators did not have the tools needed to address problems with these financial products when the crisis hit seven years later. With our current rulemaking, we are working to change that. We believe that the transparency and other benefits of more formally defined trading, reporting and clearing regimes for derivatives will diminish the chance of another systemically challenging event. Similarly, the expanded oversight and data reporting we will have with respect to private funds and credit rating agencies will go a long way toward bringing greater public transparency and market accountability to the financial system, and give the SEC important tools to better protect investors.

SEC IG

A few weeks ago, this subcommittee heard testimony from the SEC Inspector General about areas in which the SEC needs improvement.

Q20. One area highlighted during that hearing was the Tips and Complaints system. Can you tell us how the SEC is working toward improving this system?

A20. In January 2010, the Enforcement Division created the Office of Market Intelligence ("OMI") to serve as a central office for the handling of tips, complaints and referrals ("TCRs") received by the SEC, coordinate the Division's risk assessment activities, and support its strategic planning activities. OMI has enabled the Division to have a unified, coherent and coordinated response to the huge volume of TCRs the Commission receives every year, thereby enhancing our ability to open the right investigations, bring solid cases and more effectively protect investors. The Division plans to use TCR information received by OMI to identify emerging threats to investors and markets, which will in turn inform how we employ our limited enforcement resources in order to maximize investor protection and deterrence.

The Division's creation of OMI dovetails with the Commission's broader efforts over the last two years to revamp the way the agency handles TCRs, including the development and launching of a new TCR System and the promulgation of Commission-wide policies and procedures for the handling of TCRs. The new TCR System allows staff across the Commission to review, analyze, archive and route TCR information from a centralized database and processing platform. The system is designed to improve the Commission's ability to obtain relevant information from the public while providing the staff with workflow tools to better correlate, prioritize, assign and track the progress of TCRs from intake through resolution.

In addition, we are making a number of enhancements to the new TCR System. We currently are in the midst of a procurement to build an analytics component to the system that will enable us to better link data among various Commission databases and to automate based on risk characteristics the initial review of TCRs so they can be prioritized as they come into the system. Additionally, we are working with self-regulatory organizations to update the manner in which those organizations submit referrals to the Commission in an effort to achieve uniformity in our TCR intake system. Finally, we continue to strengthen our policies and training to ensure that every member of the agency understands his/her role when receiving or handling TCRs.

We will, of course, continue to monitor our TCR System as well as our policies and procedures for any additional necessary improvements on an ongoing basis.

Q21. The Inspector General also expressed concerns over inefficiencies in the leasing and procurement areas. What do you intend to do to address these concerns?

A21. As you point out, our Inspector General is looking at these functions and I look forward to any recommendations he may have. We have brought in a new Chief Operating Officer who has a great deal of experience with operational issues, and under his leadership we will devote the resources necessary for timely and appropriate follow-up to implement any necessary reforms in these areas.

Questions for the Record Submitted by Congressman Alexander

THE INVESTOR'S COMMITTEE

Q22. In the Stanford case, are you aware that there is a 7 member court approved Investor's Committee? Has your office had any interaction with this committee?

A22. Yes, I am familiar with the Investor Committee established by the Court in the Stanford matter. On March 30, 2010, the Receiver filed a Stipulation and proposed Order, submitted as agreed between the Receiver, investors who had petitioned for permission to put one or more Stanford defendants into involuntary bankruptcy proceedings, the Examiner, and the SEC, that would, if approved by the Court, establish the Investor Committee. On August 10, 2010, the Court entered the proposed Order, establishing the Investor Committee to, as stated in the Order, represent the Stanford Investors. The Order called for the Investor Committee to be comprised of seven voting members including the Examiner and six other members, representing a cross-section of the Stanford Investors.

SEC staff has worked closely with the court-appointed Examiner since his appointment and we are continuing that interaction now that he is also serving as a member (and the initial chairperson) of the Investor Committee.

We have also had discussions with other members of the Investor Committee on multiple topics, including the professional fees associated with the receivership and efforts by the Committee to

pursue further recovery on behalf of investors. We welcome the Investor Committee's input concerning any issues related to our ongoing efforts to maximize investor recovery.

Q23. It has come to my attention that today a letter has been sent to your General Council, Mr. Cahn's office requesting a meeting with Mr. Cahn, Mr. Kotz and this Committee. Can you assure me that your office will make certain that this request is fulfilled in a timely manner?

A23. Mr. Cahn and Mr. Kotz met with the Investors Committee on May 10, 2011.

SECURITIES INVESTOR PROTECTION

Q24 & 25. Currently, investors have no standing to file a suit to allow an impartial judge to determine if a failed Securities Investor Protection Corp (SIPC) member brokerage firm qualifies for a liquidation under Securities Investor Protection Act (SIPA). Are adequate safeguards in place to prevent a miscarriage of justice for investors?

What options do investors have when they do not agree with the SEC's or SIPC's interpretation of the Securities Investor Protection Act (SIPA)?

A24 & 25. Pursuant to SIPA, the Commission is required to notify SIPC of situations in which the Commission believes that SIPC member firms are in or are approaching financial distress. If SIPC determines that a SIPC member firm has failed or is in danger of meeting its obligations to customers, SIPC would assess the situation to determine whether a SIPA liquidation proceeding is appropriate for the protection of the firm's customers. As part of that process, customers of SIPC member firms and their representatives can and do communicate with SEC staff and commissioners (in writing and through in-person meetings) when customers believe that a member firm should be liquidated under SIPA. SEC staff thoroughly evaluate such requests for SIPA protection. In every case in which the SEC has concluded that a SIPC member firm should be liquidated under SIPA, SIPC has agreed to do so. If SIPC were not to agree, Section 11(b) of SIPA gives the SEC the right to file an action to compel SIPC to begin a liquidation proceeding to ensure that the protections provided by SIPA are available to the customers of the SIPC member firm.

In Securities Investor Protection Corporation v. Barbour, 421 U.S. 412 (1975), the Supreme Court analyzed SIPA and concluded that customers of a SIPC member firm do not have an implied private right under SIPA to ask a court to require SIPC to begin a liquidation proceeding. Without deciding whether customers may challenge the SEC's decision not to seek an order compelling SIPC to begin a liquidation proceeding, the Court in Barbour noted that the SEC's brief in that case indicated that such a decision "might be reviewable under the Administrative Procedure Act for an abuse of discretion." Id. at 425 n.7. No customer has sought judicial review of an SEC decision not to request a court to order SIPC to begin a SIPA liquidation.

SHAREHOLDER THRESHOLD

Q26. The 500 shareholder registration threshold under the 1934 Act has not been updated since the 1960s, and, for a substantial number of community banks it is either a restraint on raising capital or a disproportionate cost. In both cases, it acts as a restriction on lending for community banks, indirectly slowing economic activity and job creation. When does the SEC expect to act to raise the threshold? Will the SEC also act to raise the level of shareholders at which registered community banks can deregister?

A26. Section 12(g) of the Exchange Act and the Commission's related rules require a company to register its securities with the Commission within 120 days after the last day of its fiscal year if, at the end of the year, the securities are held of record by 500 or more persons and the company has total assets exceeding $10 million. Issuers may terminate registration and suspend reporting by filing a certification that the class of securities is held of record by fewer than 300 persons, or by fewer than 500 persons and the issuer's total assets have not exceeded $10 million on the last day of each of the most recent three fiscal years.

As you note, the 500-shareholder threshold was adopted in the 1960s, and since that time, securities markets have changed significantly. Also a fundamental shift has occurred in how securities are held in the United States. Today, the vast majority of securities of publicly-traded companies are held in nominee or "street name," which means that the brokers that purchase securities on behalf of investors typically are listed as the holders of record. One broker may own a large position in a company on behalf of thousands of beneficial owners, but since those shares are held in "street name," those shares count as being owned by one holder of record. This means that for most publicly-traded companies much of their individual shareholder base is not counted under the current definition of held of record. At the same time, this method of holding securities has allowed a number of public companies, many of whom likely have substantially more than 500 shareholders, to stop reporting or "go dark," because there are fewer than 500 holders of record. Conversely, for most private companies, shareholders hold their shares directly and are counted as holders of record under our definition. This has required private companies that have more than $10 million in total assets and that cross the 500 record holder threshold to register and commence reporting.

I believe that the questions of how holders are counted and how many holders should prompt registration need to be examined. I recently instructed the Commission's staff to review the impact of our regulations on capital formation for small businesses, specifically focusing on, among other topics, the number of shareholders that trigger public reporting. In considering these standards, the Commission and the staff have been, and will be, informed by a wide range of proposals relating to possible amendments to Section 12(g) reporting standards that have been advanced by a variety of proponents. Some of these proposals seek to reduce the number of issuers required to report pursuant to the Exchange Act, such as the American Bankers Association, which has made the argument for increasing both the 500-shareholder threshold and the number of shareholders below which deregistration should be allowed in order to reduce the regulatory burdens on small community banks. Other proposals would increase the number of issuers required to report, such as by revising the held of record definition to look through record holders to the underlying beneficial owners of securities. The staff is carefully considering these

issues. The staff's review will also include evaluating the recommendations of our annual SEC Government-Business Forum on Small Business Capital Formation, as well as suggestions we receive through an e-mail box we recently created on our website. I also expect that our efforts will benefit from the input of a new Advisory Committee on Small and Emerging Companies that the Commission is in the process of forming.

Questions for the Record Submitted by Congressman Womack

IDENTIFYING INEFFICIENCIES

Ms. Shapiro, you have emphasized the need for more resources. In fact, over the past year, all we have heard is that the SEC needs more resources; that, if it had additional resources, these things would not happen.

As you may know, Ms. Shapiro, the SEC has received significant increases in its funding; since 2001, its budget has more than doubled.

Q27. Are there any areas you have identified where the SEC could squeeze out some inefficiencies and cut its budget or even reallocate that money to another function within the agency? If so, which areas have you identified? If not, can you identify areas within the SEC that can absorb cuts?

A27: The SEC curtailed its core program activities significantly to operate under the Continuing Resolution (CR) level in place for the first half of the fiscal year. With the help of a "tiger team" led by the Chief Operating Officer, the agency identified opportunities to cut back expenses so as to protect key priorities as much as possible during the CR. For example, the agency cut $12 million from equipment purchases, nearly $10 million from staff awards and retention benefits, $2 million from enforcement litigation support, and over $1 million from travel. It is important to note that, during the CR, the SEC has had to focus resources on the greatly expanded levels of rulemaking related to the agency's new or enhanced responsibilities for derivatives, hedge fund advisors, municipal advisers, and credit rating agencies, entirely through existing staff.

The SEC continues to work to identify areas for efficiencies and savings. For example, the SEC's Office of Information Technology (OIT) is undertaking an initiative to review all steady state costs to identify areas for longer-term savings. OIT has identified opportunities to spend funds now in order to significantly reduce out-year costs. For example, by investing in "virtual" servers, upgraded storage, and rolling replacement of network equipment now, the agency can reduce its long-term maintenance costs and increase staff productivity. In addition, the SEC has launched a multi-year initiative to migrate its core financial system to a Federal Shared Service Provider, the Department of Transportation. Once completed, this project will help the agency strengthen internal controls, enhance functionality, and save almost $3 million a year in contract costs.

Although we have made significant progress in reforming the Commission's operations and allocating our resources effectively, we continue to seek ways to improve our efficiency and effectiveness. The study conducted by the Boston Consulting Group (BCG) as required under the Dodd-Frank Act identifies additional opportunities for efficiencies for the agency's operations. The report discusses ways to reprioritize regulatory activities, reshape the organization, invest in enabling infrastructure, and enhance the Self-Regulatory Organization (SRO) engagement model. The agency is currently assessing the report's findings and is forming a series of working groups under the leadership of the Chief Operating Officer (COO) to implement the report's recommendations. The agency already has acted on one such

recommendation, by asking for reprogramming authority from Congress to streamline the reporting lines for the agency's back office functions, so they all report to the COO. In the coming months, the SEC will report back to Congress on the agency's progress on other recommendations in the BCG study.

IMPACT OF THE DODD-FRANK ACT

As you know, Ms. Shapiro, the Dodd-Frank Act gave the SEC several new responsibilities, including rulemaking and reporting, as well as oversight, responsibilities.

Q28. Is the SEC capable of undertaking even more responsibility than it already has?

A28. Over the past two years, we have worked to make the SEC more vigilant, agile, and responsive, and are moving on multiple fronts to enhance the agency's effectiveness and provide robust oversight of the financial markets. We have new senior leadership in all key positions and have embarked on a vigorous agenda.

This year finds the SEC at an especially critical juncture in its history. Not only does the Dodd-Frank Act create significant additional work for the SEC, both in the short and long term, but the agency must also continue to carry out its longstanding core responsibilities. These responsibilities — pursuing securities fraud, reviewing public company disclosures and financial statements, inspecting the activities of investment advisers and broker-dealers, and ensuring fair and efficient markets — remain essential to investor confidence and trust in financial institutions and markets. Our FY 2012 budget request is designed to provide the SEC with the resources required to achieve several high-priority goals: to adequately staff the agency to fulfill its core mission; to continue to implement the requirements of the Dodd-Frank Act; and to expand the agency's IT systems and management infrastructure to serve the needs of a more modern and complex organization. However, unless the SEC receives the additional resources contemplated in our FY 2012 request, there is a significant risk that we will not be able to operationalize many of the new regulations designed to provide greater transparency and enhanced supervision of important functions such as derivatives and hedge funds.

AVERTING PONZI SCHEMES

Another issue that has been raised is that the SEC does not have enough people who have experience and understand the intricacies of the financial markets.

Q29 & 30. In your opinion, Ms. Schapiro, is there a competency issue at the SEC? Put another way, are they hiring the right folks?

If so, why is the SEC not catching the Madoffs of the world? If not, what is the SEC doing to address this problem?

A29 & 30. Ponzi schemes like that perpetrated by Barry Madoff come in all shapes and sizes, and to ensure that we stay on the cutting edge of newly emerging types of fraud, the SEC is

embracing a range of initiatives designed to increase our ability to identify new threats and to act quickly to halt misconduct and minimize investor harm. Across the agency, we are launching risk-based investigative initiatives, tapping into the expertise of the Division of Enforcement, Office of Compliance and Inspections (OCIE) and other SEC offices and divisions, hiring talent with particularized market expertise, and reaching out to academia, law enforcement, and the regulated community to collect data on fraud hotspots.

One example of this new approach is the Division of Enforcement's national specialized units, which were formally staffed and launched in May 2010. These units are focused on building expertise in the key areas of Structured and New Products, Market Abuse, Municipal Securities and Public Pensions, Asset Management, and violations of the Foreign Corrupt Practices Act. To assist them in their investigative efforts, the units are, subject to budget constraints, hiring industry experts to work directly with our teams of experienced attorneys and accountants.

In addition to investigative work, Enforcement's specialized units are engaged in a number of initiatives with colleagues in OCIE and other Divisions to develop risk analytics proactively identifying red flags for further examination and investigation. To take but one of numerous examples, Enforcement, OCIE and the SEC's Division of Risk, Strategy and Financial Innovation (RiskFin) developed metrics and risk analytics for an Aberrational Performance Inquiry to identify those investment advisers whose operations shared characteristics of those of a Ponzi or other illegal scheme. Specifically, working with RiskFin's computer platform, we applied performance and volatility benchmarks to thousands of hedge fund advisers, and those that emerged from that analysis as outliers (e.g., those with above-market returns coupled with an absence of expected volatility) are being subject to further examination or investigation. This kind of proactive, risk-based investigative approach is being duplicated across the Division.

The SEC also has completely revamped the way that it receives and processes the tips, complaints, and referrals ("TCRs") that it receives about potential wrongdoing, including Ponzi schemes. This year, the SEC deployed a new TCR system to house all tips, complaints, and referrals in a central location in order to enhance the staff's ability to identify potential violations of the federal securities laws and to ensure appropriate and timely responses to allegations of wrongdoing. To facilitate the operation of the TCR system, the Division created the Office of Market Intelligence, which has primary responsibility for analyzing, risk-weighting, triaging, referring, and monitoring the TCRs we receive. By analyzing tips according to internally developed risk criteria, as well as our priorities, and by making connections between and among tips from different sources, we expect to be better able to focus our resources on those tips with the greatest potential for uncovering wrongdoing.

The enforcement program must continue to innovate to match the pace of wrongdoers who seek to use new technology to profit from manipulating our financial markets. In particular, our enforcement efforts may increasingly target market structural issues such as market fragmentation, large volume trading, large-scale organized insider trading, account intrusions, high frequency and algorithmic traders, data feed latency disparities, the practices of equities and options market makers, professional liquidity providers and direct market access providers, and the interplay between dark pools and displayed markets and cross-market trading dynamics. As we continue to gain expertise against the backdrop of these evolving structural issues and

practices, the enforcement program will seek to efficiently marshal our resources to vigorously investigate fraud in these complex and novel areas.

Our efforts are already bearing fruit as the SEC has brought twice as many cases against Ponzi schemes in each of the last two fiscal years than it brought in FY 2008. Our work continues and we must remain diligent, but I believe that our staff is smart, driven and dedicated to stopping fraud and protecting investors.

Questions for the Record Submitted by Congresswoman Lee

RESOLUTION OF BERNIE MADOFF AND ALLAN STANFORD PONZI SCHEMES

Madam Chair, last year I asked you about how victims of Bernie Madoff would be compensated for losses.

Q31. Can you provide us an update of how much has been recovered on behalf of investors?

A31. The SEC is working aggressively to maximize recovery to investors harmed by the Madoff fraud. Approximately $10 billion has been recovered on behalf of Madoff's harmed investors. A brief summary of recovery efforts follows.

The SIPC trustee has recovered approximately $7.6 billion. The Securities Investment Protection Corporation ("SIPC") initiated liquidation proceedings in bankruptcy court on Bernard Madoff Investment Securities LLC's ("BMIS") behalf and secured the appointment of a trustee over BMIS, Irving Picard. The SIPC trustee has taken a primary role in returning funds to victims and has brought civil actions against various Madoff-related individuals and entities, including many of those defendants listed below. The SEC staff has coordinated its efforts with those of the SIPC trustee in order to maximize efficiency in the protection and collection of assets for the benefit of investors. The SIPC trustee has recovered approximately $7.5 billion to date, and expects to make pro-rata distributions to harmed investors later this year.

Criminal authorities have recovered approximately $2.5 billion. In parallel with the SEC staff, the United States Attorney's Office for the Southern District of New York is conducting a robust investigation of Madoff and related individuals and entities, and has recovered approximately $2.5 billion in forfeited funds. These funds will eventually be returned to harmed investors.

The Commission has filed suit against Madoff's cohorts seeking disgorgement and penalties. The SEC staff is also pursuing financial relief against defendants in seven enforcement cases pending in the federal district court for the Southern District of New York. These cases include charges against:

- Frank DiPascali, Jr. Our complaint charged that he oversaw the mechanics of Madoff's entirely fictitious investment strategy, and played a critical role in helping Madoff avoid

detection by creating reams of counterfeit books and records designed to conceal the fraud from regulators, auditors and investors.

- David G. Friehling and his accounting firm, Friehling and Horowitz, CPAs, P.C. Our complaint charged that they enabled Madoff's Ponzi scheme to continue by falsely stating that F&H audited BMIS's financial statements under generally accepted auditing standards, when in fact they took no meaningful steps at all.
- Cohmad Securities Corporation, its Chairman Maurice J. Cohn, chief operating officer Marcia B. Cohn, and registered representative Robert M. Jaffe, who we alleged brought investors to Madoff while they were aware of, and failed to disclose, facts that should have raised serious questions about the propriety of the Madoff investment.
- Stanley Chais, who we charged with committing fraud by misrepresenting his role in managing investors' assets that he forwarded to Madoff, and for distributing false account statements. Chais is recently deceased, and the Commission's case against him has been dismissed in light of the SIPC trustee's pursuit of proceeds from Chais's estate.
- Daniel Bonventre, the Director of Operations at Madoff's firm. Our complaint chared that he knew that Madoff did not use investor funds to purchase securities on their behalf, and falsified accounting records to hide the fraud.
- Jerome O'Hara and George Perez, Madoff's computer programmers, who we charged with developing computer programs to help Madoff generate phony paper records that made his $64 billion Ponzi scheme appear legitimate to investors, auditors, and regulators.
- Annette Bongiorno and Jodi Crupi, two long-time Madoff employees who we charged with producing fictitious account statements for investors.

The investigation remains active and the SEC may file additional enforcement cases in the future.

Q32. The Madoff Trustee has collected approximately $7.6 billion to be distributed to customers. However, as of April 7, 2011, only approximately $2.4 billion is available for distribution to customers. The remaining funds (including approximately $5 billion from one settlement) are under litigation and cannot be distributed until the lawsuits, including appeals, are complete. In addition, the U.S. Attorney's office has collected approximately $2.5 billion through forfeiture proceedings that will be distributed to customers once those proceedings are finalized.

What are the ongoing efforts of the SEC on behalf of the many investors who lost funds to Ponzi schemes under your predecessor's watch?

A32. The SEC is actively investigating Ponzi schemes and filing enforcement actions in federal courts around the country and administrative proceedings to halt the misconduct and hold accountable those who have perpetrated the fraud. These actions seek injunctions, bars and suspensions from the securities industry, and disgorgement of ill-gotten gains and penalties from the perpetrators. In Ponzi scheme matters, as in all our enforcement actions where appropriate, we actively coordinate with court-appointed trustees and receivers to identify, recover, and distribute assets to harmed investors. Many of our Ponzi scheme investigations involve a

parallel criminal investigation. We closely coordinate with the criminal authorities to encourage a swift and just resolution of Ponzi scheme matters. We take seriously the injuries suffered by investors victimized by Ponzi schemes and other frauds and work extremely hard to send a strong deterrent message to prevent future investor harm.

CREDIT DEFAULT SWAPS

The market for derivatives and credit default swaps is massive, in the trillions of dollars, hut is unregulated and so complex that our largest financial institutions are unable to set prices for their own holdings.

While the housing crisis may have triggered the crisis, the hidden world of derivatives and Credit Default Swaps is the tool that spread the risk throughout the entire financial sector and across every conceivahle fund.

Q33 & 34. I know that we have yet to pass strong regulatory reform for derivatives that has tight controls and asset requirements, but I want to ask you if the SEC has been able to take any action to reduce the dangers and risks for investors and taxpayers that remain in this unregulated market?

What types of authority and regulations do you believe are needed to give regulators the oversight and enforcement tools they need to safeguard investors from the unknown risk of yet another derivative crash?

A33& 34. Title VII of the Dodd-Frank Act provides the CFTC and the Commission with regulatory and enforcement authority over the swaps and security-based swaps markets. More specifically, Title VII provides the Commission with regulatory and enforcement authority over security-based swaps, including: (1) the registration and comprehensive regulation of swap dealers, security-based swap dealers, major swap participants, and major security-based swap participants; (2) the establishment of clearing and trade execution requirements for security-based swaps (subject to certain exceptions); and (3) the creation of rigorous trade reporting regimes. Title VII also maintains the Commission's enforcement authority over security-based swap agreements, and enhances the Commission's ability to use the authority through access to books and records regarding security-based swap agreements.

We have already made significant progress in implementing Title VII, although much remains to be done. To date, the Commission has proposed ten rulemakings required by Title VII, as well as two rulemaking required by Title VIII. In addition, the Commission has issued an interim final rule governing reporting of pre-enactment security-based swaps.

We believe that the Commission's rulemaking and enforcement authority established under Title VII provides us with the necessary oversight and enforcement tools to fulfill our mandate to protect investors and maintain investor confidence in the markets. I note, however, that, as I have explained in other testimony and public statements, the Dodd-Frank Act has added significantly to the Commission's workload. Absent additional funding and staffing, the demands placed on the Commission by the Dodd-Frank Act necessarily will reduce the

Commission resources available for its traditional regulatory responsibilities which may impact our ability to safeguard investors from risks in both the derivatives markets as well as the debt and equity markets, regardless of the regulatory and enforcement authority provided to us under the Dodd-Frank Act.

LOCAL COMMUNITY BANKS

Last year I also shared with you some of the concerns that some of the small community banks in my district had shared with me regarding some of the restrictions and reporting requirements that came with TARP assistance.

Q35 & 36. What is the status of the reporting requirements for small local banks?

Has the SEC found that small banks have complied with requirements and safety and soundness standards?

A35 & 36. I am not familiar with the specifics of the restrictions and reporting requirements for small local banks under the TARP program, as those entities are generally subject to regulation principally by federal and state banking authorities. Those authorities, in particular the Federal Deposit Insurance Corporation, would be better positioned to address your concerns.

MINORITY HIRING AND CONTRACTING

Q37. Will you provide the Subcommittee with information regarding the diversity of the professional full time employees at the SEC broken down by job title, pay scale and management hierarchy?

A37. Please see the attached charts prepared in connection with the agency's Annual EEO Program Status Report as filed with the Equal Employment Opportunity Commission.

Q38. What is the SEC doing to ensure that it is recruiting and hiring a diverse staff including from different race and ethnicities, for instance does Treasury recruit or have an internship programs at Historically Black Colleges and Universities or other Minority Serving Institutions?

A38. The SEC has continued to expand its efforts to attract a diverse applicant pool for positions at all levels of the organization and build a broad talent pipeline for the future. The Commission's strategies to accomplish this include:

- Recruiting Efforts Targeting Diverse Candidates for Executive and Mid-level Positions;
- Building Partnerships and Alliances with Professional Organizations;
- Participating in Events Targeting Women and Minorities; and

- Developing a Diverse Talent Pipeline for the Future.

Highlighted below are specific efforts and initiatives within each of these strategies that the SEC has engaged in to creating a more diverse environment at the Commission.

Recruiting Efforts Targeting Diverse Candidates for Executive and Mid-level Positions

- The SEC has retained a recruiting firm to seek diverse talent for a number of senior executive positions and recruit mid-level professionals.
- In 2010, the SEC also hosted, sponsored and/or participated in a number of recruiting events targeting women and minority audiences.
- The SEC hosted two recruitment events at Headquarters targeting diverse attorneys, accountants, and industry professionals.
    - These two events drew over a total of 700 individuals, some traveling from other metropolitan areas to learn more about opportunities with the Commission, as well as to network with SEC professionals representing diverse affinity groups, practice areas, and divisions/offices (including regional offices).
- The SEC advertised employment opportunities at conferences and in print in such magazines as the Women of Color (WOC) Magazine.
    - Three of the SEC's top women of color (an African American, Asian, and Latina) were featured in the WOC Magazine in its spring 2010 edition as the "Most Powerful Women in Finance".
    - One of these SEC leaders was honored at the 15th Women of Color STEM Conference in Dallas, Texas, in October 2010.
- In addition, the SEC participates in recruiting events each year sponsored by professional organizations, such as the National Bar Association, and educational institutions with high minority enrollment, such as Howard University School of Law.

Building Partnerships and Alliances with Professional Organizations

- The SEC uses alliances and partnerships with professional organizations to recruit a diverse pipeline of professionals and disseminate employment and financial literacy information to their members. Currently these organizations include the D.C. chapters of:
    - Association of Latino Professionals in Finance and Accounting ("ALPFA");
    - Hispanic National Bar Association;
    - National Association of Black Accountants; and
    - National Black MBAs.
- Senior level SEC officials have hosted meetings with leaders from several professional organizations with minority membership to discuss optimal means of disseminating employment opportunities with their respective membership, as well as partnership and sponsorship opportunities. Meetings with these professional associations will continue in 2011.

Events Targeting Women and Minorities

The SEC recently sponsored:

- "Women of ALPFA" event in Washington, DC, at which an SEC Assistant Regional Director presented; and
- A conference co-hosted by the American Society of Women Accountants and American Woman's Society of Certified Public Accountants in Nashville, Tennessee.

Developing a Diverse Talent Pipeline for the Future

- As part of our efforts to develop a diverse talent pipeline, the SEC is proactively developing relationships with organizations and schools that serve minority students.
    - The SEC participated in a youth leadership summit targeting college and graduate students – Latinos on Fast Track – hosted by the Hispanic Heritage Foundation in 2010. The SEC will continue to partner with the Hispanic Heritage Foundation to expand opportunities for talented youth.
    - The SEC has also commenced discussions to explore partnership opportunities with the National Association of Black Accountants and YearUp (an organization focused on providing career opportunities in Information Technology to inner-city youth).
    - On March 2, 2011, the SEC sponsored a conference targeting college and graduate students at University of Texas, San Antonio. The Deputy Director of the SEC's Office of Investor Education and Advocacy conducted presentations on saving and investing, and careers with the Commission.

- The SEC is also developing and maintaining partnerships with schools and organizations creating opportunities for minorities and women by placing them in industry internships, summer employment, and full-time positions.
    - In March 2010, the SEC co-sponsored with Catholic University School of Law a symposium focused on increasing the diversity in the securities and financial services industry and invited law school students from the Washington, DC metro area. The SEC hired at least two participants as externs.
    - SEC employees co-developed and co-taught a securities course at Howard University Law School beginning in 2008. A similar course has been offered at Florida International University (FIU) School of Law since fall 2009. The FIU Law School student with the highest grade in the course was offered an internship for this summer with our Miami Regional Office (MIRO).
    - The SEC participated in three national conventions targeting minority communities, and provided information about career opportunities with the SEC, as well as financial literacy material.
        - National Urban League National Convention in Washington, DC;

- National Council of La Raza National Conference in San Antonio, Texas; and
- Organization of Chinese Americans National Conference in Houston, TX.

Upcoming Recruitment and Outreach Events

- On April 12, 2011, the SEC will host approximately 30 high school students from Prince George's County in Maryland at its Headquarters to pique students' interest in the securities and financial services industry, and in particular, in the SEC.
- The SEC is exploring paid internship program for high school students interested in the securities/financial services industry. This program will be contingent on available funding.

Q39. On the procurement and contracting side, can you also provide us with information regarding the amount and percent of contracts that the SEC makes with small and disadvantaged business enterprises, particularly women and minority owned firms?

A39. The SEC collects standard small and disadvantaged business award information through the Federal Procurement Data System (FPDS). In FY 10, the SEC awarded an average of 32% of all contracts to Small Business; with 13% going to Woman-Owned Business, and 19% to all other categories. Of the 32% awarded to Small Business, an average of 9% was awarded to Small Disadvantaged Business (SDB). The SEC's acquisition office is currently utilizing new legislation allowing set-asides for Economically Disadvantaged Women Owned Businesses (EDWOSB's) and will continue to partner with Small, SDB, Veteran-Owned and Woman-Owned Business.

Q40. What is the SEC doing to ensure a diversity of companies can compete for any contracting opportunities that might exist?

A40. The SEC Office of Acquisitions follows the Federal Acquisition Regulations (FAR) to promote, encourage, publicize, and seek maximum competition for all procurements. The SEC uses the Federal Business Opportunities website (www.fbo.gov) when seeking full and open competition, leverages GSA's E-Buy when using FAR Part 8 Federal Supply Schedules, and has begun using a commercial application that reaches over 5,000 registered small businesses for hardware procurements. In addition, we participate in vendor outreach programs. Most recently we developed an email link (VendorOutreach@sec.gov) which will be available from www.sec.gov allowing vendors wanting to do business with the SEC the ability to reach the appropriate point of contact.

Q41. When small business subcontracting goals are developed, are the goals broken out by minority owned, women owned, veteran owned and disabled owned subcontractors or all of those categories lumped together as small businesses in meeting the goals?

A41. Given the size and budget of the SEC, the value of the contracts at the SEC rarely meets the criteria provided in the FAR requiring a subcontracting plan. The SEC utilizes GSA schedules for many of its high dollar buys and subcontracting performance is reported through schedule contracts; for those actions the SEC is not requiring separate subcontracting plans. If the Commission identifies subcontracting opportunities, the subcontracting plan would follow the established breakout of minority owned, women owned, veteran owned, and disabled owned subcontracts to enable the prime contractor to submit all subcontracting plan information to the Electronic Subcontracting Reporting System (www.esrs.gov) in accordance with the FAR.

Q42. If they are lumped together and the ultimate performance measure is not disaggregated as to the inclusion of these distinct communities, is it possible for the SEC to require that they be separately recorded and that any bonus or liquidated damages be applied to these goals separately?

A41. As previously indicated, the SEC does not utilize separate subcontracting plans for most actions at the current time; for those actions where a subcontracting plan is required, goals are identified separately in the Plan.

NEW OFFICE OF MINORITY AND WOMEN INCLUSION

Q43. As you stand up the new Office of Minority and Women Inclusion will the SEC reach out to other agencies with expertise, such as the SBA to ensure that all the agencies maximize the impact of new offices of Minority and Women Inclusion?

A43. Yes. In fact, the SEC has had preliminary discussions with two federal agencies whose mission it is to ensure equal employment opportunity vis-à-vis federal government vendors: Department of Labor's Office of Federal Contract Compliance Programs and the Equal Employment Opportunity Commission. In addition, several staff members have attended meetings with Office of Minority and Women Inclusion (OMWI) directors at other agencies and their legal and procurement staff. The SEC will continue to reach out to other agencies to obtain and provide necessary expertise, as appropriate.

Q44. Will the SEC have a role in influencing best practices for how regulated financial services sector companies do more to ensure fair and equal opportunities for Minorities and women?

A44. The SEC expects to have such a role and impact within in the scope of Section 342 (b)(2)(C) of the Dodd Frank Act, which provides that the SEC's OMWI director shall develop standards for "assessing the diversity policies and practices of entities regulated by the agency."

THURSDAY, FEBRUARY 10, 2011.

SECURITIES AND EXCHANGE COMMISSION

WITNESS

H. DAVID KOTZ, INSPECTOR GENERAL, SECURITIES AND EXCHANGE COMMISSION

CHAIRWOMAN EMERSON'S OPENING STATEMENT

Mrs. EMERSON. Okay, we'll go ahead and get started. I want to thank you very much, Inspector General Kotz, for coming today. This is the first hearing for the Financial Services and General Government Subcommittee of the 112th Congress. I'm really very honored to have been selected to be chairwoman of this important Subcommittee. The Subcommittee has many new members this year on both sides of the aisle. Mr. Diaz-Balart from Florida is here, and I guess the others will be coming along because we probably have several committee meetings that are scheduled simultaneously, as usual.

We're going to follow the five-minute rule for questions, except for Ranking Member Serrano who can take as much time as he wants as long as he's not talking about the Yankees. We just have this running argument about the St. Louis Cardinals and the New York Yankees and——

Mr. SERRANO. I just want to know that the——

Mrs. EMERSON [continuing]. I guess we're going to get the Florida teams involved here too.

Mr. SERRANO. I just want to know if the Republican cuts will affect Pujols' contract. [Laughter.]

Mrs. EMERSON. I certainly hope not. I'm a little worried about the Pujol's contract, but I'm assured that it's all going to work out, Joe, so keep your fingers crossed. Although you all can afford him and I'm not sure that we can, but we're going to have to make do.

For everybody else, we'll go on the five-minute rule although, quite frankly, I'm not going to cut off anybody in mid-sentence. We'll also recognize members in order of seniority based on who's present at the beginning of the hearing, going back and forth between the parties. For latecomers, you'll be recognized in the order that you arrive.

Joe, you did a great job in the last Congress of being very understanding of all of the concerns that my side of the aisle had and obviously we will do the same of yours. We know that we're going to disagree on many issues, but I also believe it's very important for us to hear each other and really understand where everybody's coming from.

We have a very difficult challenge in front of us. The federal government's debt is almost $14 trillion and we have to begin living within our means. The Appropriations Committee has been tasked

with reducing spending to the fiscal year 2008 level and this will require a 17 percent reduction in spending from fiscal year 2010 for this Subcommittee. It's not going to be easy. It's going to require incredibly tough choices, but I'm committed to holding as many hearings as we possibly can about the operations of agencies under our jurisdiction to find ways to make reductions to low priority, ineffective, and duplicative programs.

The budget request for fiscal year 2012 will be submitted next week, but we wanted to get to work so we are beginning this hearing season by meeting some inspectors general. Quite frankly, we can learn an awful lot from you all, and I am very pleased that you're here today. Part of the reason is that, all inspectors general are a great check on our government agencies and the fact that you're able to find efficiencies within agencies is quite critical. We're looking to you all, especially this year, to really help us identify ways to reduce spending, and particularly spending which we would consider wasteful.

Our Subcommittee has jurisdiction over a diverse group of agencies, many of which have a profound impact on Americans' lives and the financial stability of our economy. The SEC in particular has the unique task of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, while at the same time not over-regulating our markets and hindering economic recovery. Since 2001, Congress has provided the SEC with additional regulatory tools and has more than doubled the SEC's annual appropriation. That is a very short time period in which the SEC's budget has been doubled. It's difficult to understand how the SEC was not better positioned to deal with the economic turmoil of the last few years, and how the SEC allowed the Madoff and Stanford Ponzi schemes to continue for many years when they had complaints registered about these two entities over a decade before the individuals were charged.

In addition, the SEC has been cited by GAO for inaccuracies in its financial reporting almost every year since it began producing audited financial statements in 2004. This is especially troubling as certainly the SEC would not tolerate a company with possible material inaccuracies in their financial statements for seven years. This past year, the SEC has also been cited by you, Mr. Kotz, for lacking clear leasing practice guidelines as well as waste and inefficiencies in their procurement and contracting costs. I really am encouraged that your office is looking into these issues and working with the SEC to correct the problems in a timely manner.

Both the IGs and Congress should be watchdogs for taxpayer money. We should be actively looking for improvements and efficiencies in order to ensure that taxpayer money is being effectively utilized. I look forward to our Subcommittee members' contributions and I'd like to remind members again of the five-minute rule for questions. Now let me recognize my good friend from New York, Mr. Serrano, for any opening statements you'd like to make.

MR. SERRANO'S OPENING STATEMENT

Mr. SERRANO. Thank you, Chairwoman Emerson, and congratulations. As I said to Chairman Wolf yesterday in the Commerce, Justice Subcommittee, to tell you that I'm glad to see your side in

the majority would be a lie. But to tell you that if I had choices of who—which Republicans should head Subcommittees, I felt that way about Mr. Wolf and I certainly feel that way about you, that you're the best person to lead this Subcommittee when I'm not leading it.

And the relationship we have—which, you know, the public, it's sad in a way, doesn't understand, doesn't understand that we as Members of Congress have relationships that go beyond the political stances we have to take. And what I always tell people back in my district when they tell me, "Well, that person from that place," I say, "You know, whether it's in front on an American Legion Hall, whether it's in front—during a parade for veterans, whether it's at the Puerto Rican parade in New York,—we all get here the same way, by begging somebody to vote for us and then getting insulted right after they vote for us." [Laughter.]

Mr. SERRANO. So we understand that. And I want to thank you for your support in the past for the kind of work that we've done. And I look forward to working with you again. Now, I read this morning that unfortunately you broke your arm and you can't do a lot of things for yourself, so I'm volunteering to, within House rules, to vote for you on the House floor.

If you can't put the card in, I know how to vote "no" all the time now. I'm learning to do that——

Mrs. EMERSON. I thought you might be offering to wash my hair and save me some money every day.

Mr. SERRANO. My people will call your people. [Laughter.]

It has been a pleasure to work with you on this Subcommittee for so long. Although our roles are now switched, I'm hopeful that we can continue to work in a bipartisan fashion on the many important issues under this Subcommittee's jurisdiction. I'd also like to take a moment to join with Chairwoman Emerson in welcoming new members from both sides of the aisle to this Subcommittee. There are a lot of important decisions to be made over the next couple of years and I believe that this Subcommittee has a significant role to play. I would like to join Chairwoman Emerson also in welcoming the Inspector General to the hearing in Financial Services today. You have an important role in conducting oversight of the Securities and Exchange Commission. I'm looking forward to hearing your testimony today and learning more about your work and ongoing investigations.

With the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC has a critical role to play in the successful implementation. The new powers given to the Commission are vital in preventing another financial meltdown. We must make sure that the SEC receives the robust funding that it needs in order to undertake these new responsibilities. I know that as Inspector General, you will be monitoring this important implementation. So again, thank you, Chairwoman Emerson, and welcome to you.

And I must say, Madam Chair, that it's ironic in a way that we are facing the cuts we are because you remember how much you and I fought to make sure that whatever came out of Dodd-Frank would be in this Subcommittee. There was talk whether—what committee it would go to. So now we have this implementation in

our Subcommittee and we have to make sure that it survives. And lastly, just in sort of saying goodbye officially to my chairmanship and welcoming yours, I hope that it survives, and I hope that as we work through these very important and serious cuts, that we keep three things in mind. One, that we created a lot of programs that help the consumer. And if you notice in the bills that you and I passed in the last four years, or tried to pass, all the bills speak in the prefacing comments about consumerism. Whether it's the product safety commission or whether it's investors—that the SEC has to protect consumers.

Secondly, and very personal to me, we were very fair to the territories, to Puerto Rico, to Guam, Samoa, and all those American citizens who live in territories. And I hope that that continues.

And lastly, for me again very personal, but for this committee and I know for you too, we did a lot of good things, a lot of good things in bringing dignity and giving the respect that the people that live in the District of Columbia deserve. I know that there are some folks who would like to bring back old issues, social issues that deal only with the District of Columbia. I hope that's not the case. I hope we realize that all American citizens should be treated equally, and while there are some constitutional requirements on our part in dealing with the District, that we don't have to make that hurtful or mean in our approach. And I know that's not who you are, and I know that your only pain in life, as you continue to think the Cardinals will win a World Series sometime soon—which is not going to happen—but other than that, I welcome your chairmanship and I stand ready to support you.

Mrs. EMERSON. Thank you so much, Joe, and perhaps we should make a bet on the World Series after the hearing is over. Thank you for your very kind comments and very thoughtful comments. Let me take a moment to welcome Ms. Lee from California, Mr. Womack from Arkansas, and Mr. Alexander from Louisiana; and I already acknowledged Mr. Diaz-Balart from Florida. I thank you all so much for being here. And Mr. Bonner from Alabama, thank you. Inspector General Kotz I'd appreciate it if you keep your statement to five minutes so we can maximize the opportunities to ask questions. Thank you so much.

INSPECTOR GENERAL KOTZ' TESTIMONY

Mr. KOTZ. Thank you for the opportunity to testify before this Subcommittee with respect to the Securities and Exchange Commission. In my testimony, I am representing the Office of the Inspector General, and the views that I express are those of my office and do not necessarily reflect the views of the Commission or any Commissioners. I'd like to begin my remarks by briefly discussing the role of my office and the oversight efforts we have undertaken during the past few years.

The Office of Inspector General is an independent office within the SEC that conducts audits of programs and operations of the Commission, and investigations into allegations of misconduct by agency staff or contractors. The OIG does not make policy decisions for the SEC, or substantive determinations regarding the commission's program, functions, or budgetary process. Rather, the OIG's mission is to promote the integrity, efficiency, and effectiveness of

the programs and operations of the SEC, and to report its findings and recommendations to the agency and to Congress.

Since my appointment as Inspector General of the SEC in December 2007, our investigations unit has conducted numerous, comprehensive investigations into significant failures of the SEC in accomplishing its regulatory mission, as well as investigations into allegations of violations of statues, rules, and regulations, and other misconduct by commission employees and contractors. In August 2009, we issued a 457-page report of investigation analyzing the reasons why the SEC failed to uncover Bernard Madoff's $50 billion Ponzi scheme. This report was issued after a nine-month investigation in which we conducted 140 interviews and reviewed approximately 3.7 million e-mails.

In March 2010, we issued a thorough and comprehensive report of investigation regarding the history of the SEC's examinations and investigations of Robert Allen Stanford's alleged $8 billion Ponzi scheme.

More recently, we issued reports on the circumstances surrounding the SEC's proposed settlements with Bank of America, and allegations of improper coordination between the SEC and other governmental entities concerning the SEC's enforcement action against Goldman Sachs.

The office's audit unit has also issued numerous reports involving matters critical to SEC programs and operations in the investing public. These have included, just to name a few, an examination of the commission's oversight of Bear Stearns and the factors that led to its collapse, a review of the SEC bounty program for whistle-blowers, and an analysis of the SEC's oversight of credit-rating agencies and an audit of the SEC's real property and leasing procurement process.

In addition, following the investigative report related to the Madoff Ponzi scheme, we performed three comprehensive reviews providing the SEC with 69 specific and concrete recommendations to improve the operations of both its enforcement and examination functions. Over the past three years, many of our efforts have been directed at identifying waste or misuse of government funds by the SEC. The two largest areas in which we have found significant waste and inefficiencies have been in procurement and contracting, and costs relating to real property leasing and office moves. In the procurement and contracting area, we've identified numerous deficiencies in the management and oversight of the SEC's contracts: A lack of written internal policies and procedures for administering contracts, a failure to maintain accurate records and data regarding contracts, and improprieties in the selection of vendors and the awarding of contracts. These failures led to the cancellation of contracts and the expenditure of funds to re-procure required services.

In addition, numerous OIG investigations, audits, and reviews have revealed excessive costs and inefficiencies in the SEC's leasing of real property and the relocation of staff offices. We found situations in which the SEC made excessive payments that could have been avoided if appropriate policies and procedures had existed and been followed. We also found that SEC management approved a project to reconfigure internal office space at a significant monetary cost, without performing any cost-benefit analysis of the

project prior to its undertaking. In the instances that I've described in which our office found wasteful expenditures and inefficiencies, we have provided SEC management with detailed descriptions of our findings, as well as concrete and specific recommendations to alleviate the problems and concerns we identified. We have also followed up to ensure that these recommendations have been agreed to and are fully implemented. We've also made recommendations designed to increase the SEC's oversight capability and its internal controls.

In certain instances, it has been and will be necessary for the SEC to incur additional expenses to implement our recommendations. For example, after our investigative report found the SEC failed to respond appropriately to credible tips and complaints about Bernard Madoff's operations by conducting competent exams and investigations, we recommended numerous reforms to the SEC's Tips and Complaint system. The SEC has instituted a new Tip, Complaint, and Referral system in order to ensure that complaints received are acted upon in a timely and appropriate manner, at a total estimated cost of $21 million.

I believe that the SEC's mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital information is more important than ever. At the same time, the SEC has a responsibility to utilize government funds in an efficient and effective manner. The Office of the Inspector General intends to remain vigilant to ensure that scarce government resources are utilized wisely and cost-effectively, and instances of waste and abuse are eliminated. Thank you.

[The information follows:]

Written Testimony of H. David Kotz
Inspector General of the
Securities and Exchange Commission

Before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. House of Representatives

Thursday, February 10, 2011
10:00 a.m.

Introduction

Thank you for the opportunity to testify before this Subcommittee with respect to the Securities and Exchange Commission (SEC or Commission). I appreciate the interest of the members of the Subcommittee in the SEC and the Office of Inspector General (OIG). In my testimony, I am representing the OIG, and the views that I express are those of my Office, and do not necessarily reflect the views of the Commission or any Commissioners.

Role of the OIG

I would like to begin my remarks by briefly discussing the role of my Office and the oversight efforts we have undertaken during the past few years. The OIG is an independent office within the SEC that conducts audits of programs and operations of the Commission and investigations into allegations of misconduct by agency staff or contractors. The OIG, in accordance with the Inspector General Act of 1978, as amended, does not make policy decisions for the SEC and/or substantive determinations regarding the Commission's program functions or budgetary process. Rather, the OIG's mission is to promote the integrity, efficiency and effectiveness of the programs and operations of the SEC and to report its findings and recommendations to the agency and to Congress. Since my appointment as Inspector General of the SEC in December 2007, the OIG's investigative and audit units have engaged in aggressive and vigorous oversight of the SEC.

SEC OIG Investigations

The Office's investigations unit has conducted numerous comprehensive investigations into significant failures of the SEC in accomplishing its regulatory mission,

as well as investigations into allegations of violations of statutes, rules and regulations, and other misconduct by Commission employees and contractors. Several of these investigations involved senior-level Commission officials and represent matters of great concern to the Commission, Congressional officials and the general public. Where appropriate, we have reported evidence of improper conduct and made recommendations for disciplinary actions, including removal of employees from the Federal service, as well as recommendations for improvements in agency policies, procedures and practices.

Specifically, we have issued investigative reports regarding a myriad of allegations, including claims of failures by the Division of Enforcement (Enforcement) to pursue investigations vigorously or in a timely manner, improper securities trading by Commission employees, conflicts of interest by Commission staff, post-employment violations, unauthorized disclosure of non-public information, procurement violations, preferential treatment given to prominent persons, retaliatory termination, perjury and falsification of documents, failure of SEC attorneys to maintain active bar status, and the misuse of official position, government resources and official time.

In August 2009, we issued a 457-page report of investigation analyzing the reasons why the SEC failed to uncover Bernard Madoff's $50 billion Ponzi scheme. This report was issued after a nine-month investigation in which we conducted 140 interviews and reviewed approximately 3.7 million e-mails. In March 2010, we issued a thorough and comprehensive report of investigation regarding the history of the SEC's examinations and investigations of Robert Allen Stanford's alleged $8 billion Ponzi scheme. More recently, we issued reports on the circumstances surrounding the SEC's proposed settlements with Bank of America, which included an analysis of the impact of

Bank of America's status as a Troubled Asset Relief Program (TARP) recipient on the SEC's Enforcement action and settlement, and allegations of improper coordination between the SEC and other governmental entities concerning the SEC's Enforcement action against Goldman Sachs & Co.

SEC OIG Audits

The Office's audit unit has also issued numerous reports involving matters critical to SEC programs and operations and the investing public. These have included an examination of the Commission's oversight of Bear Stearns and the factors that led to its collapse, an audit of Enforcement's practices related to naked short selling complaints and referrals, a review of the SEC's bounty program for whistleblowers, an analysis of the SEC's oversight of credit rating agencies, an audit of the SEC's real property and leasing procurement process and an audit of the FedTraveler travel service. In addition, following the investigative report related to the Madoff Ponzi scheme described above, we performed three comprehensive reviews providing the SEC with 69 specific and concrete recommendations to improve the operations of both Enforcement and the SEC's Office of Compliance Inspections and Examinations (OCIE.)

SEC OIG's Identification of Waste of Government Funds

Over the past three years, many of our efforts have been directed at identifying waste or misuse of government funds by the SEC. We have issued numerous reports in which we identified waste and inefficiencies, as well as inadequate oversight on the part of various SEC components. By reviewing our audit and investigative reports issued over the past three years, we found that the two largest areas in which we have identified

significant waste and inefficiencies have been procurement and contracting and costs relating to real property leasing and office moves.

In the procurement and contracting area, we have identified numerous deficiencies in the management and oversight of contracts into which the SEC has entered, a lack of written internal policies and procedures for administering contracts and other agreements, a failure to maintain accurate records and data regarding contracts and agreements, and improprieties in the selection of vendors and the awarding of contracts. These failures have led to the cancellation of contracts and the expenditure of funds to re-procure required services.

In addition, numerous OIG investigations, audits and reviews have revealed significant excessive costs and inefficiencies in connection with the SEC's leasing of real property and the relocation of staff offices. We found numerous situations in which the SEC made excessive payments that could have been avoided if appropriate policies and procedures had existed and been followed. We also found that SEC management approved a project to re-configure internal office staff space at a significant monetary cost without performing any cost-benefit analysis of the project prior to its undertaking. An OIG survey to the Commission staff affected by the moves revealed that they were satisfied with their workplace locations prior to the project and generally felt the project was a waste of time and money.

SEC OIG's Follow-up on its Recommendations

In the instances that I described in which our Office found wasteful expenditures and inefficiencies, we have provided SEC management with detailed descriptions of our findings, as well as concrete and specific recommendations to alleviate the problems and

concerns we identified. We have also followed up to ensure that these recommendations have been agreed to and are fully implemented. We are pleased to report that the overwhelming majority of our recommendations have been implemented and, accordingly, we are confident that the situations we identified have been ameliorated and will not recur.

Funding Necessary to Implement OIG Recommendations

We have also made recommendations designed to increase the SEC's oversight capability and its internal controls. In certain instances, it has been and will be necessary for the SEC to incur additional expenses in order to implement our recommendations. For example, after our investigative report found that the SEC failed to respond appropriately to credible tips and complaints about Bernard Madoff's operations by conducting competent examinations and investigations, we made numerous recommendations designed to reform the SEC's system for handling tips and complaint system. The SEC has implemented these recommendations and instituted a new Tip, Complaint and Referral (TCR) system in order to ensure that complaints received are acted upon in a timely and appropriate manner at a total cost of approximately $21 million. Additional funding will be required to ensure that the SEC has sufficient resources to implement many of the recommendations that have arisen, and will arise, out of our audits, reviews and investigations.

Identification of Efficiencies Within SEC Operations and Functions

We are also pleased to report that senior SEC officials, particularly those within the Office of Information Technology (OIT), have informed us that they are analyzing the SEC's operations and functions to identify efficiencies and areas in which costs can be

reduced. The SEC's new Chief Information Officer has recently indicated that he plans to cancel a $2 million information technology contract that he found not to be cost-effective. We support and applaud these efforts and will continue to encourage this type of approach in the future.

Conclusion

I believe that the SEC's mission of protecting of investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, is more important than ever. As our nation's securities exchanges mature into global for-profit competitors, there is even greater need for sound market regulation. At the same time, the SEC has a responsibility to utilize government funds in an efficient and effective manner. The OIG intends to remain vigilant to ensure that scarce government resources are utilized wisely and cost-effectively and instances of waste and abuse are eliminated.

I appreciate the interest of the Subcommittee in the SEC and my Office. I believe that the Subcommittee's and Congress's continued involvement with the SEC is helpful to strengthen the accountability and effectiveness of the Commission. Thank you.

H. David Kotz, Inspector General
U.S. Securities and Exchange Commission

H. David Kotz has served as the Inspector General for the Securities and Exchange Commission (SEC) since December 2007. He leads a distinguished team of auditors, investigators, and administrative staff in the Office of Inspector General's efforts to uphold the effectiveness, efficiency, and integrity of the SEC.

Under Mr. Kotz's leadership, the SEC Office of Inspector General has issued numerous audit reports involving issues critical to SEC operations and the investing public, including an audit of practices related to naked short selling complaints and referrals, a review of the Division of Enforcement's (Enforcement's) process for recommending disgorgement waivers, an examination of the Commission's oversight of Bear Stearns and the factors that led to its collapse, a review of the Commission's broker-dealer risk assessment program, and additional analyses of the Regulation D exemption process, the Self-Regulatory Organization (SRO) rule filing process, and Enforcement's oversight of receivers and its case-management system.

Mr. Kotz has also led SEC Office of Inspector General's investigative unit in issuing reports of investigation relating to claims of improper preferential treatment given to prominent persons, retaliatory termination, Enforcement's failures to pursue investigations vigorously or in a timely manner, inappropriate trading by Enforcement attorneys, perjury by supervisory Commission attorneys, misrepresentation of professional credentials, falsification of personnel forms, the unauthorized disclosure of non-public information related to an Enforcement investigation, and the misuse of official position, government resources and official time. Mr. Kotz is currently leading an ongoing investigation into complaints received by the SEC regarding Bernard Madoff and affiliated entities.

Prior to joining the SEC, Mr. Kotz served as the Inspector General for the Peace Corps. In that capacity, Mr. Kotz was responsible for overseeing the internal operations of Peace Corps programs in Washington, D.C., at 11 regional offices, and in nearly 70 countries around the world. Before being named Inspector General for the Peace Corps, Mr. Kotz served for over three years as Associate General Counsel for Litigation for the Peace Corps and was responsible for overseeing all agency litigation, including administrative and Federal court proceedings, labor arbitrations and employee grievances.

Mr. Kotz is a graduate of the University of Maryland, completing a Bachelor's of Arts degree in political science with the honors of cum laude and Phi Beta Kappa. After graduating from the Cornell Law School, he worked for nearly 10 years for the international law firms of Graham & James in New York City and Pepper Hamilton LLP in Washington, D.C, practicing Federal administrative law. While working in private practice, Mr. Kotz successfully represented and advised numerous Fortune 500 companies and major Universities. He joined the Federal government in May of 1999, and worked in several capacities at the U.S. Agency for International Development (USAID), both in the Office of General Counsel and as head of all administrative and disciplinary investigations for USAID.

Mrs. EMERSON. Thank you Mr. Kotz. I'll start the questions, but let me just ask you—I've got four quick ones that I want to ask, and then I'll turn it over to Mr. Serrano—when you say that you're recommending an expenditure of $21 million to update the Tips and Complaints Department, what does that entail?

Mr. KOTZ. Well we didn't recommend that particular expenditure. What we said was The Tip, Complaint, and Referral system at the SEC doesn't work. You know, Harry Markopolos and others came forward with tips about Bernie Madoff, the tips were not reviewed appropriately, competent exams and investigations weren't done. And so the SEC put in a new system, a computerized system that involves ensuring that all different offices within the SEC are advised of the tips, that there's appropriate triage of the tips, that they're followed up appropriately. And so the SEC decided to put in a new system, in response to our recommendation, and they informed me that the system cost $21 million.

Mrs. EMERSON. So $21 million includes the computer system itself and the people to run the system?

Mr. KOTZ. I believe it's all-inclusive, yes. I believe the total cost of putting the system in and having the appropriate manpower—You know, one of the issues is, obviously the SEC gets a tremendous number of complaints.

Mrs. EMERSON. Right.

Mr. KOTZ. They have to weed through the complaints to make sure that they don't miss any that are significant. So they need significant manpower to be able to do that. So I believe, and this is what I've been advised, is that that's the total cost.

Mrs. EMERSON. So, you make the recommendation, they go ahead and follow through and put in place a better system, and then do you come back to see that in fact, yes, this new system they've put in place would in fact work, should another situation like Madoff or Stanford happens?

Mr. KOTZ. Right, yeah. Certainly. I mean, we initially make sure that they actually put in a system, that the system in finalized and up and running. But yes, I believe that our office needs to go back once all the improvements have been put in, particularly with respect to Madoff and Stanford, and test it to ensure that it works. I mean, we don't want systems put in that sound good on paper but don't actually make a difference. So we will go back and look into these systems and make sure that they will actually put the SEC in a better position to catch frauds that have occurred.

Mrs. EMERSON. So in fact, this system, is it complete?

Mr. KOTZ. I think it's nearly complete.

Mrs. EMERSON. Okay. I would appreciate it if you would come back to us and let us know what your review shows.

Mr. KOTZ. Sure. I mean, we have to give, obviously, a significant time for the system to be up and running in order to review it, but yeah. Absolutely. We definitely intend to look back on all these improvements, because again, you can put new policies in, you can put new systems in. We have to make sure that it makes a difference.

Mrs. EMERSON. Indeed. Especially for $21 million, which you know, in the whole scheme of things may not sound like a lot of

money but in fact, you add $21 million up a few times and then you're talking about real money.

Mr. KOTZ. Twenty-one million dollars for me is a lot of money.

Mrs. EMERSON. Believe me, for me it's a lot of money, too. That speaks to the whole issue of really taking seriously our commitment to reduce spending. While the SEC's appropriation is offset by collections, we still need to look at all agencies in an effort to reduce funding for ineffective programs, no matter what their funding sources are. My concern is that we have doubled the SEC's budget over the last nine years, and yet at the same time we've had Madoff, we've had Stanford, we've had numerous other issues. There is skepticism among my colleagues that the SEC can effectively do its job, in spite of what you say that they followed through on some of your recommendations. Can you tell us, I'm going to ask these four questions in order——

Mr. KOTZ. Great.

Mrs. EMERSON. Number one: how would a reduction of the SEC's appropriation to fiscal year 2008 levels affect the SEC? Do you believe, based on all of the internal investigations that you've done, that taxpayer dollars are being used effectively or spent effectively? What can you do or what are you doing proactively to identify inefficiencies within the SEC budget itself? What recommendations might you offer for more efficient and effective use of taxpayer money for the SEC?

Mr. KOTZ. Okay, sure. In terms of reduction and appropriations to fiscal year 2008, obviously I can't speak for the entire SEC; I've not done a full analysis of how the budget would affect the SEC as a whole. Certainly, they tell me that if we went back to 2008 levels, it would require a significant reduction in force, possibly over 600 people. And I think I would have some concerns about the SEC losing 600 people in terms of being able to do the work they did. You know, in terms of efficiencies, one of the things we do is look for areas where there are inefficiencies. And so I certainly can't say that every penny spent is being spent in an efficient way. In fact, we've identified areas in which it's been inefficient, as I indicated. In the procurement area we've identified inefficiencies; we've identified inefficiencies in leasing area, and proactively, what we do is we look carefully at the areas where historically there have been problems. And so we'll go back, I mean we have offices and divisions who say "Why are you auditing us again?" and we say "We're auditing you again because we had a lot of problems the last time we audited you." And so we are very aggressive and very vigilant in looking into the programs that have historically had problems. We do what we can to ensure that there are efficiencies.

Look, the SEC's made a lot of mistakes, we've chronicled many of those mistakes, you know, in painstaking fashion, particularly with Madoff and Stanford and others. But I believe that the SEC is on the road to making improvements. I believe the SEC understands the importance of fixing the problems that they have, and I believe that they are working to do that. Our job is to ensure that it's reality, that it's not just a paper record. So I mean I don't know that I'm in a position, particularly, to make recommendations in terms of overall SEC. But you know our office is very aggressive and vigilant in looking at the SEC carefully. And anywhere we find

any waste or inefficiencies, we point them out and we're very aggressive about ensuring that the SEC responds to our recommendations and does the appropriate thing. And I can tell you that Chairman Shapiro has been very good about assisting in that process. If I ever have a situation where I feel an office or division isn't being responsive enough, and we require a lot of responsiveness to our recommendations and we take them very seriously, her office is very helpful in ensuring that things are done the right way.

Mrs. EMERSON. I appreciate hearing that. One quick follow-up. You've been told that if the SEC was to go back to 2008 funding levels, that it would result in a loss of 600 people. The question is are the people who are currently working within the SEC doing the right jobs? Hypothetically, if you lose 600 people, are there other people within the organization itself who perhaps should be doing something differently than they are today? Do you all look at that sort of thing?

Mr. KOTZ. From time to time in a particular office. We wouldn't do sort of a global view of that. You know, I don't know, I can't speak sort of for the SEC overall. Certainly, where we feel that people are not working hard, or they're engaging in inappropriate conduct, we'll recommend they be terminated. We have done that many times in my three years at the SEC, and many people have been terminated as a result of our investigations. So you know, certainly the ones we're aware of, we take action. Could I tell you that there is no one there who couldn't be in a different job? I couldn't.

Mrs. EMERSON. Some of the people who were involved in the Madoff scheme are still working there, is that not correct?

Mr. KOTZ. Many of the people who were involved in the Madoff scheme are gone. Some are still working there, but there is disciplinary action going on with respect to many of the folks who were involved in the Madoff matter.

Mrs. EMERSON. Okay, thanks. Mr. Serrano.

Mr. SERRANO. Thank you. Just a follow-up. I don't want to spend too much time on this, but you say that you're probably not equipped to, or prepared to tell us how cuts would hurt the agency—because that's the inner workings of the agencies. But you do know waste when you see it.

Mr. KOTZ. Right.

Mr. SERRANO. So, if you see waste, don't you also see when the budget gets too low to perform their duties? Doesn't that play——

Mr. KOTZ. Yeah, I mean, I would say so. I mean, as I said, I think that significant cuts or furloughs, 600 or more people, I think would have an impact. I don't think that there are 600 people in the SEC who are not providing value, and so I would say that that would have an impact on the SEC's operations. As I said in my oral testimony, many of our recommendations require that people do additional things. So I'm in a position where I'm recommending that action be taken to redress something. You know, I don't want there to be a situation where they say, "We'd like to redress it but we can't because we have budget cuts," or "We can't because we don't have the people anymore to do it," or "We don't have the funds to put in a system," so that is certainly a concern.

Mr. SERRANO. We would hope that the SEC has changed since the financial crisis started and the Ponzi schemes were discovered,

and I believe they've changed, but for the record just say we hope they've changed. Question is, How has your office changed because of what's happened? How have you had to adjust? Have you had to look at things differently? Have you had to allocate your staff differently? When do you go after an investigation, you know, how do you determine which one to go after?

Mr. KOTZ. Yeah, well I think we've become even more vigilant and frankly more skeptical of things that happen. And so, you know, whenever there's a request, we look at it. We look at all of them. I mean, we certainly don't want to be caught in a situation where there's a complaint that comes in that we haven't reviewed carefully, so we review all the complaints. And you know, we have had more people added to our staff, we have a very small staff as it is. We have 18 full-time employees at the moment. We did the Madoff investigation with four investigators. And so there have been need—we've gotten a lot more complaints in since the Madoff and Stanford scandals, and so we've had to address them. But frankly, I'm certainly very skeptical and suspicious, and if I see a complaint that comes in that alleges that something was missed, then we look at it very carefully to see if it was missed. Because there was a track record where important matters were missed, and so we have to look at them. I feel that I have to stay on my toes; I have to be very vigilant. We investigate everything thoroughly, and sometimes it turns out that the SEC did nothing wrong, but we have to take everything very seriously.

Mr. SERRANO. Are you at liberty to tell us without, obviously, getting specific or giving us information we don't need to know in public, where the complaints come from? I mean, who gives you these tips to follow in addition to whatever you uncover yourself?

Mr. KOTZ. We have some tips from inside, inside the SEC, employees coming forward in making claims, but the majority of the tips come from the outside, from investors, from folks who are either under investigation by the SEC or somehow affected by what the SEC does, and so I think that's the lion's share of them, is folks from the outside, investors who come in and say, "This was done wrong."

Mr. SERRANO. Thank you. Getting back to the Dodd-Frank legislation which created more responsibilities and oversight responsibilities for the SEC, again, talking about staffing, do you feel, or do you have information that can tell us, whether in fact the SEC is equipped, staff-wise, now to handle these new responsibilities?

Mr. KOTZ. Again——

Mr. SERRANO. And by the way, I understand that friendly or unfriendly agency; all agencies always want more staff.

Mr. KOTZ. Right.

Mr. SERRANO. I only remember once, and it was an issue that I kept bringing up, and it was the SEC. In the prior administration, they were the only agency that came before us, and said that "We don't need any more money." That should have been a sign that something was wrong, because every agency wants more staff——

Mr. KOTZ. Right.

Mr. SERRANO. They didn't want anymore, and obviously it was a problem, because they needed more. So do you think they're equipped to handle what they have to handle, assuming it goes for-

ward, because, you know, there are some folks who would like no oversight of Wall Street.

Mr. KOTZ. Right, I mean I know that there are a lot of responsibilities associated with Dodd-Frank. Our office even has one relatively small responsibility, but we have a responsibility involving an OIG employee suggestion program. And I do think that at the moment what the SEC is doing is they're using other folks who were working on other matters to handle Dodd-Frank matters, because I don't think that they've been able to do any significant hiring for Dodd-Frank, so, you know, while I haven't done an analysis, per se, of the effect of Dodd-Frank on the SEC, I would certainly venture to say that it would be difficult to implement many of those responsibilities if there were cuts, and if they didn't have sufficient funds to do it.

Mr. SERRANO. One last question. The President's budget proposal for the SEC. Did you feel that, for what you may know about the President's budget proposal, that there are areas that are vulnerable at the SEC under that budget?

Mr. KOTZ. Yeah, I mean that, I have not really analyzed, you know, the particular budget proposals; I'm not really involved in that process, you know, so I don't know that I could really give an educated opinion on what the impact would be. But I do know that there are new responsibilities, I do know that there are many times where our office will recommend things that require additional funds. I can tell you that, you know, we will certainly be very watchful to ensure that if additional money comes to the SEC, that it's used wisely and efficiently. But I'm not sure I could give an educated opinion on, you know, one particular budget versus another.

Mr. SERRANO. Thank you.

Mrs. EMERSON. Thanks, Mr. Serrano. Mr. Womack.

Mr. WOMACK. Thank you, Mr. Inspector General, thank you, Madam Chairman. I appreciate the testimony today. I've only got a couple of questions. Having spent 30 years in uniform, having been the subject of a number of Inspector General visits in my various military units, I recognize very quickly that troops, as it were, in this case the SEC, typically work on the things that they know the Inspector General is going to check, and so I have a couple of questions, reference your oral testimony about particularly the TCR, and the fact that, if I heard you correctly, the recommendation or the investment was about $21 million.

And I want to know—I want to be confident that we haven't created a $21 million paper tiger. Because on one hand, in your testimony you talk about the tips, and what later turned out to be credible evidence of problems, Madoff, Stanford, et cetera, were not followed up on, not taken seriously, something happened, there was a disconnect somewhere, and you are confident that the implementation of the TCR is going to fix those problems. What systems do you have in place from your office to check, to ensure, that those are happening, i.e., have we performed any test cases, have we engaged the system that is in place to ensure that there is a tracking program established to ensure that information that comes into the system is triaged and accurately determined to be credible or not credible?

Mr. KOTZ. Well I'm certainly hopeful that the system works, I don't know that I'm entirely confident, as you are, that the new system will work, and I couldn't——

Mr. WOMACK. I didn't say I was confident. I want to be confident.

Mr. KOTZ [continuing]. As you were saying, I'm not sure I'm that confident either. I agree, certainly, with what you're saying, sometimes it's easy to put in a computer system, to make IT changes as a way to solve all problems. And you know, I've seen many times, both as Inspector General of the SEC and another job as Inspector General, that sometimes the easiest solution is to say, "Oh, we'll just put a new computerized system in, that'll solve all the problems." And it sometimes is a paper tiger, and it doesn't necessarily work. So, as I indicated, once the system is put in fully, begins to work, there is sufficient time to be able to audit it, we will go back in and test it, because we need to ensure that there has been real change, not just a system put into place in which the individuals involved will do the same thing that they did before, which was not follow up appropriately. So I agree, and we will absolutely look carefully at this system, it's a significant expense, to ensure that it provides real change and isn't just a paper tiger.

Mr. WOMACK. Do you have a certain timeframe, a certain date circled on the calendar, when you, as the Inspector General, have to be confident and certain that the systems that you have recommended are fully implemented, are working, because I think you said in your oral testimony that you think that the systems are pretty well operational.

Mr. KOTZ. Six months after it's fully implemented is the time period that we usually look at in order to conduct some kind of test or audit. You have to give it enough time to ensure that there's something to look at. But at the same time, you don't want to give it too much time, because if it's not working you want to get to it. So as a rule of thumb, we look at six months from the time it's fully implemented.

Mr. WOMACK. Thank you very much.

Mrs. EMERSON. Let me ask a follow-up to his question, I probably shouldn't do this because it's Ms. Lee's turn, but: if we put a new computer system in place that's going to cost $21 million, and we're hopeful that it's going to work, how would that, then, have caught the fact that the Fort Worth SEC employee shoved all the Stanford stuff aside for so many years? How does the computer system supersede any person like that?

Mr. KOTZ. Right. What happened in the Fort Worth situation was there were examiners in the Fort Worth office who believed that Allen Stanford was running a Ponzi scheme. They were trying to get the enforcement part of the Fort Worth office to take action, and the Enforcement Division would not take action over a series of years, and the examiners watched the alleged Ponzi scheme grow and grow over time, and couldn't get action. One of the new improvements in the system is to allow the examiners to have access to other folks, so the information the examiners put into the system then goes not just to the folks in the Enforcement Division in Fort Worth who were unwilling to go forward at that time, but to folks in Washington, folks other places where if somebody else looked at it, I think it's reasonable to believe that if others, other

than the folks who were in place in Enforcement in Fort Worth, had read those exam reports, and had been aware of the significant findings, that they would have forced action to be taken.

Mrs. EMERSON. Okay, I appreciate that clarification. Ms. Lee?

Ms. LEE. Thank you very much, thank you for your testimony and your service during these very challenging times. We congratulate Chairwoman Emerson again, and I want to associate myself with the remarks of our Ranking Member and, I mean our minority member, I said a Ranking Minority Member, and I want to just, say to you we look forward to our continuing work together. This has been a Subcommittee that has been very bipartisan in our work, and of course our goal is to make sure that the mission of the SEC and the other agencies are really serving the people of this country, so, congratulations again. And also, to you Mr. Kotz, let me just thank you for the thorough investigations that you have conducted, and say that I think that has restored some confidence in the SEC's enforcement mechanisms. And I want to make sure, though, that the budgets that we look at allow you to continue with our efforts, and would be very reluctant to support any budget cuts; of course I know we're going to have to deal with that. But I think the SEC really is on the right track now. And so, thank you very much.

I know out of the Dodd-Frank Bill. The Congressional Black Caucus members on the Financial Services Committee made sure that each of our agencies had the Office of Minority Inclusion as part of their new mission. Could you kind of tell me, or do you know where that is, in terms of the SEC now?

Also, in addition to that, I always want to know what the diversity numbers look like in all of these agencies as it relates to professional staff, as well as the types of—if you contract out any of your services, the contracts' amount, and to whom. I mean, do you contract with small and disadvantaged businesses, if so, how much? And what are you doing to ensure that the recruitment and training of the SEC goes into historically black colleges and universities to ensure a diverse staff?

Mr. KOTZ. Okay. We have not done an overview, per se, of the new office with respect to Dodd-Frank. I am aware of the office, I couldn't tell you right now what the status is because that isn't something that we've looked at. A lot of these new offices under Dodd-Frank are in the process of being implemented so it would be premature for us to look at. You know, certainly I can speak with respect to my office.

My office takes diversity matters very, very seriously. We have a very high percentage of employees in our office from minorities, and women as well. When we do contract out, our office we generally contract out with smaller entities, we have, you know, generally smaller projects as well. So it isn't an analysis that I have done overall in the SEC, and I think that others, the Chairman and others, could speak to that. I am aware that this new office was placed in under Dodd-Frank, I am aware that there is an effort to staff it up, but I couldn't tell you the exact stats.

Ms. LEE. Okay, well I guess, would your office, then, if it's possible to get sort of a report or breakdown of your staffing patterns

and the contracting patterns, you know, the type of businesses by ethnicity, gender, you know the standard reporting.

Mr. KOTZ. Sure.

Ms. LEE. I'd like to see that.

Mr. KOTZ. Sure, absolutely I can get that to you.

Ms. LEE. Okay. And also let me just ask you in the implementation, who will be responsible for making sure, I mean, will yourself as IG be responsible for making sure that the implementation of the Office of Minority Inclusion is what it should be, and that it adheres to the law and the requirements, and who would oversee that?

Mr. KOTZ That's absolutely under our purview, you know, where the SEC has a requirement, we compare what they're doing to what the law requires, and if we find that there is not sufficient regard to the regulations and the separate requirements, then that would be an audit function. And so, you know, that is an office that certainly, again, once it's put in place and the SEC comes forward and says "We've done what we were supposed to do," that would be the subject of an audit for us to ensure that it's actually happening appropriately. And if it doesn't, we would report back to you that it's not.

Ms. LEE. Would we have to ask you to report back? I mean, should I ask you this question next year, or, how should we——

Mr. KOTZ. No, no, no. No, no. No, no. No, I mean, you know, again, the only proviso being we have to make sure that the SEC has an opportunity to staff it appropriately——

Ms. LEE. Right, I understand that.

Mr. KOTZ. But no, you wouldn't have to ask, it would be in our semi-annual report that we would send to Congress.

Ms. LEE. Okay, Okay. Thank you very much, thank you Madame Chairwoman.

Mrs. EMERSON. Thank you so much, Ms. Lee. Mr. Diaz-Balart?

Mr. DIAZ-BALART. Thank you very much, Madame Chairwoman. A couple questions, and fully, frankly, kind of piggybacking on what you mentioned, you asked. Jo Ann mentioned that the SEC's budget had doubled since, I guess since the Enron incident. And yet, we still had these Ponzi schemes that were, again, that had been tipped on, but no action had taken place. In the case, for example, of the Stanford Ponzi scheme, between 1997 and 2005, supposedly it grew from 250 million to 1.5 billion, and the lack of action on behalf of the investors by the SEC, as noted in your report, frankly cost a number of my constituents their entire life savings, because, again, I do have constituents that were affected by that.

So, since your report, a number of changes have taken place, and you mentioned some of them. Enforcement practices, policies, whatever. But my question is, how much confidence can we actually have that it's been taken care of, and that something like this would be caught in the future, that another Stanford Ponzi scheme would be found, and what other things does the SEC need to do? I'm going to just ask you two real quick questions, that is one.

Mr. KOTZ. Right.

Mr. DIAZ-BALART. Level of confidence that you have, or that we should have, on that. And the other one, again piggybacking on the chairwoman's question about the tips and complaints, the 21 mil-

lion dollars. When they go out and get this new system, do they first consult with the private sector as to what systems are already available for—I understand it's a unique kind of area, but there may be others that do things that are similar in the private sector that already have systems, do they have to recreate the system or were they able to look at something that already existed and kind of adopt it? That would be my other question, and thank you Madame Chairwoman.

Mr. KOTZ. Okay. Sure, as to the level of confidence, you know, you cannot guarantee that the next one won't be missed. I mean, I can tell you, I have a level of confidence with respect to the specific issues that were both in the Madoff and the Stanford situations. In other words, the mistakes, the failures that were made by the SEC and those particular issues that we have put forward recommendations to fix those; And with the recommendations being implemented, I believe those same circumstances would not occur. Now of course, you have to ensure that there isn't some other situation, because obviously you can't just deal with the particular situations. So I mean, we have to stay vigilant, we have to stay skeptical. I believe, personally, that the SEC is in a much better position than it was when I first started as Inspector General, when these scandals took place. But we need to ensure that we continue to review and look at them carefully to make sure that there isn't something else happening that we would potentially miss.

You know, with respect to this particular system, I wasn't involved, per se, in putting together that system. I will tell you that one of the recommendations we made arising out of Madoff, was more discussion with the private sector. In the Madoff case, folks in the private sector, there was sort of a whispering campaign, people knew there was something funny with Madoff's returns. I think a lot of people didn't think it was a Ponzi scheme, I think a lot of people thought it was some sort of insider trading or whatever.

But people thought there was something suspicious about it, and yet that information was not really brought to the attention of the folks in the government, and I don't think the government folks had the same suspicions. So, there's a wealth of information out there in the private sector, and that information needs to be provided to folks in the government, because they have a better, sometimes a better finger on the pulse of what's going on.

One of the things we recommended rising out of Madoff was for there to be more communication, more information brought, more incentives for folks in the private sector to bring forward that case. When we talked to folks who had suspicions about Madoff, we said, "How come you didn't bring it to the SEC's attention?" And they said, you know, "What good would it do us? What does it do for me? Why should I? Now I might get sued." You know, "My name will be involved in something, I may get sued. So there's no benefit for me, there's only a negative; why would I do that?"

And so I think that the SEC needs to create incentives to get that information in, to learn about it. These folks agreed that they would give seminars to SEC folks about how, you know, how operations particularly work. And so I think that that's something that's an excellent idea, and I encourage the SEC to do that.

Mrs. EMERSON. Mr. Serrano. Your turn.

Mr. SERRANO. That quickly?

Mrs. EMERSON. Well, unless you want me to go to Mr. Bonner first.

Mr. SERRANO. You can, Mr. Bonner.

Who under my chairmanship got the best attendance award, do you remember that?

Mrs. EMERSON. He did?

Mr. BONNER. I hope to live up to that standard, now that I am back on the Subcommittee. Thank you, Madame Chair. Mr. Kotz, you have had an impressive career.

Mr. KOTZ. Thank you.

Mr. BONNER. Working with the Peace Corps——

Mr. KOTZ. Right.

Mr. BONNER [continuing]. USAID, and now the SEC, so you probably have a better vantage point than some people do because you've had the chance to see three different government agencies, with different roles and responsibilities. But especially as the Inspector General, you've had a chance, in this instance, to see up close perhaps some things that worked well in other agencies that you were in that may—that those ideas could be brought over to the SEC.

I have a few questions that I'd like to get your comments on. And never to try to correct the Chairwoman, but by my math, the budget of the SEC has actually tripled, almost, over the last decade. It was $377 million in 2000, and by the President's budget request last year, that was 2010, was 1.1 billion, so——

Mrs. EMERSON. You are correct. I believe I said their budget has more than doubled.

Mr. BONNER. But, regardless, it's a sizable increase.

Mr. KOTZ. Right.

Mr. BONNER. And so, while I've acknowledged you've had a lot of very important roles in government. Put yourself in our shoes and help me, as a guy from Mobile, Alabama, go back home when I do a town hall meeting, and explain to my constituents, some of whom, like Congressman Diaz-Balart, have lost in the Stanford scheme especially, this is an agency that has had its budget doubled or tripled over the last decade, depending on when you start the calendar. And yet, we have been—it's the agency that was asleep at the wheel for some of the biggest failures that had direct responsibility. How could I explain to my constituents, we need to give them more money, which is what the Commissioner is actually asking for, every Commissioner is, as Mr. Serrano said, would like more—we need to give them more money, and yet they've had a triple increase over the last decade, and they were asleep at the wheel during three of the biggest, with, if you count Bear Stearns and Lehman, four of the biggest issues that we've dealt with since the Commission was created. How would I explain that to my constituents?

Mr. KOTZ. I understand, certainly, I'm a taxpayer, too.

Mr. BONNER. I know you are.

Mr. KOTZ. And, you know, the amount of money we're talking about is over a billion dollars, incredible amounts of money. The only thing I would say is that the SEC has to take action against, sometimes, very powerful, very rich, very well-funded interests.

You know, Bernard Madoff had a tremendous amount of sums available to him to fight the SEC. So I'm not sure I could give you a specific thing to explain to a taxpayer, even like myself, why more money would be given to an agency that missed so many things. At the same time, I think it's worth noting that in order to keep up with the fraudsters, in order to ensure that there is compliance, the amount of money that those folks spend dwarfs anything the SEC could get, whether under the previous budget or under these budgets. You know it's a very difficult mission, I think, the SEC has, in order to stay ahead of what's going on in certain places in the private sector, and they need sort of the tools to be able to deal with the Madoffs and the Stanfords. And I don't think it's only a matter of money. And let me say this, the idea that they would solve the problem of Madoff by putting in a $21 million system, that's not going solve it; it's not just about more money to solve all problems. I think there needs to be, and you know, we're ensuring that there are significant changes in how about they go about doing their work, not just sort of, write a check, and now you have a new system and everything's fine. But I think it is important to realize what they're up against, and they are up against some very heavily-funded entities.

Mr. BONNER. Let's go back to a comment you made earlier in response to a previous question, because I want to understand this. At the Fort Worth office, there were employees of the Securities and Exchange Commission who were suspicious, but they were not able to get anyone else in that office to be interested in it, and they didn't have any other avenue; there was a firewall where they couldn't call someone in another office, perhaps in Washington or New York, and say, "Hey, we've got a problem here, no one is answering the phone, the building's on fire, but we can't get anyone to respond to us."

Mr. KOTZ. Yeah, I mean, they didn't utilize it. They certainly could have, and we asked them how come they didn't. You know, sometimes you don't want to go over people's heads, sometimes there's an effect if you do that. I mean, certainly there was a director of enforcement in Washington that could've been gone to. I think the new system tries to make it easier for that to happen so it isn't dependent on a particular individual. I mean, maybe that is a failure even of the individuals who were suspicious, and found evidence of the Ponzi scheme, that they should have pushed it even further and gone above their heads to the head of the Enforcement Division, and then to the Chairman, and then to Congress, if they needed to, to ensure that something was being done.

Mr. BONNER. The new tips and complaints system is $21 million. The New York Times article on February 2, it actually cites that, in one of your reports, that you identify that there was more than $15 million in office space leased in Manhattan. I don't think that's in my friends' district. I think the gentleman is from the Bronx, is that correct?

I wanted to make sure I drew that distinction. But $15 million for space in Manhattan, where no SEC employees worked for five years?

Mr. KOTZ. Yeah, yeah that's outrageous.

Mr. BONNER. What are some other examples that you might share with us? Because, again, we're in a pickle. We're trying to dig out of a fourteen and a half trillion dollar hole that we're in.

Mr. KOTZ. Right.

Mr. BONNER. And the last thing any member of this committee, Democrat, Republican, left coast, west coast, south coast, wants to do is to cripple an agency that has a very vital role, but, boy, that's a lot of money that someone lit a match to.

Mr. KOTZ. Right. No, there are other examples, particularly in the office and leasing area. We looked at a case involving the San Francisco lease where the SEC sort of delayed in making a decision on what action to take, ended up paying a holdover rate that was significantly higher than market rate. There was a situation not too long ago where the agency decided to conduct a re-stacking, move 1,700 employees to different places in the office so they would be more efficient and more productive. We did a survey, that folks in the SEC said mostly they communicate by e-mail and phone anyway, so they don't necessarily think that moving them to a different spot is going to make any difference. They believed it was a waste of money. We found there was no cost-benefit analysis done to ensure that it was appropriate before it was done. You know, we were very harsh in our report on that. There have been some areas in procurement and contracting where contracts have been mismanaged, where the invoices haven't been carefully scrutinized to ensure that the government's not getting ripped off. Sometimes you have situations where you have an initial contract come in at a relatively low rate, and so that entity gets the bid, but then there are so many modifications that go forward that it ends up being much higher than originally. So, you know, look, we have found instances where there is waste, and where there is, we have been very strong in recommending that action be taken.

Mr. BONNER. Just one final question. How many people do you have in the IG's office, and how many people are there at the SEC, although I should know that, I apologize I don't.

Mr. KOTZ. Yes. There's I guess a little under 4,000 FTEs at the SEC. We have 18 full-time employees right now in our office, there's another few that we are hiring—in the process of hiring. So we have a relatively small office. And frankly, many folks have said, "Why don't you have more people?" But I feel like, if our office isn't efficient, then, you know, there's no office that should be efficient. The office of the Inspector General has to be efficient, and if we can do what we need to do with 18 people, then we don't need 40 people.

Mr. BONNER. That's a good philosophy. Thank you, Madam Chair.

Mrs. EMERSON. You're welcome. Mr. Serrano.

Mr. SERRANO. Thank you. In your testimony, you stated additional funding will be requested to ensure that the SEC has sufficient resources to implement many of the recommendations that have arisen, and will arise out of the audits, reviews, and investigations. With that stated, are we playing with fire to even contemplate cuts to the SEC? We don't want to be sitting here a few years from now talking about the next Madoff scheme, knowing

that we didn't give the agency the tools to prevent another such scandal.

Mr. KOTZ. Yeah, I do think that is a concern. And there are times, you know, our reports come in, we do investigations, we do audits, we make recommendations. And there are times where, in a budget situation the agency will come back and say, "We'd like to do it but we simply can't." You know, in that situation there's not much we can do. I mean, the agency gets to decide where they want to allocate their resources. And so there are times where that is the response. Sometimes we come back and say, "We want you to do it anyway, find the money for it."

But it is a concern, because in order to fix things, sometimes they require change in policies, change in people, but sometimes they also require additional resources if something is not staffed up enough. For example, in the Madoff situation, in one of the complaints that they were working on, they were analyzing the complaint, and they decided to take those resources and put it somewhere else because there was another issue that was even more pressing. And so the individuals who were working on the Madoff exam stopped, started working on something else.

And so, you know, if we come back with a recommendation and say, "You need to ensure you have sufficient people working on this," and they say, "we don't have the money to do it," it sometimes can be a concern.

Mr. SERRANO. Right. By the way, Madame Chair, just as an aside to Mr. Bonner, nobody being in that place is an issue, in Manhattan. Fifteen million dollars of rent, that's cheap in Manhattan.

The issue is why nobody's there, not how much. That's, in Manhattan, you all know that's very cheap. How much can you tell us about the Constitution Center, the 900,000 square feet that were leased—and then the CR comes along and implementation. Now first of all, your understanding is that this space was to meet the new responsibilities of the SEC in general or specifically with Dodd-Frank?

Mr. KOTZ. I think it was both. We are conducting, currently, an ongoing investigation of all those issues——

Mr. SERRANO. Right, and I know you can't comment fully, but, whatever you can tell us——

Mr. KOTZ. I mean, and we're going back actually prior to the decision to go forward with the Constitution Center lease. We're going back to prior decisions that were made or not about space. We're looking at the entirety of the SEC's space decisions over time. What we believe happened in that case was the SEC believed that it was going to get certain funding; it needed people to house, and so went forward and made the decision to lease that space, which was 900,000 square feet and, you know, a very large amount of space.

What we're looking at is, you know, was there a sufficient analysis done? Were there studies? You know, when you expend government funds, you have to ensure that it's done appropriately. There are processes that have to be put into place. There are studies that are be done—has to be a reasoned, you know, and thorough decision. Sometimes decisions are made, sometimes they're

the right decisions, sometimes they're the wrong decisions. We look to make sure that it was reasoned decision, and so we're going back—I took testimony on that earlier in the week. We're working very hard to ask the SEC, "What was your thinking? Why did you make that decision? What analysis did you do to support that decision? Could you have gotten a better deal somewhere else?"

And so we're looking at it very carefully, and we hope to have a full report of it within a short timeframe.

Mr. SERRANO. Thank you. We await that. Let me ask you on one of my favorite subjects again. What kind of involvement does the SEC have, direct physical involvement, with the territories? I mean, are there field offices, if you will, in the territories? What is the exchange? And also, you know, one of America's best kept secrets is in addition to territories, we also have associated republics, like Palau and Micronesia, and so on. Is there any involvement with that? And I'm not including Hawaii; I know there's some comment about—Hawaii is a State.

Mr. KOTZ. You know, I can't say we have looked at that particular issue. Maybe that is something that——

Mr. SERRANO. That was a personal Democrat-Republican joke, you know, that Hawaii's a State.

Mr. KOTZ. As I said, we haven't looked at that particular issue; maybe that is something we need to look at, you know, so I don't know that I could tell you exactly, you know, I'm certain that there is some coverage. I don't believe that there's necessarily a field office——

Mr. SERRANO. Right.

Mr. KOTZ. But, you know, that is something that maybe we need to look at too——

Mr. SERRANO. Because I know that people in the territories, just like all Americans, get up in the morning. And there are some folks in those places, just like some folks in the States, that invest in the market and I'm sure there are some folks who are maybe trying to figure out ways to be cute in the market right now.

Mr. KOTZ. And, absolutely.

Mr. SERRANO. And so, how do we keep tabs on that, and how do we protect the investors in those areas? Or do they all deal through New York, or Miami, or——

Mr. KOTZ. Yeah, I mean, I think that's something that we should be looking at to ensure that there are appropriate procedures in place so that you can get feedback, and you get information from folks out there.

Mr. SERRANO. All right.

Mr. KOTZ. I appreciate that.

Mr. SERRANO. I would appreciate that too. Thank you.

[The information follows:]

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

March 17, 2011

Via Electronic Communication and First Class Mail

The Honorable José E. Serrano, Ranking Member
Subcommittee on Financial Services and General Government
2227 Rayburn House Office Building
Washington, D.C. 20515-3216

Re: February 10, 2011 Request for Information Concerning the SEC's Involvement with the U.S. Territories and Republics

Dear Congressman Serrano:

I submit the enclosed memorandum report in connection with an issue you raised during my testimony before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. House of Representatives, on February 10, 2011. During my testimony, you requested that I provide you with information concerning the involvement of the U.S. Securities and Exchange Commission in the U.S. territories and republics. My review of that involvement together with suggestions for improvements is attached hereto.

If you have any questions concerning this matter or if I can be of further assistance to you, please do not hesitate to contact me at (202) 551-6037.

Respectfully,

H. David Kotz
Inspector General

MEMORANDUM

March 17, 2011

To: Carlo V. di Florio, Director, Office of Compliance Inspections and Examinations
Lori J. Schock, Director, Office of Investor Education and Advocacy
Robert S. Khuzami, Director, Division of Enforcement

From: H. David Kotz
Inspector General

Re: Review of Commission Activities in U.S. Territories and Republics

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This memorandum transmits the U.S. Securities and Exchange Commission (SEC), Office of Inspector General report on the activities of the SEC in U.S. territories and republics.

Should you have any questions regarding this report, please do not hesitate to contact me.

Attachment

cc: Kayla J. Gillan, Deputy Chief of Staff, Office of the Chairman
Elisse Walter, Commissioner
Luis Aguilar, Commissioner
Troy Paredes, Commissioner
Mark Cahn, General Counsel

BACKGROUND

The mission of the Securities and Exchange Commission (SEC) is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The SEC's vision is to strengthen the integrity and soundness of U.S. securities markets for the benefit of investors and other market participants, and to conduct its work in a manner that is as sophisticated, flexible, and dynamic as the securities markets it regulates.

The Office of Inspector General (OIG) is an independent office within the SEC that conducts audits of SEC programs and operations and investigations into allegations of misconduct by agency staff and contractors. The mission of the OIG is to detect fraud, waste, and abuse, and to promote integrity, economy, efficiency, and effectiveness in the SEC's programs and operations.

On February 10, 2011, the SEC Inspector General testified before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. House of Representatives, concerning his oversight of the SEC vis-à-vis the OIG's audit and investigative functions. During that testimony, the Inspector General was asked by U.S. Congressman José E. Serrano (D-NY):

> What kind of involvement does the SEC have direct physical involvement with the territories? I mean, are there field offices, if you will, in the territories? What is the exchange? And also, you know, one of America's best kept secrets is in addition to territories, we also have associated republics, like Palau and Micronesia, and so on? Is there any involvement with that?

See Transcript of Hearing, Financial Services and General Government Appropriations for 2012, Thursday, February 10, 2011, Securities and Exchange Commission – Inspector General, at p. 47.

The Inspector General replied that he would provide Congressman Serrano with information responsive to his questions and concerns.

As a result of Congressman Serrano's request, the OIG has researched the involvement that the SEC has with respect to U.S. territories and republics and has determined that the following Divisions of the SEC have contact with investors in U.S. territories: the Office of Investor Education and Advocacy (OIEA), the Office of Compliance Inspections and Examinations (OCIE), and the Division of Enforcement (Enforcement).

REVIEW

I. RESPONSIBILITY FOR U.S. TERRITORIES AND REPUBLICS

The SEC has 11 regional offices around the country, in addition to its headquarters office in Washington, D.C. The regional offices that have been assigned specific responsibility for U.S. territories are the Miami Regional Office, which is responsible for the U.S. Virgin Islands and Puerto Rico, and the Los Angeles Regional Office, which is responsible for Guam. We understand that the SEC's headquarters office assumes primary responsibility for all other U.S. territories and republics.

II. OCIE

OCIE administers the SEC's nationwide examination and inspection program for registered self-regulatory organizations, broker-dealers, transfer agents, clearing agencies, investment companies, and investment advisers. OCIE conducts examinations of investment advisers, broker-dealers, and transfer agents in U.S. territories. It also reviews and responds to investor complaints and has fielded complaints from investors located in U.S. territories and from investors outside the territories with respect to subjects located in the territories.

The following table provides data on the number of registrants and number of examinations that OCIE has conducted over the past five years in U.S. territories and republics.

U.S. Territories and Outlying Areas

source: http://www.usa.gov/Agencies/State_and_Territories.shtml

	IAs [Principal Place]	Examinations of IAs (FY2005 - present)*	IAs [# of Branch Offices]**	BDs [Principal Place]	Examinations of BDs (FY2006 - present)*	BDs [# of Branch Offices]***	Tranfer Agents****	Examinations of TAs (FY2006 - present)*	Investment Companies
Puerto Rico	8	1	15	12	7*****	242	2	3*****	-
Northern Mariana Islands	-	-	-	-	-	1	-	-	-
U.S. Virgin Islands	2	-	1	6	-	9	-	-	-
American Samoa	-	-	-	-	-	-	-	-	-
Guam	2	-	1	1	-	12	-	-	-
Minor Outlying Islands		-			-			-	
Baker Island	-	-	-	-	-	-	-	-	-
Howland Island	-	-	-	-	-	-	-	-	-
Jarvis Island	-	-	-	-	-	-	-	-	-
Johnston Atoll	-	-	-	-	-	-	-	-	-
Kingman Reef	-	-	-	-	-	-	-	-	-
Navassa Island	-	-	-	-	-	-	-	-	-
Palmyra Atoll	-	-	-	-	-	-	-	-	-
Wake Island	-	-	-	-	-	-	-	-	-
Federated States of Micronesia	-	-	-	-	-	-	-	-	-
Midway Islands	-	-	-	-	-	-	-	-	-
TOTALs	12	1	17	19	7	264	2	3	0

Notes -

*Examination totals are of those firms with principal offices in the locations listed. The staff has also conducted a limited number of examinations of the branch offices listed (preliminary estimates indicate that there have been ~6 BD branch office exams since the beginning of FY2006).

**Only 7 unique IAs

***Only 54 unique BDs

****Neither of these TAs are registered with the SEC. Banco Popular is registered with the Fed and Banco Santander with the FDIC. However, the SEC has joint-examination authority over both TAs.

*****Respective numbers represents 5 unique BDs and 2 unique TAs.

The OIG has further found that OCIE conducted a joint broker-dealer/investment advisor examination in December 2010 of a firm located in Puerto Rico. The firm was examined for cause based on the SEC's prior knowledge of the firm's poor compliance controls. The impetus for conducting the cause examination was Enforcement's initiative to bring coordinated enforcement actions against registered investment advisers that have willfully failed to adopt or implement written policies and procedures reasonably designed to prevent, detect, and correct violations of the Investment Advisers Act. When OCIE previously examined the firm five years ago, OCIE found that the firm had very poor compliance controls. In addition, an October 2009 Financial Industry Regulatory Authority review found compliance issues that indicated that the firm still had poor overall compliance controls. During the examination, OCIE examiners found numerous and recidivist deficient practices and confirmed its suspicions that the firm had not developed a robust compliance program since the last examination. OCIE staff had preliminary discussions with Enforcement regarding the examination in January 2011, and provided Enforcement with an outline of issues and supporting documentation in February 2011. The examination report was completed on March 9, 2011. OCIE has informed us that it intends to issue the firm a deficiency letter by the end of March.

III. OIEA

OIEA has three main functional areas: the Office of Policy, which has responsibility for reviewing agency action from the perspective of individual investors; the Office of Investor Advocacy, which responds to questions, complaints, and suggestions from members of the public; and the Office of Investor Education, which carries out the SEC's investor education program.

According to information retrieved from OIEA's Investor Response Information System (IRIS) database, which has captured data since November 2009, the following contacts of OIEA by investors in U.S. territories have occurred during the last 15 months:

- Puerto Rico (25 contacts)
- U.S. Virgin Islands (5 contacts)
- Guam (3 contacts)
- American Samoa (0 contacts)

OIEA also provided the following historical information on contacts from U.S. territories from 2002 to November 2009, when IRIS was instituted:

- Guam (38 contacts)
- American Samoa (2 contacts)
- Federated States of Micronesia (0 contacts)
- Puerto Rico (226 contacts)
- U.S. Virgin Islands (24 contacts)

OIEA indicated that it responded to these complaints in the normal course of business and confirmed that it had responded appropriately to all of the contacts from U.S. territories, many of which were forwarded to Enforcement.

The following are examples of the types of follow-up work that OIEA has completed with respect to contacts from U.S. territories:

Example 1: In November 2009, the Chicago regional office received a phone complaint from an investor in Puerto Rico about a potential offering fraud by an entity that he thought was under SEC investigation. The matter was forwarded to Enforcement.

Example 2: An investor in Puerto Rico asked the SEC staff to investigate claims by the chief executive officer of two non-registered entities that they would be the subject of an initial public offering. These claims allegedly had been made for ten years. The company has changed its name more than once, moved location, and issued new share certificates to its investors. The matter was referred to Enforcement.

Example 3: An investor in Puerto Rico complained that she and her husband were charged account management fees in 2008 and 2009 by a broker-dealer, although their investments had remained with their predecessor financial firm until March of 2008. The SEC contacted the broker-dealer on behalf of the investor and her husband. Although the broke-dealer denied any wrongdoing, it agreed to waive the account management fees for 2010 in the amount of $595.

IV. ENFORCEMENT

Enforcement assists the SEC in executing its law enforcement function by recommending the commencement of investigations of securities law violations, by recommending that the SEC bring civil actions, and by prosecuting these cases on behalf of the agency. Enforcement has stated that it obtains evidence of possible violations of securities laws from many sources, including investor tips from U.S. territories and republics. Enforcement also regularly conducts investigations involving allegations concerning entities and individuals located in U.S. territories, and certain matters have involved a significant number of investors in U.S. territories. However, a search of the public webpage of Litigation Releases made by Enforcement shows only matters related to Puerto Rico. The public webpage indicates no filed Enforcement actions with significant contacts with American Samoa, Guam, or the U.S. Virgin Islands and no reported Enforcement actions relating to Wake Island, Jarvis Island, the Northern Mariana Islands, Baker Island, Howland Island, or any of the other minor outlying islands.

On March 14, 2011, Enforcement deployed its new Tips, Complaints and Referrals (TCR) Intake and Resolution system to capture and track investor complaints made to the SEC. Enforcement simultaneously launched a TCR website containing links to the TCR Intake and Resolution system policy and procedures, user guide, training material, support information, and points of contact. During this review, Enforcement reported receiving the following TCRs regarding the U.S. territories since 2004:

TCRs Received from Individuals Located in U.S. Territories	
Guam	6
Puerto Rico	18
U.S. Virgin Islands	2

TCRs Received Where Subject Is Located in U.S. Territories	
Puerto Rico	10
U.S. Virgin Islands	5

One example of an action brought by Enforcement involving conduct in a U.S. territory was an August 2009 civil injunctive action against a Florida resident and company for operating a multi-million dollar fraudulent pyramid scheme involving investors from Puerto Rico.

CONCLUSION

The OIG found that while the SEC does not maintain a presence (as in a physical office) in any U.S. territory or republic, it does respond to complaints from the territories and conducts examinations in the territories. The SEC has also filed enforcement actions involving conduct in or related to U.S. territories. Some U.S. territories are assigned to specific regional offices, but many of the territories and all of the republics are not currently assigned to any regional office.

The OIG also found that OIEA has identified investor complaints from the U.S. territories, with over 250 coming from Puerto Rico alone, and that OCIE has conducted examinations of firms located in Puerto Rico.

Based on our review, we suggest that the SEC reinforce the roles and responsibilities of headquarters and the regional offices regarding investor protection in U.S. territories and republics. Furthermore, we suggest that OIEA consider performing investor outreach and education in U.S. territories and republics to ensure that they have the knowledge and opportunity to have their concerns addressed by the SEC.

Mrs. EMERSON. Thanks, Mr. Serrano. Let me ask you another couple questions about this Constitution issue because it's just shocking to me. I realize that since you're still investigating it, there are some things that you can't say, but it's my understanding that the SEC has been able to release 600,000 square feet of that space, and are keeping 300,000 square feet as a hedge against another lease that's coming due in October. 300,000 square feet of space is a lot, and it's not cheap, I know. Just by having it sit there until October, to me, doesn't sound very efficient.

Mr. KOTZ. Right.

Mrs. EMERSON. Have you all actually made concrete recommendations to the folks at SEC on their leasing practices? Or are you waiting to do that until the investigation is complete?

Mr. KOTZ. We looked at leasing issues, sort of on an audit side before, made some recommendations with respect to that. We will wait until we finish our investigation to make recommendations with respect to the 300,000. I'm not sure that at the end of our report, we will recommend that they hold on to any part of Constitution Center.

And I'm also not sure that there are finalized decisions on that, yet. I know that the SEC has been making efforts to try to get rid of some of that space. I don't know that, necessarily, they have made a final decision——

Mrs. EMERSON. I see.

Mr. KOTZ [continuing]. To hold onto 300,000. It may very well be that we recommend that they don't hold onto any of it, and it may very well be that do that on their own anyway. There is a facility out in Virginia; there was some talk about moving the folks from Virginia out to Constitution Center, but I think we have to look at the costs of that, whether that's effective and efficient or not.

You know, there are sort of things on both sides. Washington, D.C. is more expensive than Virginia, but if you have folks in Virginia, you have this shuttle service that goes [inaudible] so the question is, how much lost time is there on the shuttle? How much does the shuttle cost? I mean, all those things need to be looked at carefully. We need to ensure that the SEC is making, you know, good, thorough decisions on all these matters, and I think certainly, given that we're in the middle of this investigation; the SEC is looking carefully at all its different options before going forward with anything with respect to those leases.

Mrs. EMERSON. I know, having worked in the private sector for many years here in Washington, D.C., and knowing how much a square foot of office space is, this is alarming to me.

Mr. KOTZ. It is an incredible amount.

Mrs. EMERSON. And that was 14 years ago.

Mr. KOTZ. Yeah, well we're asking the question, "How on earth could you have thought that you would need 900,000 square feet of space? I mean, you know, in the budget climate we're in, how is it possible for you to think that?" And so, you know, we're going to get the answers. You know, we haven't made any determinations; we're still in the middle of the investigation, maybe there are good answers. But you know, we're going to go forward, and we'll report back what we found.

Mrs. EMERSON. I appreciate that. Speaking of leases, though, do you have any other concerns outside of Constitution Place or Constitution Center at this time?

Mr. KOTZ. You know, but we've looked at a couple of areas, we've found some concerns, we found that there weren't policies in place that are appropriate. We have to make sure that the people involved have the expertise that's necessary. Right now, we're looking at Constitutional Center. Again, we're looking at numerous spacing decisions in Washington, D.C. We know that there is new space that they're looking at in other cities; we may be looking at them eventually.

You know, we feel this is an area that is of concern, and so we have to look at all aspects of it. If there's, you know—if it's the same people making the decisions, then wherever they're making the decisions, we have to look carefully at those decisions.

Mrs. EMERSON. Okay, so there are 11 regional SEC offices. I understand the need to have one in New York, perhaps even Boston, and maybe one on the West Coast. Is it efficient to have all of the SEC offices spread out around the country? It may well be, and perhaps you can make me feel more comfortable about that.

Mr. KOTZ. Yeah, I mean, I don't know that we've analyzed that point, but that again may be one that we need to look at. There is certainly, as time goes on, you know, the ability to communicate without being in the same place, you know, one of the—we have the suggestion program that is going on, and one of the suggestions was to have fewer people, for example, in New York City. Let them be out in Long Island or New Jersey where it's cheaper. Do you really need everybody to be in Manhattan? You know, one—two buildings, certainly not, maybe not even one building. And so maybe there are ways. Again, I don't know that we've done enough work.

You know, we look very carefully when we conduct our audits; we're very thorough before we come up with the recommendation. But I do think it is worth looking at in today's age, whether there can be inefficiencies that way.

Mrs. EMERSON. It just seems, to me, that we do so much with tele-health and everything else today. Some of these spots just doesn't seem particularly necessary, but then maybe you can convince me otherwise, if in fact, those people are needed and the office space is cheaper than it is in DC.

Mr. KOTZ. Right.

Mrs. EMERSON. I would be curious to know if that's something that could be looked at.

Mr. BONNER. Madam Chair.

Mrs. EMERSON. Yes, sir.

Mr. BONNER. While we're talking about it, I am confident that there's rental space available in Mobile, Alabama for much cheaper than Manhattan——

[Laughter.]

Mrs. EMERSON. I've got a great big factory in Dexter, Missouri that'd be happy to take them——

Mr. BONNER. Just wanted to put that on the record.

Mr. SERRANO. Let the record show that I try to build you a courthouse, but——

Mr. BONNER. And I'm proud to fill it right here.

Mr. SERRANO. Okay.

Mr. BONNER. Thank you.

Mrs. EMERSON. Ms. Lee.

Ms. LEE. Thank you very much. Let me just follow up with that by asking you what the dollar amount is in terms of the markets that you supervise, and investigate, and have to look out for?

Mr. KOTZ. Yeah, I don't know that I know a total dollar amount of the markets. I mean, I do know that, you know, one of the things the SEC looked at is in terms of sort of information technology budgets. You know, and I know that many of the additional funds that the SEC was seeking to get was in the area of information technology. And I understand that, you know, that the amount of money spent by large companies on information technology is, you know, many, many, many times more than the SEC's budget with respect to those areas. I'm not sure I could give you a total figure, but certainly as I indicated before, there are individuals with tremendous resources. I mean, Bernard Madoff was running a $50 billion Ponzi scheme. And so they have access to tremendous resources which can be used to sort of fight the SEC in going forward, and committing fraud, and other misconduct.

Ms. LEE. You must know about how much of the $50 billion, for example, you know, in, that—bottom line is, you have responsibility for that $50 billion.

Mr. KOTZ. Right. Right, absolutely.

Ms. LEE. Okay. So, how much? $100 billion? $200 billion? How much do you think that the SEC has responsibility to oversee or to be responsible for?

Mr. KOTZ. I would think it would be certainly over a trillion dollars, in terms of all the funds out there, but I'm not sure that I could give you a specific number.

Ms. LEE. That's over a trillion. Okay, so, and what's the full staff—how many people total in the SEC?

Mr. KOTZ. A little less than 4,000, I think, full-time employees.

Ms. LEE. 4,000. Less than 4,000. And you have how many, again?

Mr. KOTZ. 18 full-time employees right now, and we have—we're hiring four more.

Ms. LEE. Twenty-two——

Mr. KOTZ. Twenty-two.

Ms. LEE. For maybe over a trillion dollars, maybe. Certainly $500 billion. Somewhere close to that.

Mr. KOTZ. The SEC has a very important, very difficult mission——

Ms. LEE. Yeah, but with 22 people to kind of watch over, that seems to be very few. I mean, I would think you'd need three times that amount to protect us and the American people from these fraudulent scam artists.

Mr. KOTZ. Right. Certainly.

Ms. LEE. You know? So, the—Chairman Rogers, I think that the 13 percent budget cut has been proposed, and I know I heard your answer earlier about you really haven't evaluated these. But what would it do to your office? Just your office?

Mr. KOTZ. Well, so, again, we have 18 full-time employees; we're trying to hire four more. They're important positions. If something

like that were to go through, it very well may stop us from being able to hire those four people. I mean, you know, we have five investigators and six auditors. We do a lot of work with that, but, you know, we had somebody who recently left us, took a higher paying job. There's no way we could compete financially with the job this person got.

We want to replace the position; it's an important position to replace, so there's certainly the possibility that if the budget cut is severe, that we won't be able to replace that person. And you know it would have an impact on our operations going forward. You know, we are lean and we are efficient, but we do need the bodies to be able to perform the work.

Our complaints have gone up over time and we need to be able to assess them all.

Ms. LEE. And you have to protect investors, right?

Mr. KOTZ. Yes, absolutely. And that's certainly the mission of the SEC.

Ms. LEE. You've got at least $500 billion you've got to protect with 22 people.

Mr. KOTZ. Right.

Ms. LEE. Maybe 18. Sure, Okay. Thank you very much.

Mrs. EMERSON. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Madam Chairwoman. You mentioned a little while ago, in the back-and-forth, you know, money is not always the answer, obviously. And going back to some of the roles of the SEC—could part of the problem be that the SEC's faculty has been given too many issues to look at, too many things on its plate and that—to the point where they can't do any of them well because they're spread so thin? I mean, could that not also be an issue?

Mr. KOTZ. I think it's certainly a possibility. And one of the things that we try to focus on is that if the SEC is going to take on something, it needs to be able to do it well. And you know, one of the things we saw in the Madoff situation was, you know, the SEC would do these exams or investigations, and they would not do thorough ones. And so it would actually send the wrong message.

I mean, we had—I talked to somebody in the private sector who was suspicious about Bernard Madoff. He said, "Well I knew it wasn't a Ponzi scheme." I said, "How did you know it wasn't a Ponzi scheme?" He said, "Because I knew that there was a complaint to the SEC that Bernie Madoff was running a Ponzi scheme. And so, if there was a Ponzi scheme, the SEC would have caught it. So I knew it's not that."

Well in fact, the SEC did not do a competent job in that. And in fact, both Bernard Madoff and Allen Stanford would use when they spoke to folks who would be skeptical about investing, they would say, "The SEC was just here. You know, they gave me a clean bill of health." And so, sometimes it is a concern when you conduct an investigation, and you don't necessarily staff it fully. You don't do it appropriately; you're almost better off not doing it. You know, I don't know that I've looked at all the issues—I certainly haven't analyzed all the new responsibilities under Dodd-

Frank—but I do think that that is something to be cautioned about.

Mr. DIAZ-BALART. I think what you're saying there is that some people get so dependent and so reliant on government that frankly, other things that would naturally take place, don't take place, because oh, it's you know, government, in this case the SEC, is going to take care of it. It's all fine; they're going to take care of it, so therefore, individuals don't do their part that they would otherwise do. Is that basically what you're saying?

Mr. KOTZ. Yeah, but I think that perhaps that the natural skepticism of Madoff, you know, the fact that he was having these continuous returns over time was lessened because they figured the government was watching.

Mr. DIAZ-BALART. Going kind of on the same point, and I know it may be an oversimplification, but you know, you would think that there are sometimes things that would trigger people to like, take notes. I know that if, you know, you use your ATM in the gas station twice, you know, like if I fill up my car and my wife's car and all of a sudden get a call or an e-mail saying, you know, "Is that really you? Is there fraud there?"

Mr. KOTZ. Right.

Mr. DIAZ-BALART. And that's, you know, whether it's a $100 transaction, which is like three gallons of gas now, or whether it's, you know, $4 on a—or I should say $10 for a cup of coffee in certain places, you know, you'll get that. And obviously they have systems to do that. And, going back to the $21 million expense that they're going through, is that—again, you would think, and from, you know, your report, there were some of those triggers that just weren't acted on, but somehow, the credit card companies, and I know it's kind of a different, but yet related situation. They have triggers and they have—and they act on them. And, you know, why can't—the question that I get a lot, is why can't the federal government do what, frankly, every single credit card company does?

Mr. KOTZ. Right, well——

Mr. DIAZ-BALART. In that sense.

Mr. KOTZ. Yeah. No, I agree. I mean, the Federal government has to be held to the same standard, you know, the credit card company doesn't do its job, somebody else takes over. And so the federal government has to be held to that same standard, and simply putting it into a system is not enough. They have to ensure that the triggers are appropriately looked at. You know, they have to make sure that they have the right skill set of individuals being involved. One of the issues that we looked at in the Madoff case, was, you know, there was some very intelligent lawyers came out of very, very impressive law schools, but didn't know enough about trading to be able to analyze these carefully.

Perhaps you got in somebody who had worked, you know, on the trading floor for many years. That person might have been in a better situation to identify these issues, rather than somebody who was, you know, a smart person. And so, the SEC needs to do more, clearly, than just put in a new system that costs $21 million. But, we are working on those issues as well and trying to recommend that they put together the right skill sets.

Mr. DIAZ-BALART. Well, I appreciate that, and if I may, Madam Chairman, just on the same point, because it seems that obviously one of the obvious things that I've learned is that sometimes it's not how much money is spent but how that money is spent. And, so—and it's going back to the fact that if there's one area where, I think, taxpayers cannot be told that it's because there wasn't enough money, it's frankly the SEC because of that tripling of the budget.

So, I just want to make sure that, because it's so easy to just—and you haven't done that, on the contrary. But, for some of us to say, "You know, we just need to spend more money, spend more money," well here's the case where a ton more money has been spent and yet, you've been able to find areas where that money was not well spent——

Mr. KOTZ. Right.

Mr. DIAZ-BALART [continuing]. Was not certainly focused on the right area. Obviously, one of the things that we need to do is obviously listen to you more often. A lot of times, we get the reports and we just don't act on them as well. So, anyway, thank you.

Mr. KOTZ. Thank you.

Mrs. EMERSON. Thank you, Mr. Diaz-Balart. Mr. Womack.

Mr. WOMACK. Just a couple of follow-up questions. And, forgive me if I show my rookie nature to this panel and to perhaps, the subject matter that we're talking about here. But when recommendations go out of your office, when the Office of the Inspector General makes recommendations to the SEC for improvements to the systems that are designed to protect American investors, what are the consequences for the failure of the SEC to act on those recommendations to your satisfaction?

Mr. KOTZ. Well, that information is essentially reported to Congress. And so, in our semi-annual reports to Congress, we chronicle the recommendations that we made and how many recommendations are open. And you know, if necessary, we will come forward to a committee like this, and say, you know, in addition to providing the semi-annual report, because I know you both get lots of semi-annual reports, to maybe highlight the fact that there's a concern that recommendations are not being implemented.

You know, we are very strict in our implementation. We require, initially, a corrective action plan to ensure that it's started. Then we require documentation to ensure that it's finished, and then only then do we agree to close it. And we report where it's not closed. So, you know, I certainly believe it's my obligation to bring to your attention, if that is the case, where we are—we're recommending many, many different actions, and they're not being taken, and there's no good reason provided why they are not being taken. So, I—my job is to bring that to your attention and to see how you all and others can help us assist in that process.

Mr. WOMACK. Another question is more in the area of the competency issue at the SEC level. There's an argument out there that it's got too many lawyers and not enough subject matter experts in the areas where their jurisdiction falls. Comment on that. I'd like to know, do we have the right people in the seats there that have the proper expertise to be able to see what a good part of the American public has been able to see from a distance.

Mr. KOTZ. Yeah, I think that was an issue that we found in some of our investigations. As I said, concerns that folks do not have the experience to understand the issues, even though they may be lawyers, they may be smart, they may be hard working. I mean, many of the folks who worked on the Madoff matter actually worked very hard, worked very long hours, but missed sort of very obvious things.

I know that the new director of Enforcement has looked to set up these sort of specialized groups to ensure that there are folks who have specific, specialized experience, that one can go to. When the Ponzi scheme investigation was done in the SEC, from Harry Markopolos's complaint, the individuals who worked on that investigation had very little, if any experience in conducting Ponzi schemes.

They didn't know how to conduct a Ponzi scheme. They were very smart, they were very hard working, they tried very hard, but they didn't know how to conduct a Ponzi scheme investigation. And so, I believe that they're putting in place, sort of specialized groups, so you have a resource to go to.

But I think part of that may very well be, in addition, hiring other folks. Now there was a time where it was difficult for the SEC to recruit, say, Wall Street folks, because they were making a lot more money, there were big bonuses, there was no way they were going to come work for the SEC.

You know, with the economic times, that—I don't think that that's an excuse anymore, frankly. Because the times are tough on Wall Street, at least they have been. And perhaps there's more of an opportunity to get those people. And so, I absolutely agree that we need—the SEC needs to get in the people who understand how the fraudsters work, not just people who are very smart, and are trying hard and hard working.

Mr. WOMACK. I would agree with that. The gentleman from Florida was talking about triggers just a minute ago, and at the risk of sounding like a broken record in part of my earlier line of questioning—and I will use metaphorically the TSA, although I'm not necessarily endorsing the activities of the TSA.

But, when they developed a system to find, say, a gun in a bag that might be put on a conveyor belt, the best way to test whether the effectiveness of that system was to basically put a gun in a bag and put it on the platform and let it go through to see if it does its job. And my strong recommendation, my strongest recommendation is for any of the processes, the $21 billion TCR or whatever system that has been recommended and it is in place, that we put the gun in the bag and check the system. And that's the only way that you can restore consumer confidence, investor confidence that we have in place fail-safe systems that are designed to protect, and in fact, do protect the investor.

Mr. KOTZ. Yeah, and that's an excellent idea. I'm not going to say specifically that I'm going to do that, because the SEC's probably listening—but, in order to test the system, you have—that's an absolutely excellent idea, you know. In other words, to see specifically if a complaint comes in, what happens to it?

Mr. WOMACK. And I just want to follow up with what the gentleman from Alabama said. I believe there are market rates in Ar-

kansas that are even more competitive than Mobile, Alabama and certainly, much more competitive than Manhattan.

Mrs. EMERSON. You notice, he didn't say Missouri.

Mr. SERRANO. Madame Chair, it's a good thing I don't represent Manhattan. I may be offended by that.

Mrs. EMERSON. Yes, but you represent Yankee Stadium, Joe, which is quite lovely real estate.

Mr. SERRANO. Yes. The salaries there are quite high.

Mrs. EMERSON. And the ticket prices are outrageous.

Mr. WOMACK. I will take exception to the gentleman from New York. He's complaining about Cardinal baseball, and let it be a matter of the record here, that Madame Chairwoman is joined by a die hard St. Louis Cardinal baseball fan.

Mr. DIAZ-BALART. Those are fighting words.

Mr. SERRANO. I like the Cardinals.

Mrs. EMERSON. Just not as much as the Yankees. All right, so playing off of everything that my colleagues have talked about with regard to staffing, and I actually really like Mr. Womack's idea about testing the systems at the SEC. I think that's a great idea.

Right now, there are 23 offices that currently report directly to the chairman of the SEC, and I think Dodd-Frank will add even more offices that—if you look at the functions of the office on the charts—seem to mirror, to some extent, existing offices already within the SEC.

We know, as we've just been discussing for quite some time, that there was poor coordination between the offices within the SEC. So, have you all actually considered doing an internal review of the entire SEC structure, not just focused on Madoff or Stanford?

Mr. KOTZ. Yeah, I think that's a good idea. I mean, you know, perhaps, particularly as you say, with respect to Dodd-Frank, once the SEC puts in all those offices, we need to ensure that those offices are not doing the same thing that another office is doing. So I think at that point in time is probably a good time to look at an overview and to ensure that both, there is communication between offices, but also that there isn't duplication of effort.

Mrs. EMERSON. Well, I know that there is, if I remember correctly, something within Dodd-Frank with regard to whistleblowers, but yet there already is a function within the SEC that does that. I think perhaps four of the five offices that Dodd-Frank recommends putting in place mirror something in the title. So it seems to me that, if those existing offices can be refashioned, and the people have the right skill sets, that it's absolutely wasteful to set up all new offices that mirror the same thing that the other offices are supposed to be doing already.

Mr. KOTZ. Right. No absolutely, absolutely. That's something that we have to be very careful about. I think anytime you have legislation, new legislation, particularly as comprehensive as Dodd-Frank is, you have to ensure that it gets acclimated into your own environment in an efficient way, and not just sort of added on. I mean, a lot of those situations—there's statutory requirement that somebody report to the chairman, and I think that's why there are many, you know, situations where the offices report to the chairman's office. But we have to make sure that they're all doing different things, and are not duplicating efforts.

Mrs. EMERSON. Well, and 23 direct reports is really a lot for any organization.

Mr. KOTZ. Yeah.

Mrs. EMERSON. I want to flip over to a totally different subject, which is fascinating and scary at the same time. High-frequency, or algorithmic trading—and specifically, I want to refer back to May of last year when the Flash Crash occurred. I think by some accounts, computer-aided high-frequency trading now counts for 70 percent of total trading volume, and so there is much more influence by the algorithms rather than actual traders.

Do you think that the SEC is currently able to keep up with these new ways of trading? Is this something that you all are looking into?

Mr. KOTZ. Yeah—there have been some complaints that came in about what happened in May. We have begun to look at it. I mean, the SEC actually has done a lot of its own analysis on how it happened, why it happened, came out with a report. So we haven't sort of duplicated their process in that way, but I think that is something that does need to be looked at in the future. I mean, I think things are getting more complicated, more difficult, and we have to ensure that the SEC's able to keep up.

Mrs. EMERSON. So, within their report, do they talk about how they could better detect those kinds of issues in the market?

Mr. KOTZ. I haven't thoroughly analyzed the report, but I believe that that is part of it. I believe they looked at, you know, what happened, why it occurred, and what we can do in the future to move forward appropriately.

Mrs. EMERSON. Okay, because it's a fascinating issue, but it's also somewhat intimidating and hard to track.

Mr. KOTZ. Right.

Mrs. EMERSON. It begs the question as to whether or not there are obsolete regulations that might need to get thrown out, and perhaps Congress should look at this whole issue, because of the manipulation that can occur.

Mr. KOTZ. Right, right. No, absolutely. That's a real concern.

Mrs. EMERSON. All right, thank you. Mr. Serrano?

Mr. SERRANO. I just want to first of all ask unanimous consent to submit some questions for the record.

Mrs. EMERSON. Without objection and we will all, I believe, have questions to submit for the record. I forgot to say that earlier, so thank you.

Mr. SERRANO. Okay. And just one follow-up question on the issue of the territories. So you said that you were not aware, which I understand because I'm not aware myself either. I was not asking a question that I knew an answer to. So you will look at it, and you will report to the Committee?

Mr. KOTZ. Yes, absolutely.

Mr. SERRANO. Okay.

Mr. KOTZ. Absolutely.

Mr. SERRANO. Because I'd like to know what our relationship is with the SEC, and how they deal with that, and just what's going on out there.

Mr. KOTZ. Okay. No, absolutely.

Mr. SERRANO. Which, by the way, it's a general pattern throughout the federal government that in so many cases, the territories are sort of an afterthought.

It's true in funding. If you look at the way we fund, we fund using a formula for the 50 States and then you have to bargain to get the territories, you know, a certain amount of money and it's never based on population like in the other States and so on. So I'd like to have a better understanding of that.

Mr. KOTZ. Okay. Good, good. Thank you.

Mr. SERRANO. Thank you. Any timeline on that, I don't want to give you more work to do.

Mr. KOTZ. Well, no. I'd be happy to get back, you know, in a short timeframe. Just initially what's done, if there's a more thorough analysis——

Mr. SERRANO. Okay.

Mr. KOTZ [continuing]. That's required, I'll go forward. But I can get back in a few weeks just generally what's happening.

Mr. SERRANO. That's great, that's great. Thank you. I have no further questions.

Mrs. EMERSON. Thanks, Mr. Serrano. Mr. Diaz-Balart, more questions?

Mr. DIAZ-BALART. None.

Mrs. EMERSON. Mr. Womack?

Mr. WOMACK. None.

Mrs. EMERSON. Ms. Lee?

Ms. LEE. One more. Let me ask, now the FDIC is responsible for the oversight of—as it relates to the new rules governing credit cards? Is it the FDIC?

Mr. KOTZ. I'm not sure, sorry.

Ms. LEE. Okay. But whichever agency it is, you know, we'll talk to them about this, but, you know, the credit card companies now have found new ways to scam the system.

Mr. KOTZ. Right.

Ms. LEE. So I'm wondering now as it relates to Dodd-Frank, how—well, I do know. The traders in some of the financial institutions are really busy now developing ways to game the system.

Mr. KOTZ. Right.

Ms. LEE. Now, given that, what's your staffing like to try to anticipate these new games that are being put together?

Mr. KOTZ. Yeah, I mean——

Ms. LEE. So you can do this on the front end and how do you recognize what they are? Because let me tell you—the credit card companies and the new scams that they're running are just as serious as the ones before.

Mr. KOTZ. Right.

Ms. LEE. And consumers are really paying the price now.

Mr. KOTZ. Right. No, I mean, it's very difficult I think to stay ahead of the curve with respect to those kinds of things, with respect to fraud. And I think the SEC needs to not just react sort of when they get a complaint. They put this new system in, they react to complaints. They also need to be proactive. And I know that's something that the Enforcement Division is looking at. I know that that's a priority for them. But I absolutely agree that

they need to sort of look for the next fraud before it happens, anticipate it, and set up systems to deal with it.

Ms. LEE. Well, what's the staffing that's required for that and how do you anticipate, knowing that this is taking place right now, how do you do that within the current staffing patterns? And again, I think you should have a 50 percent increase myself to really protect consumers and investors from what has taken place given the magnitude of your job. And so how are you going to do this?

Mr. KOTZ. Yeah, you know, I think it's difficult. I think you need the bodies who are focused only on sort of the new risk areas, the proactive measures and not have them, you know, if they're sort of dealing only with complaints that are brought in regarding past issues, they don't have the time and resources to be able to look at those things. So I think that where you have significant budget cuts, I think that that's a concern.

Ms. LEE. And I hope this committee will really look at that very carefully because I can see a new wave of fraud, new games that are being played and put together right now that we don't even know what they are. And you're going to have to look at what the dynamics are and what they look like and then be able to prevent them from taking place.

Mr. KOTZ. Right, right. Absolutely.

Mrs. EMERSON. Thank you so much. I want to thank all my colleagues. Mr. Kotz, thank you so very much for being here today. We really appreciate your direct answers and we look forward to working with you.

Mr. KOTZ. Thank you very much.

[The information follows:]

Financial Services and General Government Subcommittee
FY 2012 Budget Hearing with the Inspector General of the Securities and Exchange Commission

Questions for the Record From Chairwoman Jo Ann Emerson

BANK OF AMERICA/MERRILL LYNCH MERGER

Mrs. Emerson: In your investigation into Bank of America's merger with Merrill Lynch, you found that Bank of America's (BofA) status as a TARP recipient had an impact on the favorable settlement that the SEC's staff first recommended. Are there other instances of the SEC treating TARP and non-TARP recipients differently?

Mr. Kotz: As discussed in the Securities and Exchange Commission (SEC) Office of Inspector General's (OIG) report of investigation entitled *Investigation of the Circumstances Surrounding the SEC's Proposed Settlements with Bank of America, Including a Review of the Court's Rejection of the SEC's First Proposed Settlement and an Analysis of the Impact of Bank of America's Status as a TARP Recipient*, issued on September 30, 2010, we found in our investigation that notwithstanding that the traditional criteria for determining waivers of certain disqualifications were not met, the Commission initially approved a waiver for Bank of America in connection with the SEC's first proposed settlement of its action against Bank of America. We also found that the SEC's Division of Corporation Finance had recommended the waiver for Bank of America based, at least in part, on Bank of America's status as a Troubled Asset Relief Program (TARP) recipient. We did not specifically investigate other instances where the SEC may have treated TARP and non-TARP recipients differently.

Mrs. Emerson: Do you believe the SEC was inappropriately lenient with regard to its treatment of Bank of America in this case?

Mr. Kotz: While we did not make a determination that the Securities and Exchange Commission (SEC) was inappropriately lenient toward Bank of America, we noted the departure from SEC practice and the inconsistent manner in which the SEC had acted. We did find that the SEC considered Bank of America's financial condition as a significant factor in its decision not to oppose the grant of the waiver, despite the fact that, under the SEC's traditional criteria, Bank of America would not have been entitled to this waiver.

Mrs. Emerson: Do you believe that the SEC was looking out for BofA over the interests of retail investors?

Mr. Kotz: While we did not conclude that the SEC was looking out for Bank of America over the interests of retail investors, our report did find that the waiver in question allowed Bank of America to issue registration statements without review by the SEC, which could potentially have some impact on retail investors.

SEC ORGANIZATION

Mrs. Emerson: Currently, there are 19 offices reporting directly to the Chairman of the SEC, and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) adds even more offices that seem to duplicate functions elsewhere within the SEC. Can you see any redundancies in the SEC structure as it is now that might be causing the SEC to be less efficient and effective in its goal of protecting investors and maintaining orderly and efficient markets?

Mr. Kotz: We have not yet conducted an analysis or review of the Securities and Exchange Commission structure to determine whether the number of offices reporting directly to the Chairman have created redundancies or duplication. However, we are concerned about potential redundancies, particularly with the new responsibilities and offices created as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act. We plan to conduct such a review and will report back to the Committee the findings of our review.

Questions for the Record From Representative Barbara Lee

IMPACT OF THE CONTINUING RESOLUTION

Ms. Lee: I am concerned that the SEC is already straining to operate under a continuing resolution (CR) that has frozen their hiring of new employees with critical skill sets.

Traders and banks are busy developing new ways to attempt to game the system, such as flash trades and new financial products that will need oversight and regulation.

How will deep cuts to the SEC effect efforts to effectively implement the ongoing recommendations from OIG audits as well as their ability to implement the new rules and regulations from the Dodd-Frank Wall Street Reform and Consumer Protection Act, which are intended to stabilize our markets?

Mr. Kotz: As I testified before the Committee, I believe that significant cuts in the Securities and Exchange Commission's (SEC) Budget may negatively impact the SEC's ability to effectively implement Office of Inspector General recommendations and new responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act, as well as the SEC's ability to detect fraud in the capital markets. In certain instances, it will be necessary for the SEC to incur additional expenses to implement improvements necessary for the SEC to continue to perform its critical functions.

Ms. Lee: What must the SEC be able to do to ensure that the blatant fraud, systemic risk and massive capital losses of the recent crisis never happen again?

Mr. Kotz: The SEC must remain vigilant in its mission of protecting investors and conduct aggressive oversight in its areas of responsibility. It also must have the resources necessary to conduct such oversight and have access to up-to-date technology.

Ms. Lee: Will your agency be able to accomplish this if the budget is returned to 2008 levels or cut 13 percent?

Mr. Kotz: The Securities and Exchange Commission (SEC) must be provided with the requisite funds to undertake recommended improvements, and cuts of 13 percent or more may make it difficult for the SEC to accomplish its mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation, which is now more important than ever as the nation's securities exchanges mature into global for-profit enterprises.

REPORTING ON DIVERSITY

Ms. Lee: Please provide for the Subcommittee information regarding the diversity of professional full time employees at the Office of the Inspector General, broken down by job title or GS level?

Mr. Kotz: As of February 10, 2011 the Office of Inspector General (OIG) has 17 full-time employees. Of these 17 employees, 9 are women and 8 are minorities. The breakdown is as follows:

Inspector General	Male Caucasian
Deputy Inspector General	Female Caucasian
Counsel to the Inspector General	Female Caucasian
Assistant Inspector General for Audits	Female African-American
Assistant Inspector General for Investigations	Male Caucasian
Senior Auditors – 5 in total	4 African-American; 1 Asian-American; 3 Female; 2 Male
Senior Investigators – 3 in total	1 African-American; 2 Caucasian; 2 Male, 1 Female
Investigator	1 Male Caucasian
Audit Support staff	1 Female Caucasian
Investigative Support staff	1 Male Caucasian,
Other Support staff – 2 in total	2 Female, 1 African-American, 1 Caucasian

RECRUITMENT AND HIRING

Ms. Lee: What is your office doing to ensure that it is recruiting and hiring a diverse staff? Does your office recruit or have an internship program at any Historically Black College/s and University/ies?

Mr. Kotz: The Securities and Exchange Commission (SEC) Office of Inspector General (OIG) prides itself on the diversity of its staff. As of February 10, 2011, approximately 53 percent of its full-time employees are female, and 47 percent of its full-time staff are minorities. The OIG participates in the SEC's internship programs and, through its involvement in these programs, has employed interns attending Howard University, a Historically Black College and University. In addition, many of the interns the OIG has employed through the various SEC internship programs have been women and minorities.

PROCUREMENT AND CONTRACTING

Ms. Lee: Are you able to provide us with information regarding the amount and percent of contracts with small, disadvantaged businesses that are female or minority-owned?

Mr. Kotz: The Securities and Exchange Commission Office of Inspector General (OIG) prides itself on the use in its outside contracting of small, disadvantaged businesses that are female- or minority-owned. In 2009, 33 percent of the OIG's outside contracts were with small, disadvantaged businesses that are female- or minority-owned, and in 2010, 40 percent of its outside contracts were with small, disadvantaged businesses that are female- or minority-owned.

ENFORCEMENT OF ACQUISITION PROCEDURES

Ms. Lee: Does the OIG ensure that the SEC meets all Acquisitions Procedures as they apply to small and disadvantaged business enterprises, particularly women and minority owned firms?

Mr. Kotz: The Office of Inspector General has recently conducted two audits of the Securities and Exchange Commission (SEC) Acquisitions Procedures. In September 2009, we completed an audit of all aspects of the procurement and contract management processes and functions of the SEC's Office of Administrative Services, Office of Acquisitions, covering the period from fiscal year (FY) 2006 to FY 2008. We reviewed whether the SEC was following all pertinent rules and procedures and made recommendations where we found noncompliance with the Federal Acquisition Regulation and SEC procurement and contracting policies. In December 2010, we conducted a follow-up review scrutinizing several particular time-and-materials and labor hour contracts to ensure compliance with applicable requirements. One of the contracts we reviewed was a contract with a Small Business Administration–certified small and disadvantaged business.

THE NEW OFFICE OF MINORITY AND WOMEN INCLUSION

Ms. Lee: As the SEC enacts the requirements of the Dodd Frank Wall Street Reform and Consumer Protection Act and establishes the Office of Minority and Women Inclusion at the SEC, will the OIG ensure that there is proper oversight over the goals set out by the office and that the SEC, agency-wide, fully implements the policies and procedures promulgated by the new office?

Mr. Kotz: The Securities and Exchange Commission (SEC) Office of Inspector General plans to initiate an audit of the SEC's newly established Office of Minority and Women Inclusion within the next several months. In this audit, we plan to assess whether the Office has been properly established and provided with the necessary resources to fulfill its functions and goals. We also plan to analyze the impacts of this new Office and make appropriate recommendations if we find there are impediments to the Office's having the desired effect in the financial sector.

Ms. Lee: Will the OIG report back to the subcommittee on the impact of the new Office of Minority and Women Inclusion, especially if the SEC lacks the resources to ensure that all of the financial firms under their jurisdiction are in full compliance with the policies, advisories and regulations of the new office?

Mr. Kotz: We will report back to the Committee about the results of our audit as soon as it is completed.

Questions for the Record From Representative Jo Bonner

INVESTOR PROTECTIONS

Mr. Bonner: The four (4) separate examinations the SEC completed during the period 1997-2004 each concluded Stanford was likely operating a Ponzi scheme. The size of the fraud was, in each instance, larger than the entire SEC budget. How could any decision not to pursue the Stanford case be considered discretionary and good public policy?

Mr. Kotz: The Office of Inspector General (OIG) does not believe that the decision not to pursue the Stanford case was "good public policy," and the OIG's report of investigation on the Stanford matter was critical of the Securities and Exchange Commission (SEC), finding that the SEC's Fort Worth Enforcement program made no meaningful effort to obtain evidence relating to Stanford's alleged Ponzi scheme. We also found that the Fort Worth Enforcement program's decision not to undertake a full and thorough investigation of Stanford was due, at least in part, to the perception that the Stanford case was difficult and novel, and not the type of case favored by the SEC. We recommended that the SEC clarify its procedures to ensure that the Enforcement program makes better decisions in the future and that the SEC consider the significance of bringing cases such as the Stanford case, which are difficult but important to the protection of investors.

Mr. Bonner: Was Securities Investor Protection Corporation (SIPC) ever notified of the Stanford Group Company's net operating deficit or its financial dependence on significant cash infusions from Allen Stanford, inter-company loans and referral fees paid by one of its own affiliated entities?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: What efforts were pursued to protect investors when Stanford Group Company (SGC) financial reports indicated a broker dealer in financial difficulty with 70% of its revenue coming from Stanford International Bank (SIB), an entity under common ownership? Did the staff ever discuss the probability that customer funds were in great jeopardy of being stolen (either directly or indirectly) by a SIPC member?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: The Securities and Exchange Commission (SEC) OIG report dated June 19, 2009 states, "The OIG interviewed Steve Korotash, Associate Regional Director of the SEC's Fort Worth Regional Office on May 12, 2009, regarding the chronology of the SEC's Stanford investigation." Did that interview involve any discussion about the findings in the SEC's four examinations of Stanford Group Company between 1997

and 2004, which specifically resulted in reports stating "possible Ponzi?" If not, would you consider such an omission an attempt to impede your investigation?

Mr. Kotz: The interview of Mr. Korotash in May 2009 related to the Securities and Exchange Commission's (SEC) investigation of Stanford during the 2006-2010 time period. In fact, Mr. Korotash was appointed as the Associate Regional Director for Enforcement in the SEC's Fort Worth Regional Office on October 26, 2007. Thus, we would not consider that Mr. Korotash impeded our investigation.

Mr. Bonner: Was or is the SEC Enforcement staff aware that Errol Cort, the Finance Minister for the Government of Antigua and Barbuda during the time the SEC had an open investigation of the Stanford Financial Group of Companies, was Stanford's local counsel in Antigua? Was that perceived as suspicious?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: The unreasonable 4-year delay in getting Stanford International Bank's (SIB) investment information from the Antigua regulators seems like a weak excuse to explain why the SEC didn't act earlier in the Stanford case. The SEC was told that SIB's portfolio was managed by a team of experts in Memphis. Why would the Enforcement staff take four years trying to get information from the Antiguan regulators instead of just asking this Memphis team about the portfolio of holdings or the size of assets under management for SIB?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: Can you outline Enforcement's specific efforts that were pursued to get records from Stanford International Bank or the banking regulator in Antigua once they were refused? Was the State Department, Treasury, or the State of Texas ever notified or asked to assist in getting the records from the Antiguan regulators? Does the SEC have any rules about how to compel a foreign government to produce information when there is an entity in their jurisdiction that is issuing securities to US citizens?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: Did any SEC employees ever travel to Antigua to meet with Stanford International Bank staff or ask Antiguan banking regulator to cooperate?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: In 2007 and 2008, Financial Industry Regulatory Authority (FINRA) fined Stanford Group Company for several compliance issues, including not maintaining minimum net capital requirements and improperly holding customer checks without promptly forwarding them to the clearing firm for processing. To what extent did the SEC follow-up on these violations considering it was 2-3 years into its investigation at that point? What efforts were pursued to protect investors during this time?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: Wayne Secore, the former head of the SEC Fort Worth Regional Office, represented Stanford Group Company (SGC) in its response to the SEC's enforcement inquiries for many years. Once the Fort Worth Regional Enforcement Director Spencer Barasch left the SEC in 2005 and also sought to represent SGC, was that ever considered by the Fort Worth staff to be a conflict of interest or a matter of concern of any type?

Mr. Kotz: The OIG found in its Stanford investigation that the Securities and Exchange Commission Ethics Office did advise Spencer Barasch on several occasions that his representation of Stanford was impermissible under the post-employment ethics rules. In addition, we found evidence that several Fort Worth employees were concerned about Barasch's attempts to represent Stanford.

Mr. Bonner: During the SEC's investigation period, SGC hired the former Director of the regional FINRA office, Bernard Young, as its Chief Compliance Officer. Was this matter ever questioned in the course of the SEC's investigation of SGC and was it noted as a concern that Stanford was establishing a pattern of hiring former regulators who had some level of exposure to the regulators' history of concern about a possible fraud involving the Stanford Financial Group of Companies?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: Once the SEC's Fort Worth Regional Office made a referral of the Stanford case to FINRA in 2005, what steps were taken to follow-up with FINRA on that referral?

Mr. Kotz: In our Stanford investigation, we found no evidence of any specific steps that the Securities and Exchange Commission's Fort Worth Regional Office took to follow up with Financial Industry Regulatory Authority on this referral.

Mr. Bonner: At what point in the investigation process did the SEC notify Stanford Group Company's Clearing House, Pershing LLC, to stop sending funds to the Stanford International Bank (SIB)? Knowing that Pershing & Bear Sterns were making transactions for SGC/SIB, was there ever any follow-up as to where the routing instructions resulted in the funds being deposited?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: Are there any other investigations you've conducted that involve the SEC's Fort Worth office? What were the general findings in those investigations?

Mr. Kotz: We have conducted several other investigations involving the Fort Worth Regional Office. For example, in September 2009, we issued a report of investigation into allegations of retaliatory personnel actions. In this investigation, we found that opposition on the part of an Assistant Director in the Fort Worth Regional Office's Broker-Dealer group to an Securities and Exchange Commission (SEC) program contributed to her being issued a letter of reprimand. Our investigation also found that a former Branch Chief in the same group received a performance counseling memorandum shortly after he complained to SEC senior management about his supervisor.

We issued another report of investigation in September 2009 finding that an Associate Director in the Fort Worth Regional Office violated ethics regulations during official government travel to Kansas in July 2007 by making arrangements for herself and three other Fort Worth Regional Office staff members to stay overnight at a bed and breakfast owned by her brother and sister-in-law. In January 2010, we issued a report of investigation finding that two staff attorneys in the Fort Worth Enforcement group had disclosed non-public information to a former Federal Bureau of Investigation (FBI) agent, who used the information in a fraudulent scheme to engage in short selling, for which he and others were later indicted and convicted.

More recently, in February 2011, we issued a report of investigation finding that a Fort Worth staff attorney made an unauthorized and improper disclosure regarding a confidential informant who was assisting in an FBI investigation.

Mr. Bonner: Under what circumstances does the SEC favor receiverships as opposed to bankruptcy proceedings to liquidate businesses that become the subject of an SEC enforcement proceeding?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: Are there any rules that specify how the SEC staff oversee or interact with a receiver and is anyone watching to make sure those are adhered to in the Stanford case?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: In the specific case of the Stanford Financial Group entities, did the SEC consider, at the outset of the case, the relative advantages and disadvantages of bankruptcy versus receivership?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

Mr. Bonner: Did SEC staff in Fort Worth or Washington ever consider having Receiver Ralph Janvey removed from the Stanford case? If so, what considerations were made that led to the conclusion not to remove the Receiver?

Mr. Kotz: Per my conversation with Representative Bonner's office, the Office of Inspector General is not responding to this question as our investigation did not cover this particular issue.

TUESDAY, APRIL 5, 2011.

GENERAL SERVICES ADMINISTRATION

WITNESS

MARTHA N. JOHNSON, ADMINISTRATOR, GENERAL SERVICES ADMINISTRATION

Mrs. EMERSON. The hearing is going to come to order. I would like to welcome my colleague and friend, Mr. Serrano and Mr. Womack as well, and particularly we want to welcome you, Administrator Johnson. Thank you very much for being here today. I also want to mention for our colleagues that we have several of the GSA regional administrators here. Thank you all very much. I know that you are the ones who have the up close and personal face time with our offices and you all do a great job. We really appreciate you being here and I hope that the time that you spend in D.C. is productive. Certainly it is a crazy time and I suppose it is possibly an interesting time for you all to be here.

GSA directly provides or has contract vehicles for a wide range of services for federal agencies. Some of these services are easy to understand such as buying supplies, finding and leasing office space or constructing and maintaining courthouses. Other services are less well-known, such as managing a public key infrastructure, conveying or auctioning excess lighthouses, or providing information to the public through new media tools and technology. When done well, these services are invisible and unappreciated. When done poorly, these services are ugly reminders of waste and inefficiency.

For fiscal year 2012, the GSA requests $9.8 billion in budget authority and obligational authority, of which $9.5 billion is for the Federal Buildings Fund. The remaining $332 million in funds are for, among other things, an Office of Inspector General, the management of GSA, and notably, $38 million for an initiative to streamline acquisition management.

The Federal government's gross debt currently exceeds $14 trillion and is expected to reach $26 trillion in 2021. The government will never be entirely debt-free, but I am committed to reducing the rate at which we incur debt.

As such, this committee's goal is to reduce spending under this subcommittee's jurisdiction to fiscal year 2008 levels. GSA will undoubtedly be a part of meeting that goal through reductions in its own budget, through innovations to reduce the expenses of all federal agencies and I know that you are working towards that goal, as far as trying to use innovation to provide efficiency. We are thankful for that, once again and thank you for being here, and welcome, Administrator Johnson. I do appreciate your service and

look forward to your testimony. But now let me recognize my friend, Mr. Serrano, for any opening statements he has to make.

Mr. SERRANO. Thank you Madam Chair, and you will notice, I will not make any comments about the St. Louis Cardinals at all.

Mrs. EMERSON. I know. I am ashamed of how poorly they are doing, what can I tell you?

Mr. SERRANO. I am a Yankee fan, so it is fine with me. Actually, I feel bad.

Mrs. EMERSON. Well, I am sure it is. Do you feel badly?

Mr. SERRANO. I do. I only feel good when the Red Sox lose.

Mrs. EMERSON. Well, at the moment of two against one, but since your team is winning and ours is losing.

Mr. WOMACK. I am not saying a thing.

Mr. SERRANO. Okay, Colonel. Thank you, Madam Chair. I, too, would like to welcome GSA Administrator Martha Johnson. The General Services Administration plays a primary role in procuring goods and services, as well as managing facilities for other parts of the federal government. Because of this, the GSA has the responsibility of minimizing property costs, as well as the cost of goods and services for their clients, the other agencies of the federal government.

As we go forward in a tight budget climate, it is important to know that agencies like the GSA are doing their utmost to ensure that the federal government is operating as efficiently as possible. I am also interested in learning more about the contractor performance database, which, according to press reports, is expected to go live on April 15th. This database will provide lawmakers and the public with important information about the reliability and past performance of the federal government contractors.

I think I speak for everyone here when I say that the Federal government should not be using contractors who cannot get the job done on time, on budget, and in line with their bids. This database will help ensure greater public accountability for those contractors who fail to meet these goals. Lastly, we are now just a few days away, it seems, from a possible government shutdown. Because the GSA operates as the landlord for so many federal buildings, a possible shutdown at the GSA would potentially have a much broader impact on the many federal buildings that house other agencies.

Administrator Johnson, as you answer questions today, I think it would be helpful to learn more about the effects of a government shutdown on GSA's operations, and what plans the GSA has in place, should a shutdown occur. Once again I welcome you, and I thank you for being here. Thank you, Madam Chair.

Mrs. EMERSON. Thank you so much, Mr. Serrano. Administrator Johnson, if you could keep your opening remarks to five minutes or so, that way we will have more time for questions. We welcome you, and thanks for being here.

Ms. JOHNSON. Thank you very much, Madam Chair, Ranking Member Serrano, and distinguished members of the subcommittee. Thank you for inviting me to appear before you today to discuss GSA's Fiscal Year 2012 Budget Request.

Our Fiscal Year 2012 Budget continues efforts that we started last year to transform GSA into an innovative change agent for the government. GSA is a strategic partner for federal agencies that

helps them make efficient and effective use of resources, collaborate with and engage with the public, and make government more nimble, agile, responsive, and adaptive.

GSA is building a government that works better by changing the way we acquire, manage, and dispose of our assets, and by accelerating open government through new transparency tools and practices. We believe that open government is good government, and we have requested limited funding increases that will enable us to engage citizens even further, in so doing, receive better feedback about vital federal programs. We are also requesting targeted investments in federal buildings and land ports of entry to modernize the nation's infrastructure, create jobs, and grow trade and commerce.

GSA's Fiscal Year 2012 Budget priorities align with our goal of supporting a government that works better through a three-part strategy of supporting innovation, building customer intimacy, and creating operational excellence. The two primary drivers of this strategy are first, our focus on achieving a zero environmental footprint and second, our dedication to fostering an open and transparent government.

The Zero Environmental Footprint goal, or ZEF, is GSA's commitment to eliminate our impact on the natural environment, and use our example and our government-wide influence and positioning to reduce the environmental impact of all federal agencies. ZEF focuses GSA's efforts and resources to concentrate on reducing our consumption of energy, water, and other resources, eliminating pollution and reducing inefficiencies from all of our operations. As numerous examples from the private sector demonstrate, pursuing sustainability across our enterprise will help us stretch our budget dollars further and develop best value to the taxpayer and our agency customers.

GSA is also building expertise, technology, and processes for open government, and is putting transparency, participation, and collaboration at the center of government operations. We are publishing unprecedented amounts of government data and information online and through mobile applications to communicate government performance and services to citizens.

GSA is helping the government be more responsive by expanding citizen participation through shared information, crowd-sourcing tools and techniques, virtual workplaces, and collaborative protocols. Our efforts in open government have provided federal agencies with the tools and expertise to make a more visible and accessible government that is better able to encourage and engage the talent and contributions of our citizens, industry, academia, and our own civil servants.

To conclude, your approval of GSA's Budget Request for Fiscal Year 2012 is a vital step towards helping GSA deliver a more effective and efficient government. Our request advances the administration's goal of winning the future through strategic investments in innovation and infrastructure, while cutting waste and excess. I look forward to continuing this discussion on the Budget Request with you and the members of the subcommittee.

[The information follows:]

STATEMENT OF MARTHA N. JOHNSON

ADMINISTRATOR OF GENERAL SERVICES

BEFORE THE

HOUSE APPROPRIATIONS COMMITTEE

SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT

UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 5, 2011

Madam Chair, Ranking Member Serrano, and Distinguished Members of the Subcommittee:

My name is Martha Johnson and I am the Administrator of the General Services Administration (GSA). Thank you for inviting me to appear before you today to discuss GSA's fiscal year (FY) 2012 budget request.

Our FY 2012 budget continues efforts that we started last year to transform GSA into an innovative change agent for the government. GSA is becoming a strategic partner for Federal agencies by helping them make efficient and effective use of resources, collaborate with and engage the public, and make Government more nimble, agile, responsive, and adaptive. GSA is building a high-performing government by changing the way we acquire, manage, and dispose of our assets, accelerating open government through new transparency tools and practices, and improving the environmental and financial performance of our assets. We are modernizing our acquisition processes to reduce consumption and overcome long-standing barriers to cost savings in Federal contracting. We are demonstrating that open government is good government, and we have requested limited funding increases to continue to engage citizens in their government, make government more responsive to citizen needs, and increase the effectiveness of government programs. Finally, we are requesting targeted investments in Federal buildings and Land Ports of Entry to modernize the nation's infrastructure, create jobs, and grow trade and commerce.

GSA's FY 2012 budget priorities align with our strategic goal of supporting a government that works through Innovation, Customer Intimacy, and Operational

Excellence. The two biggest drivers for making that work are our focus on achieving a "Zero Environmental Footprint" and our dedication to building and leveraging openness and transparency.

The Zero Environmental Footprint goal, or "ZEF", is GSA's commitment to eliminate our impact on the natural environment and to use our example and our government-wide influence and positioning to reduce the environmental impact of all Federal agencies. ZEF focuses GSA efforts and resources to concentrate on reducing our consumption of energy, water, and other resources, eliminating pollution, and wringing out waste from all of our operations.

GSA efforts to reduce consumption and eliminate waste and pollution can translate directly into reduced Federal spending. We provided Federal agencies with almost 369 million square feet of workspace in FY 2010 and realized $64 billion in acquisitions through GSA business lines or through procurement vehicles developed by GSA, which is over 14 percent of Federal procurement dollars. Traditionally, the large scale of our operations has allowed us to help agencies use their workspace and contracting dollars more effectively by consolidating and centralizing procurements, using expert negotiating to get the best price, and managing assets with stewardship and financial integrity. Today, GSA can deliver even greater efficiencies by applying principles of sustainable design to find innovative ways to use Federal assets more efficiently and to make Federal programs and processes more effective.

GSA also is building expertise, technology, and processes for open government and putting transparency, participation, and collaboration at the center of government

operations. GSA is publishing more government data and information on-line and through modern information delivery channels, including mobile applications, to communicate government performance to citizens. GSA is making government more responsive by expanding citizen participation through shared information, crowd-sourcing tools and techniques, virtual workplaces, and collaborative protocols. GSA is building citizen engagement and collaboration tools to strengthen problem-solving networks. GSA efforts in open government have provided Federal agencies with the tools and expertise to make a more visible and accessible government, that is better able to encourage and engage the talent and contributions of citizens, industry, non-profit organization, academia, and our own civil servants.

ZERO ENVIRONMENTAL FOOTPRINT

Over the past year, GSA has demonstrated progress in improving our environmental performance in ways that reduce Federal government operating costs.

GSA is working to "green" the Federal supply chain through a variety of initiatives. GSA is helping other agencies meet their sustainable procurement goals by expanding our offerings of sustainable products and services. We are also verifying the accuracy of eco-labeled products that GSA provides and, in the process, we are standardizing and simplifying our labeling to ensure Federal agencies can quickly and easily procure environmentally friendly products. We are working with the vendor community to encourage Federal contractors to voluntarily disclose their Greenhouse Gas (GHG) emissions and to include vendor GHG emissions data in the Federal procurement process. We will use our market influence to ensure a continuing demand

for sustainable products, which we expect will help encourage innovation in green technologies, stimulate the green economy, and help create new jobs.

We are making significant progress in improving the environmental performance of the Federal motor vehicle fleet. In FY 2010, GSA doubled the number of hybrid-electric passenger vehicles in the Federal fleet. We used existing funds to acquire 5,603 new hybrids to replace the least fuel-efficient vehicles across the Federal fleet, without increasing the overall size of the fleet. This investment will save an estimated 7.7 million gallons of gasoline over the life of the vehicles, and with nationwide gas prices exceeding $3.50 per gallon, could produce as much as $27 million in savings over the next five years.

GSA also plans to pilot plug-in, hybrid-electric motor vehicles in the Federal fleet, but we lack statutory authority to purchase them. This new technology has the potential to substantially reduce the Federal government's consumption of gasoline. We do not believe, however, we have the authority to purchase these vehicles under current laws and at the prices that manufacturers are expected to offer. The President's Budget includes language in the Government-wide General Provisions that would allow GSA to acquire motor vehicles that operate on emerging, clean-burning technologies. If this authority were granted, GSA would use it to test new technology motor vehicles and prove their technical and economic viability before expanding their use in the Federal fleet.

We have continued to improve the sustainability of our Federal buildings. As of 2010, 47 GSA Federal buildings and leases had achieved the U.S. Green Building

Council's Leadership in Energy and Environmental Design (LEED) certification. LEED certification provides third-party verification that a building was designed and built to standards that improve energy savings, reduce water consumption, improve indoor air quality, and use more sustainable resources, when compared to existing buildings. A review of 12 GSA properties with LEED certification found that those buildings consume 26 percent less energy and 3 percent less water than equivalent commercial buildings. By consuming less energy and water, LEED buildings reduce operating costs over the life of the building.

Beginning last year, all new construction projects will be designed to achieve LEED Gold certification and to meet Energy Star requirements. These projects also will be designed to be at least 30 percent more energy-efficient than industry standards for non-residential buildings. Major renovation projects will be designed to consume energy at a level no greater than the average energy intensity of comparable GSA facilities. The GSA Energy and Water Retrofit and Conservation Measures program provides small-scale building alterations and retrofits of building systems to reduce on-site energy and water consumption in Federal buildings. GSA capital building projects will improve the environmental sustainability of our assets by reducing energy consumption and pollution; reducing energy consumption will reduce operating costs over the life of our assets.

GSA is moving beyond LEED and is exploring net-zero buildings as a springboard to significant improvements in environmental performance. Net-zero buildings benefit the environment by producing as much energy as they consume during the year, through on-site renewable energy generation and by increasing energy

efficiency to reduce consumption. GSA recently announced plans for the nation's first net-zero historic building: the 92-year-old Wayne Aspinall Federal Building and Courthouse in Grand Junction, CO. Net-zero buildings reduce operating costs by consuming significantly less energy and can improve security in Land Ports of Entry by moving facilities off the power grid.

OPEN GOVERNMENT

GSA is committed to creating a culture of open government and making openness standard practice in government operations. We have demonstrated our commitment to transparency by delivering government information and services directly to citizens and by sharing our expertise in citizen engagement with other agencies through the Office of Citizen Services. GSA increased citizen participation in government by supporting several electronic government projects, including: www.data.gov and the IT Dashboard on www.USASpending.gov; the government-wide challenges and prizes platform, www.Challenge.gov; and the citizen engagement platform, www.apps.gov *NOW*. Our experience has demonstrated that rapidly-developed, web-based technologies are the key to open government objectives of transparency, participatory government, and citizen-government collaboration.

GSA also provides faster, easier, and more efficient services directly to citizens through www.USA.gov and www.GobiernoUSA.gov, the web portal of the Federal government. We revamped the USA.gov website last year, the tenth anniversary of the website, adding a state-of-the-art search engine that provides citizen with access to Government information and services nine times faster than the previous website. We

deployed 17 mobile applications to USA.gov, giving citizens go-anywhere access to information and services from 12 Federal agencies. We recently launched Notifications.USA.gov, giving the public easy access to 7,000 real-time updates on topics ranging from food recalls to weather emergencies, delivered to their computer desktop, smart phone, or other device.

GSA supports participatory Government by providing Federal agencies with solutions that simplify the engagement process for both citizens and agencies. We conducted 12 high-value public dialogues in FY 2010, using crowd-sourcing tools to allow citizens to submit their ideas for improving Government and to vote on the ideas of others. We developed www.Challenge.gov, a no-cost, easy-to-use on-line tool for Federal agencies to solicit solutions to pressing issues by posting contests and using challenges and prizes to promote and inspire citizen participation in Government.

Inside GSA, we are employing new business practices and technologies to increase transparency and improve our internal collaboration. We are using web-based tools to hold dialogues and engage our employees in topics ranging from sustainability to workspace utilization and configuration. These on-line conversations encourage innovation and allow effective practices to spread quickly and easily across the agency. We have pioneered a new type of meeting, a "slam", which gathers key decision-makers in one room to develop solutions and plan for implementation of those solutions. We most recently held a slam meeting on the Federal Acquisition Regulations (FAR), where we brought together our rule-making partners in the Office of Management and Budget, the Department of Defense, and the National Aeronautics and Space Administration to find new ways to improve the quality and timeliness of the FAR rule-

making process. We have recently awarded a contract for a cloud-based e-mail and collaboration solution, and we expect the anytime, anywhere collaboration capabilities of this tool to provide an environment for on-line, shared problem solving.

As we continue to drive increased openness and transparency in Government, GSA has recognized the convergence of open government and electronic government. To meet these closely related objectives, we have realigned the mission and talent of the Office of Citizen Services to create a new organization, the Office of Citizen Services and Innovative Technology (OCSIT). OCSIT will identify, test, and deploy innovative technologies to make government data available and accessible online, soliciting the public for input into government decisions, and leveraging wisdom and solutions from outside the government. OCSIT will continue to provide information and services directly to the public and assist other Federal agencies in citizen engagement. In addition, OCSIT's role has been expanded to include responsibility for GSA Electronic Government Fund projects.

ACQUISITION IMPROVEMENTS – FEDERAL STRATEGIC SOURCING INITIATIVE

GSA is helping Federal agencies to reduce spending is through our Federal Strategic Sourcing Initiative (FSSI) Blanket Purchase Agreements. FSSI is an OMB-initiated program that consolidates requirements for common commodities to create government-wide procurement solutions that are easier to use and offer substantial discounts over commercial sources. GSA currently offers FSSI solutions for purchasing express and ground domestic delivery services, telecommunications management, and office supplies.

GSA recently released a second generation of FSSI solutions for domestic shipping and parcel delivery service and office supplies. GSA second generation FSSI Solutions offer additional benefits over the first generation offerings, including point-of-sale discounts, which allow government purchasers to automatically obtain agreed-upon discounts. GSA's new FSSI solution for domestic shipping and parcel delivery services will generate significant savings from commercial retail costs: The first generation solution reduced costs by an estimated $244 million over its three-year lifespan, and the new solution prices are seven percent lower. GSA's second generation office supplies solution is estimated to reduce government-wide costs by $48 million per year, for a four-year total reduction of $192 million. GSA's office supplies FSSI solution offers sustainable products and supports socio-economic purchasing goals by satisfying AbilityOne requirements and including small and small-disadvantaged businesses.

GSA offers interagency acquisition vehicles that adopt a strategic sourcing approach to reduce unit costs and reduce acquisition support costs in Federal agencies. For example, GSA telecommunications contracts aggregate government-wide requirements to deliver significant savings to customers; in FY 2010, these programs saved the Federal government an estimated $678 million, when benchmarked against comparable commercial contract offerings. The GSA SmartBUY (Software Managed and Acquired on the Right Terms) program has generated savings for software purchasers approaching $1 billion since its inception in 2003. GSA Network Services and SmartBUY programs are expected to reduce government costs by $1 billion per year by FY 2014.

EFFICIENT MANAGEMENT OF FEDERAL REAL PROPERTY

GSA supports the Administration's efforts to eliminate excess and underutilized Federal real property and make better use of the remaining assets. The President's Budget includes a proposal to establish an independent board of experts to expedite the disposal of unneeded properties and identify opportunities to consolidate offices across and within agencies. It applies approaches that have been proven successful by the Department of Defense's Base Realignment and Closure Commission.

GSA looks forward to supporting the Civilian Property Realignment Act Board and helping the Government overcome recognized barriers to the timely disposal of excess property. We will share our expertise in real property management and workspace utilization to support the Board as it formulates strategies for consolidating Federal properties. We will help the Board by providing data from the Federal Real Property Profile, the government-wide database of all non-security, Executive Branch real property, which GSA operates on behalf of the Federal Real Property Council. We expect to act as a disposal agent for some of the properties identified by the Board and approved for disposal by Congress.

GSA will continue to address the management of real property across our real estate portfolio and implement cost savings approaches which support the economic and efficient use of space. We will develop portfolio plans in collaboration with our customers to make more efficient and economical real estate decisions. Portfolio plans represent strategic relationships between GSA and its customers to determine the customer's long-term housing needs and to develop an actionable plan to address

those needs. GSA will complete portfolio plans for at least three of our largest real estate customers by September 30, 2011, and we have established a long-term goal of completing plans for our 20 largest customers by FY 2014.

COST SAVINGS IN GSA

GSA is reducing costs in our own operating budget. Our FY 2012 budget request includes seven savings initiatives that produced $27 million in cost avoidance, including $17.5 million in cuts to our discretionary appropriations.

Nearly half of these savings, $11 million total and $8.5 million from discretionary accounts, is generated by reducing business travel across all GSA programs. GSA has committed to reduce our Scope 3 Greenhouse Gas (GHG) emissions from employee business travel by 25% by FY 2020. We will meet this aggressive goal by seeking alternatives to travel, including deploying advanced videoconferencing systems, consolidating and co-locating training conferences, and reducing non-mission critical travel. This initiative is a model of how improving agency environmental performance can deliver meaningful reductions in operating costs.

We reduced the cost of our telephone network by deploying Voice-Over-Internet-Protocol (VoIP) technology. VOIP reduces costs for phone service, and because VOIP carries telephone services over the internal data network and over the Internet instead of the telephone network, reduces costs of maintaining the physical infrastructure of telecommunications equipment. GSA has reduced its FY 2012 budget by $6 million for VOIP savings, including $3.5 million from the discretionary request.

GSA found an additional $10 million in savings, including $5.5 million from discretionary funding, from several smaller initiatives. We are transitioning our supply operations away from brick-and-mortar distribution centers and moving to a model where vendors deliver supplies directly to our customers. We are eliminating our support for Telecenters because of low participation rates government-wide. We will reduce the number of building studies conducted in the Public Buildings Service, and our request identifies smaller initiatives that will deliver cost savings in the Office Government-wide Policy and Office of Citizen Services and Innovative Technologies.

TARGETED INVESTMENTS IN CRITICAL INFRASTRUCTURE

GSA's FY 2012 budget requests a total of $617 million in net budget authority. This amount is just 2.6% of our total planned obligations of $24 billion. The majority of our funding is provided through reimbursements from Federal customer agencies, for purchases of goods and services or as rent paid for space in Federally-owned and – leased buildings under GSA jurisdiction, custody or control.

Federal Buildings Fund

Our FY 2012 budget requests $9.5 billion in New Obligational Authority (NOA) for the Federal Buildings Fund, including a capital investment program of $1.7 billion. GSA is not requesting an appropriation to the Fund, and would fund the FY 2012 request from available resources.

Our request for $840 million in NOA for New Construction and Acquisition focuses on homeland security, including $218 million for the continued development of

the Department of Homeland Security Headquarters at the St. Elizabeths Campus in Washington, DC; $243 million for two Federal Bureau of Investigation projects in San Juan, PR, and Frederick County, VA; $370 million for five Land Port of Entry facilities; and $9 million to continue the environmental remediation of the Denver Federal Center. Our request includes the following projects:

- St. Elizabeths Highway Interchange in Washington, DC ($55 million);
- St. Elizabeths West Campus Infrastructure in Washington, DC ($42 million);
- St. Elizabeths Activities in Washington, DC ($100 million);
- St. Elizabeths East Campus Road Development in Washington, DC ($21 million);
- Denver Federal Center Remediation in Lakewood, CO ($9 million);
- FBI Consolidation in San Juan, PR ($146 million);
- FBI Central Records Center in Frederick County, VA ($97 million); and
- Land Ports of Entry in:
  - Columbus, NM ($60 million)
  - Alexandria Bay, NY ($174 million)
  - Laredo, TX ($75 million)
  - Dunseith, ND ($36 million)
  - Brownsville, TX ($26 million)

GSA requests NOA of $869 million for Repairs and Alterations to Federal buildings. The request includes $321 million in NOA to complete four multi-year building modernization projects; $84 million for three additional projects; and $464 million for non-prospectus level projects and Special Emphasis programs. Our proposed repairs and alteration program includes:

- Main Interior Building in Washington, DC ($50 million);
- Harry S. Truman Building in Washington, DC ($55 million);
- Prince J. Kalanianaole Federal Building and Courthouse in Honolulu, HI ($199 million);
- Phillip Burton FBI Consolidation in San Francisco, CA ($50 million);
- Prevedel Federal Building in Overland, MO ($24 million);
- EEOB Pennsylvania Avenue Screening Facility in Washington, DC ($17 million);
- Design of the Federal Building (ICE) in Los Angeles, CA ($9 million);
- Non-Prospectus Repairs and Alterations projects ($402 million); and
- Three Repairs and Alterations Special Emphasis programs:
  - Energy and Water Retrofit and Conservation Measures ($40 million);
  - Fire Prevention Program ($15 million); and
  - Wellness and Fitness Program ($7 million).

In addition to our capital program, GSA requests New Obligational Authority for our operating program, in the amount of:

- $5.3 billion for the Rental of Space program, which will provide for 201 million rentable square feet of leased space;
- $2.4 billion for the Building Operations program; and
- $127 million for the Installment Acquisition Payments program.

Cross-Border Transportation Initiative

In addition to the amounts requested in the Federal Buildings Fund, the President's Budget includes $2.2 billion that would be provided to the Federal Highway Administration (FHWA) for design, construction, and modernization of Land Ports of Entry (LPOE) at the nation's largest border crossings. If approved, FHWA would transfer LPOE funding to GSA to design and construct the LPOEs.

This investment is designed to improve the nation's transportation infrastructure by improving LPOEs to increase and expedite the flow of cross-border transportation and trade. The LPOE funding is one component of a $50 billion up-front investment proposed by the President in FY 2012 to re-build and modernize the nation's infrastructure, including roadways, railways, and runways. This investment would be funded by mandatory contract authority provided to the Transportation Trust Fund (TTF, formerly the Highway Trust Fund), within the Department of Transportation (DOT). The President has requested funding for Land Ports of Entry in the DOT budget because LPOE improvements are one component of a broader initiative to improve travel and stimulate trade and commerce through investments across the nation's transportation infrastructure. LPOEs are critical to the larger investment because all goods traveling by land must transit through a port when entering or exiting the United States. The proposed list of LPOE projects which could be funded by this initiative was identified cooperatively by the Department of Homeland Security, Customs and Border Protection, DOT and GSA.

GSA Operating Appropriations

The GSA FY 2012 budget requests $332 million for our operating appropriations, an increase of $66 million over the FY 2010 enacted level. Our operating appropriations provide for the Office of Government-wide Policy, the government-wide programs of the Operating Expenses account, the GSA Office of Inspector General, the Electronic Government Fund, the pensions and office staffs of former Presidents, and the Federal Citizen Services Fund. The budget also requests funding for the Federal Acquisition Workforce Initiatives Fund.

Our budget requests $38 million for the Government-wide Policy appropriation for the continued modernization of the Integrated Acquisition Environment (IAE). IAE is an Electronic Government initiative that combines eight separate systems that provide shared acquisition services across the Federal government. GSA is requesting funding to consolidate the separate systems onto a single, integrated platform for Federal procurement. A single platform for IAE will improve transparency and support open Government objectives by improving data quality, simplifying access to Federal acquisition data, and improving usability of procurement systems for Federal acquisition professionals and citizens.

GSA also has requested $16.9 million for strategic investments in the Federal, civilian acquisition workforce, through the Federal Acquisition Workforce Initiatives Fund. These funds would provide for activities that foster and promote the development of the government-wide acquisition workforce and support the responsibilities provided for in the Office of Federal Procurement Policy Act. Funding is requested to increase

the capacity and capability of the acquisition workforce; improve the effectiveness of the workforce; and maximize competition and value.

We have requested an increase of $3.1 million for the Federal Citizen Services Fund to improve citizen engagement with the government through innovative technologies and to improve delivery of government services to the public. The funds requested would be used to modernize GSA information delivery channels, including adding texting capability at the National Contact Center and providing easy electronic access to electronic and mobile-accessible government publications through an on-line storefront. GSA would expand our efforts to improve government service by providing other agencies with technology and expertise to improve their interactions with the public. GSA will continue to build government-wide capability to engage citizens in dialogues and challenges to solve complex issues directly impacting the public.

SUMMARY STATEMENT

The GSA FY 2012 budget request advances the Administration's goal of "winning the future" through targeted investments in innovation and infrastructure while cutting waste and excess. Our budget request includes targeted investments in our nation's physical infrastructure, but promises greater savings through the real property consolidations and disposals of the civilian BRAC Board and GSA efforts to improve space utilization in our buildings. Our budget requests funding to modernize government-wide acquisition systems and improve the capabilities of the acquisition workforce, while demonstrating that acquisition improvements such as strategic sourcing can deliver billions of dollars in savings. We have requested small increases

for open government initiatives that will improve citizen collaboration and engagement, and drive better delivery of government services to citizens. Further, our budget demonstrates that we can deliver significant gains in Federal environmental sustainability in a way that reduces costs and improves government effectiveness.

Your approval of the GSA budget request for FY 2012 is a vital step toward helping GSA to deliver a more effective and efficient Government.

CLOSING STATEMENT

Madam Chair, this concludes my formal statement. I look forward to continuing the discussion of our FY 2012 budget request with you and the Members of the Subcommittee.

GSA U.S. General Services Administration

Martha N. Johnson - Administrator

As Administrator of the U.S. General Services Administration (GSA), Martha N. Johnson works on the front lines of President Obama's agenda to build a more sustainable and effective government for the American people. The GSA is responsible for improving the government's workplace by managing assets, preserving historic property, delivering maximum value in acquisitions, and implementing technology solutions.

Prior to her appointment in the Obama Administration, Johnson worked in large, complex organizations propelling them through strategic and productivity change. With her broad cross-section of experience, from Chief Financial Officer of the architecture firm Ellenzweig Moore to change management and logistics expert at Cummins diesel engine factory, Johnson brings a deep knowledge of executive leadership in each of GSA's core business lines.

Johnson's credentials in organizational transformation began in 1979 at Cummins Engine Company where she participated in a transformation in the production of diesel engines, one of the early examples of the Total Quality Revolution in manufacturing in American industry. Johnson deepened her change management expertise as a search executive at Isaacson, Miller. In 1992, when President Clinton sought to build a leadership team that reflected America's broad diversity, she was appointed to the Office of Presidential Personnel.

In the mid-1990s Johnson was asked to serve first as Assistant Deputy Secretary at the Department of Commerce and then as Chief of Staff at the GSA. In these positions, she fostered collaboration and strengthened the leadership teams. Her strategic vision and management expertise helped GSA successfully maneuver through changes brought about by the Clinger-Cohen Act, taking the agency from a mandatory supplier of goods and services to a competitive, market-oriented, supplier-of-choice for federal agencies.

In 2002, Johnson's change management and leadership knowledge came full circle when she joined SRA International. Consulting to federal agencies, she provided strategic development, productivity improvements and methodologies for innovation. At that time she also served on the Board of Supervisors for the UK Government's Office of Government Commerce, supporting their strategies for procurement reform and acquisition workforce support. In 2007, Johnson joined Computer Sciences Corporation as Vice President of Culture where she drove innovation and collaborative capacity across the 90,000-person, global IT services company.

Johnson was unanimously confirmed by the U.S. Senate as the 19th Administrator of General Services on February 5, 2010.

Johnson received her Bachelor of Arts degree from Oberlin College and Master of Business Administration from Yale University.

Mrs. EMERSON. Thank you so much, Administrator Johnson. I am going to go ahead and start. We have been joined by Mr. Diaz-Balart and Mr. Bonner. And so I will try to keep my questions to five minutes as well.

The Bowles-Simpson Fiscal Commission proposed government-wide reduction in travel, printing, and vehicles. Can you share with us, how much does GSA currently spend on these activities for itself and what you are doing to help other federal agencies save resources in these areas?

Ms. JOHNSON. The actual numbers of what we spend I will have to provide for the record.

[The information follows:]

TRAVEL, PRINTING, MOTOR VEHICLE EXPENDITURES

What does GSA currently spend on travel, printing, and motor vehicles?

GSA response: GSA obligated $69 million for travel, printing, and motor vehicles in FY 2010. Of that amount, approximately $50 million was for travel, $13 million was for printing and reproduction, and $6 million was obligated to operate the GSA-internal motor vehicle fleet.

Ms. JOHNSON. We are attacking travel with great vigor. Our own projections are to cut our own travel $11 million this year, and to reduce that through a number of techniques.

First of all, we are working much more with a mobile workforce notion, which, I think, gives us much more flexibility and technology, so people can communicate across the country without picking up and going there. Second, we are installing some good telepresence, videoconferencing capability, which I think will get people to stay off airplanes. One of the things is you really want to have a good capability, so that your instinct is to get on the video conference, rather than get on an airplane. A change in behavior is part of this as well.

So, through our FAS, acquisition service, we are creating important tools so that people who do travel have better options and better prices. So, as usual, we are working on more efficient travel, when it is necessary.

In printing, I think we are right at the cusp of moving from really a paper-dominated government to an electronic-dominated government. And we are right in the center of that. We are reducing the publications we offer by quite a good number, although I am going to have to supply that to you. We are also, through our online capability, publishing data and making much more available to the public that way. And I think that is encouraging all of us, again, to shift behaviors to move online. So, through all of these shifts in travel and moving more towards technology, I think we are on the glide path towards much more efficiencies.

[The information follows:]

PRINTING OPERATIONS

The Administrator committed to provide the number of print publications that GSA is eliminating or reducing.

GSA Response: GSA print operations are managed by the Office of Citizen Services and Innovative Technologies (OCSIT). OCSIT promotes and manages the distribution of Federal print publications to the public; however, actual printing and print distribution is primarily accomplished through the Government Printing Office distribution facility in Pueblo, CO. OCSIT supports print distribution by creating a variety of direct marketing materials and a quarterly Consumer Information Cata-

log. OCSIT also publishes the annual Consumer Action Handbook (CAH) and its' Spanish equivalent, the Guia del Consumidor, to provide consumers with critical information on purchases, problems, and complaints.

In FY 2010, GSA promoted and distributed more than 22.9 million publications to the public through the GPO distribution facility in Pueblo, CO. Ninety-eight percent of these publications were prepared for other Federal agencies, to meet specific requirements and pass on critical information to citizens. GSA printed and distributed an additional 9.7 million publications through quarterly distributions of GSA's Consumer Information Catalog. GSA plans to reduce the number of Catalogs it produces and distributes by more than 30 percent in FY 2011 by moving from quarterly to semiannual distribution. This transition will reduce GSA printed documents by 3 million pieces.

GSA is working with customer Federal agencies to find ways to reduce print publications, but has not set specific targets for reducing their print publications. GSA has had recent successes in making Federal publications available through online document sharing tools. GSA currently offers 100 agency publications each on Scribd, a free online document sharing tool, and Google Books and the GPO Bookstore website. Publications on Scribd received 40,000 page views in FY 2010 and, in the first ten days that agency publications were posted on Google books, GSA received 2,000 orders for printed publications and 500 on-line views. GSA plans to make 500 publications available electronically through Google, Scribd and other partnerships by the end of FY 2011, and expects this will allow Federal agencies to eliminate or reduce print publications in the future.

Mrs. EMERSON. Okay. I will appreciate you getting that information back to us. On page nine of your testimony, you mentioned FSS Size Solution for Domestic Shipping and Parcel Delivery Services and the work that you all are doing to reduce costs. Given the fact that we also have jurisdiction over the U.S. Postal Service, and it is in such dire need of either new funds or trying to reduce its expenditures since it is way in the red, do you work with them and is this part of what you all are doing to try to save costs?

Ms. JOHNSON. The parcel service, direct parcel service, is one of our many cooperative buying programs that we are sort of facilitating. We are moving away from, clearly, our old mandate of being the sole supplier of these things, to organizing the agencies into kind of a cooperative buying process. We are doing it for office supplies, for wireless service, for print services, eventually for software, in a more concentrated way, and domestic parcel delivery.

The process is to go out and to ask industry, the post office, who can come in with the best bids and then to orchestrate the agencies to agree to a certain volume of purchasing. So, in that process they are among the competitors, if you will, for our consideration.

Mrs. EMERSON. So the Postal Service will be competing with UPS, with FedEx, or whomever as part of this, because it just seems to me that we should be encouraging them to be able to increase volume so that they are not in such dire financial straits.

Ms. JOHNSON. That is a good point, and I can learn more about how we consider them, and what sort of conversations we had with them.

Mrs. EMERSON. Would you? I would appreciate it because when you have got an agency, or an entity of the government that is almost $3 billion in the hole, you have got to try to figure out: Okay, are there things that we can do. And obviously a federal partnership, since it is a public-private entity anyway, anything that we can do to help them, as long as they can meet the same price threshold.

Ms. JOHNSON. Exactly. Offer the same value, which is what we can then be the arbitrators for.

[The information follows:]

USPS SERVICES

How did GSA consider the US Postal Service in the Express Ground and Domestic Delivery Service FSSI BPA, and did GSA have any conversations with the USPS when developing, competing, or awarding the BPA?

GSA response: GSA had several conversations with the US Postal Service (USPS) when developing the Express and Ground Domestic Delivery Services (ExGDDS) FSSI BPA, and worked with all potential offerors, including the USPS, to ensure they were well-positioned to participate in the solicitation.

Early in the ExGDDS procurement, GSA determined that using the GSA Schedules program was the best way to fulfill the goals and objectives of the FSSI. GSA worked with USPS to help them become a Schedule provider for the first time.

GSA conducted extensive market awareness discussions with USPS, as well as the other interested suppliers, during the solicitation development and market research phase. GSA used that industry feedback to develop a solicitation that was keenly competed among GSA Schedule participants.

Ultimately, GSA selected United Parcel Service (UPS) as the source that provided the best value to the government based on price and other technical evaluation factors. The evaluation criteria used for the procurement were technical approach, past experience/past performance, corporate qualifications, and pricing.

Mrs. EMERSON. Okay. Well, then let's have a further conversation about that if we could. Mr. Serrano.

Mr. SERRANO. Thank you. Let's talk about one of our favorite bills, H.R. 1. What is the impact on your agency? The bill proposes no funding for construction or acquisition of facilities, a cut of $676 million from fiscal year 2011 requests, and very little funding for repairs and alterations, a cut of $423 million. So, what would be the impact? If it were enacted what would it do to the impact on federal buildings, current projects, and construction jobs?

Ms. JOHNSON. Our building's projects are in sort of a number of tranches. We work with the judiciary and we have a couple of those projects, we have a number of construction projects under way. We also do a great deal of land ports of entry right now. Federal office buildings; everything from federal centers to negotiating office space and work environments, and the whole portfolio will be impacted. And it is difficult to know how the priorities work out until you actually know how much you are dealing with overall. The repair-alteration piece to it is of huge concern because our inventory is a huge valued asset, and any degradation of that just puts us that farther behind. So, while we try to be very good stewards about using the resources that we have available, holding to that line will reduce our ability to continue the repairs and alterations that we want to do, and schedules we want to keep.

Mr. SERRANO. Now what would happen to projects that are near completion? For example, buildings that are almost ready for occupation but would not receive the final installment of construction costs?

Ms. JOHNSON. We are going to have to manage it at the portfolio. If the funds are limited, we will need to look at each of the projects we have and determine where we will suffer the least, if we were to slow down, or extend the schedules, or do any kind of change of program. So it is really a comparison problem. Clearly, the priority is to start with the safety and security of the workers. So if the work that we are doing has to do with that, we need to get that taken care of. But then it is a trade-off; if you have a whole bunch of money and you have got one project that is nearing completion

or four that are at another stage, you just have to make all of those trade-offs. And we do this all the time. This is the nature of portfolio management.

Mr. SERRANO. Right. If there's something that both parties agree on, and I venture to say this out loud, it's that the economy will show that it is doing better when more jobs are added to the economy. The majority party also believes that, through very dramatic cuts and new jobs, you would turn the economy around. Some of us believe that some of those cuts can, in fact, make us lose jobs that already exist. Is there any way of knowing the impact on jobs, how many jobs you would lose if these cuts went through?

Ms. JOHNSON. I could explore that and provide that for the record. I think we could make some estimates around that.

Mr. SERRANO. I appreciate that. I am going to ask you about the potential shutdown. No, first let me ask you, a project that is very much a part of this committee, over the last few years. What would be the impact, again, I know that you cannot really outline exactly what would happen if H.R. 1 becomes law, but what would be the impact on the St. Elizabeths campus in Southeast DC for the Department of Homeland Security? That has been a project that has been mentioned quite a bit.

Ms. JOHNSON. Quite a bit; it kind of dominates our thinking in many ways. It is the largest building project we are engaged in right now. It has a number of phases of work. Essentially, if we had a smaller budget we would have to slow down the overall project. Right now, we are engaged in working through the Coast Guard's headquarters, and we would work very hard to try to stay on schedule and be as creative as possible to do that. But I think we are going to be needing to adjust on all fronts, if we are compromised on our budget.

Mr. SERRANO. I have one last question, Madam Chair. I know we have other members. Again, related to H.R. 1; the impact of a potential shutdown of the government. As the government's landlord, what happens to GSA operations if very few of your tenants are able to work after this Friday?

Ms. JOHNSON. We clearly are responsible for a major asset for the government, and need to be sure that it is secure, and where there is necessary work going on we need to be supportive of that. If there are hospitals that need to stay open, or other kinds of facilities, and we are engaged in them, although we do not do hospitals, we would be supporting the work of whichever division is still engaged. And I suspect it would be quite minimal. But our facilities play a part in supporting those vital missions and I do not think we should be the link in the chain that would be compromising that.

Mr. SERRANO. Okay, but there is a plan in place?

Ms. JOHNSON. We have a regular plan, ours was renewed a couple years ago. It is sort of a routine thing, what to do, because we are so vital to everyone in the government, and so, yes, we have a plan in place.

Mr. SERRANO. Right. Thank you, Madam Chair.

Mrs. EMERSON. Thank you, Mr. Serrano. Mr. Womack.

Mr. WOMACK. Madam Administrator, help me out with something here. Government-wide policy, if my numbers are correct, in

2008, it was $52 million and some change, and then in 2010, it was nearly $60 million, and your 2012 request is $105 million. I did some quick math on that. If I am right, that is about one and three quarters times the 2010 amount. Help me out with government policy. Why such an exponential increase in the request, there?

Ms. JOHNSON. The bulk of that is responding to the pleas and cries from across government to be sure that our acquisition workforce is trained and as professional as possible. And the acquisition workforce over the last couple of decades has not had the attention it needs. It is a complex job. It has had a huge amount of turnover. And we are all sensitive to the fact that, as it gets more complex, we need to be sure that those people, our contracting officers, and the people part of the procurement process are really well trained. So the bulk of that is leaning in the direction of the acquisition workforce.

There is a piece for cyber security, a large portion for the Integrated Acquisition Environment, some policies around that, and a couple of other minor things. But that is the piece that is most special and dear to my heart.

Mr. WOMACK. But to nearly double the budget?

Ms. JOHNSON. Well, there are a couple other pieces to it, but that is a chunk of it, yes.

Mr. WOMACK. Wow. There has been a lot of discussion at the federal level about the amount of property we own. My understanding is that there are 1.2 million different pieces of perperty, if my numbers are correct. It is my understanding that a number of properties have been designated as excess or underutilized. How many of these have been designated as excess?

Ms. JOHNSON. This is where I begin to sound like a dictionary; there are differences between excess, surplus, and underutilized. There is a database that indicates there are some 14,000 pieces of properties that are identified as individual pieces that are excess, I believe, is the word. We have 170 that we are currently working on disposing and those are ones that are working through the rather elaborate process to be sure that no one else can use them.

Mr. WOMACK. Is that 170 of the 14,000?

Ms. JOHNSON. Yes. But the 14,000 are subsets of other properties. For example, flagpoles and fences are separately designated if you are talking about a whole base. And so you have dozens of properties in one cluster, which, if it came to us as a disposal, it would be the whole collection. So it is not apples and oranges, and that is where we get everybody a little bit confused.

Mrs. EMERSON. How many buildings would be involved in the 14,000?

Ms. JOHNSON. Buildings in the 14,000; that gets to, is a shed a building? I would have to supply you that designation. There are properties, there are radio towers, there are fences, there are flagpoles, so it is a real collection.

[The information follows:]

FEDERAL PROPERTY

How many of the 14,000 Federal real property assets identified as underutilized or vacant are buildings (instead of flagpoles, fences, etc.)?

GSA response: The Administration has identified 12,217 excess properties in the United States. Of that amount, 9,070 are buildings. The remaining 3,147 properties

include undeveloped land, airfields, utility systems, roads and bridges, and a variety of structures other than buildings.

Mrs. EMERSON. Excuse me for interrupting both of you. So one flagpole would be one of the 14,000?

Ms. JOHNSON. Yes, it could be.

Mrs. EMERSON. But it is not necessarily?

Ms. JOHNSON. It could be that is specifically denoted.

Mrs. EMERSON. Would a gate be a thing, too?

Ms. JOHNSON. It could be.

Mrs. EMERSON. Could you get us a list of the 14,000?

Ms. JOHNSON. We have all of that. Now, let me explain that that is a database that is developed by each agency posting what it considers to be in that category. So this is something we collect, and we can share it, it is not something we share generally, because of security reasons. So we will share it.

[The information follows:]

LIST OF UNDERUTILIZED VACANT PROPERTIES

The Administrator committed to providing the Committee with a list of all 14,000 underutilized or vacant properties. (Rep. Emerson, transcript lines 420–425, page 21)

GSA response: A separate file is attached, listing 12,217 excess properties, including the likely disposition outcome of the properties. This file is also available online at link: http://www.whitehouse.gov/issues/fiscal/excess-property-map.

Mr. WOMACK. Do we have too many buildings?

Ms. JOHNSON. We have 170 we need to be moving on, so yes, I think we are always in a position of needing to adjust our inventory. Whether it is down or up is really a question of the individual, localized needs. For example, during the census process, we do not want to own census offices, but we need to go out and lease fairly small entities around the country to house that. So it ebbs and flows, if you will. And on any given day we always have properties that we need to be disposing of, and we always have needs that we need to be fulfilling. We do spend a tremendous amount of effort on trying to be sure that federal workers are housed first in owned property, if at all possible, and keep the consolidation and the adjustment moving, but of course that is always a matter of funding, because consolidating is not free.

Mr. WOMACK. My mother-in-law was into arts and crafts. She never sold a piece. So when I visited her home, and I love her dearly, it is all still there. And the way we acquire property, and hold onto property, and have 14,000 pieces, and in our pipeline only 170 to move right now, kind of reminds me of an organization that might hoard property. That seems to me to be a terribly inefficient way to run government, particularly when a government like this government is borrowing 40 cents on the dollar for everything it spends. So I am concerned about the amount of inventory that we have, and with each piece of that inventory, if it is not being appropriately used, there is a lot of care and well-being, and a lot of other factors that go into its management, and so I would challenge you to continue to press on that issue.

Finally, this question; GSA has a set of requirements for new construction and renovation to be certified as U.S. Green Building Council's LEED designation. I understand that the LEED standard is internationally recognized, but I am also aware that there are

other green building rating systems. And so, my question for you is; would it cost less to implement and allow for examination of the full life-cycle of building materials if we developed through some other process? Why do we only recognize one standard?

Ms. JOHNSON. The Energy Independence and Security Act asked us to lean toward one standard, to designate one that we would use, and asked us on a regular basis to review and see if that was the best one. We have, therefore, chosen LEED, and that has become quite a well-known standard, and I think there is a real value in that. At the same time, you never want to get sleepy and sit on one standard or one norm without really testing and seeing what other options you have. We have also been looking at another standard. Green Globe, I believe, is what it is called. And we have been looking at that a little bit in some of our regions, and in preparation for the sort of formal review, we have been gathering data.

I completely sympathize with the situation of standards emerging right now in the sustainability and green world. We are really at a time when we are learning a lot, and they are changing, and we need to be very adept at taking in the new information and science that is coming along to tell us which standards are helping us the best. So while LEED is a predominant one now, we are keeping our ear to the ground. And we also work in conjunction with the Energy Department. Be sure we are not just willy-nilly moving around on consumer standards. We want to be sure we are really grounding it in something. So we are in good partnership with them about it.

Mr. WOMACK. I would caution the organization about putting all of your eggs in one basket, particularly when this is an emerging area of society today. There are others out there that can do similar things in a much more cost-efficient way. And I yield back now.

Mrs. EMERSON. Thank you so much, Mr. Womack. Ms. Lee.

Ms. LEE. Thank you very much. Good morning. Let me just say a couple of things. First off, thank you so much for being here, I know your agency, you are faced with many, many challenges right now. And also, I know and recognize that we all understand the need to consolidate and streamline the operations, and also procurement activities for the entire federal government. The concern in the streamlining and consolidation is that we may be shutting out small business opportunities. First of all, in my last life, I was an 8(a) contractor. And getting on that GSA schedule was horrendous, first of all. It is almost impossible. But secondly, once on it, it never led to any opportunities at all. And so, I want to find out exactly what is taking place now to help small businesses, especially 8(a) businesses, small and disadvantaged businesses, minority and women-owned businesses, weed through this process, because certainly, a hundred years ago it was very difficult. I am hearing it is still extremely difficult. Secondly, let me just ask you about this lumping of subcontracts together. In the effort to consolidate, lumping these subcontracts, oftentimes preclude smaller businesses, minority and women-owned businesses, from those opportunities. So how do you allow for the full participation in this whole notion of consolidation? And if you have any data on how you are doing with regard to 8(a) contracting, I would like to see that.

[The information follows:]

8(a) CONTRACTING

Please provide data on GSA 8(a) contracting.

GSA response: In FY 2010, GSA conducted almost 7,500 8(a) contract actions with a face value of over $841 million.

Ms. JOHNSON. Well, the top line with regard to small business, I am actually very proud of what we are doing with small business, because I do agree with you. Working with the federal government is a big challenge, especially for small businesses. There is a whole industry, that has grown up, of consultants that will milk a small business.

Ms. LEE. Rip a small business off.

Ms. JOHNSON. Right. And we certainly are not happy with being in a position where we are creating that kind of a niche. We have an Office of Small Business Utilization, which works closely with the SBA, and also helps us, as GSA, with our purchasing so we are, I think, making some good tracks and this is the kind of thing where you want to get to the place where it is hand-over-hand, so that you are repeating your performance every year. About 29 percent of our contracting goes to small businesses; it was $2.3 billion in 2010. I am delighted that $1 billion of that was to small disadvantaged businesses, which means I think we have done some tremendous outreach. And I can provide you more statistics about that performance and that story.

[The information follows:]

SMALL, DISADVANTAGED BUSINESS CONTRACTS

The Administrator committed to providing more statistics on GSA contracting with small and small, disadvantaged businesses.

GSA response: GSA awarded over $9 billion in contracts in FY 2010, and almost $3.15 billion, or 34.8 percent, was awarded to small and small, disadvantaged businesses. GSA FY 2010 small business awards greatly exceeded the agency target of 27 percent.

Through March 2011, GSA had awarded over $500 million to small businesses, or nearly 30 percent of year-to-date obligations of $1.8 billion.

Contract data comes from the Federal Procurement Data System (FPDS).

Ms. JOHNSON. Your comments ring absolutely true. I am quite concerned about small business getting approved to work with the government and then not having any business, getting the fishing license, but no river with any fish in it. And I think we need to be honest and straight up with small businesses about the potential markets, and help them understand. We do have mentoring programs, and we are working hard at doing more and more training. The mentoring program that we began last year has really given us a good model for helping work with small businesses and giving them a possibility to work their strategy out. I worry about small businesses that find the government in their business plan to be the dominant partner, because I think that makes them very vulnerable to the swings in government spending and budgets. So it is important to counsel small businesses so they will be viable and they will be successful. So, a number of different pieces to this, and I can certainly give you more.

Ms. LEE. I appreciate that, but I do know that the big boys have contracts with the government; they negotiate the extensions, they rely on the federal government for their major contracts and perpetuity. But when it comes to small businesses, and small minority

and women-owned businesses, we are told, you have got to break loose at some point. I mean that is the whole goal of the 8(a) program, which is fine, to become independent and break off from the federal government. There is a double-standard for the small businesses and then for the big businesses because they certainly continue to get these big contracts.

Ms. JOHNSON. One of the things that we want to do, and is a big push on the part off the SBA, as well, is to be sure we understand what this picture is, because one of the difficulties in our measurement system is that we can measure prime contractors, but understanding the click throughs, and they can be two, and three, and four, and how much small business we are reaching, and how that happens, and what kind of business they are getting. That is a big challenge there, in trying to get that data and have it be proper. And that is what we are surveying our shoulders against.

Ms. LEE. That is really historical. I mean, really a hard one to crack. And finally, let me just ask, the consolidation of these smaller contracts; that is inconsistent with the goal of trying to ensure full participation for small and disadvantaged businesses, because they certainly cannot compete with the big companies on consolidation.

Ms. JOHNSON. I need to give you a more detailed brief on that later for the record. Again, it goes to really understanding what is going on at that next level. How much inappropriate bundling is going on? How much appropriate bundling is going on, where you can get some efficiency and build some partnerships? So it is a fairly complex issue, and let me supply you a more thoughtful brief on it.

Ms. LEE. Thank you very much, thank you Madam Chair.

Mrs. EMERSON. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you very much, Madam Chairwoman. Madam Administrator, good to see you. Let me first also apologize right now because I am going to have to step out right after these questions because there is another hearing, as you know, so I apologize to you as well. The GAO placed GSA a thousand years ago, I think it was 2003 in the real property management. And it is real property management and it is high-risk category. Is it still there? Are you still in that high-risk?

Ms. JOHNSON. I believe we have been released from that.

Mr. DIAZ-BALART. You have been? So there are parts that have been released. Are there parts that are not released? Okay. That is good to hear, because it has been there for a million years.

Ms. JOHNSON. I met with the head of the GAO about this, and he indicated that we were moving forward and making good progress.

Mr. DIAZ-BALART. Good. And obviously, going back to what Mr. Womack was talking about, there is some question as to, excess property, under-utilized, inefficiently utilized property. The flipside of that is when you get rid of it. Do you get rid of it when the market is really, really bad, in which case the taxpayer gets hit, as well? But having said that is there at least a plan for those if, in fact, part of the reason why we still have a lot of space that we are not disposing of, is there at least a plan? Is there a threshold that you say, when the market reaches this level, if we get this

much money, we will get rid of these properties. Is there a plan for that? Because I understand that, I guess in 2009, GSA disposal of 800,000 square-feet, generating $1.8 million, which is good, but supposedly there are 54 million square-feet of under-performing and non-performing assets. So again, I understand the issue with the market. How do you deal with that, is there a plan to make sure that when the price reaches a certain level, you already have the facilities ready to go, et cetera?

Ms. JOHNSON. We do not do the analysis quite that way. Obviously, real estate is a very localized issue. So some markets can be quite robust and others can be in a quite different position. So our analysis and our profit is dictated by law, and it has to do with an agency coming to us and declaring a property ready for disposal. So they need to come to us, and frankly, there is expense involved in disposing of properties, and in tight budget times, that is a difficult proposition. When they do come to us, we need to be sure that no one else in the government needs it, that we go through all of the routine of: do the homeless need it, or does local government need it? And only then do we begin to enter into a point of negotiating on the open market. So even if we were able to figure out the market in advance of all of those clearances, it really is at that point that we focus on trying to get the best deal.

I agree with you, I am not interested in fire sales. That does not serve the taxpayer. I am also very interested in moving property that we need to move. I think this has been a long-standing problem, almost intractable in some people's minds since President Nixon probably. It is something we work at, and I think our approach to it is to be sure that we are going through the process of seeing the entire opportunity for a piece of property, that is kind of our role. And then helping work through all of the remediation, or whatever needs to be done to that property to make it sellable and command a good price.

Mr. DIAZ-BALART. But are there more aggressive efforts? And you mentioned that some of those are not you, it is from the agencies, or others who may actually be the operatives. Because in the meantime, as Mr. Womack mentioned, we are still paying for the operating costs. We are still paying for maintenance, et cetera, so it is a double-whammy. So how aggressive can you be?

Ms. JOHNSON. I think there are a couple of ways of going about this. One is, we have committed to developing strategic plans with agencies, because they do not have strategic real estate plans and they have huge amounts of property and we need to help them, with our expertise around that. There is also a concerted effort by the administration to engage in property disposal. And we will be, we hope, working very closely, and providing our expertise, and our staff, and support, and data, to that effort. It is a fairly ambitious goal and it is meant to do just this, to drive it. We still are in a situation of honoring the various legal constraints, which are absolutely appropriate in terms of the taxpayers value, to be sure that it is available for homeless, state, and local, et cetera, historic education. But I think that the administration is quite aggressive on this one. And we are happy to be playing along as a good partner in this.

Mr. DIAZ-BALART. Good. And if I may, finally, Madam Chairwoman, an issue that I know is as frustrating to you as anybody else. Obviously, renting is not a good use of taxpayers money. For long-term, the DOT building here is one of the examples that is always used. But the fact that DOT is there, we are renting, we are going to be paying for that many times over, as opposed to if we would have just purchased it, built it. But it is an issue of scoring. And it is not your issue, it is not something you control, the way OMB and CBO scores it. Is that something that you are dealing with? Because this is, again, a good market to either purchase or build right now, and we could save a ton of money for the taxpayers, but you have got the scoring issue. Are you pursuing that? Is that an issue that the White House and you are jumping on OMB and CBO? Or is that something that we are just not dealing with at this time?

Ms. JOHNSON. We are always eager to find the best deals that we can. The lease portion of our portfolio just tipped over the 50 percent mark, which I think is even more accelerated. Everybody is concerned about this. The scoring rules and the ability to enter into public-private partnerships do create some constraints for us. I think that they are based in some real serious understanding by the administration of risks that we need to be careful about, and at the same time, there are long-term costs associated with low-risk profiles. So it is always better to figure out a way in which we can own inventory, but collecting the necessary resources to build is a pretty formidable project. And at the same time, we still need to have some flexibility, so the whole leasing and renting structures offer us that. It is complex. We want to be on the side of saying we would like to have an owned inventory that is well maintained, receiving rents, and we would like to be as aggressive about that as possible, understanding the proportionality with leasing for agility.

Mr. DIAZ-BALART. Thank you. Thank you, Madam Chair.

Mr. SERRANO. Madam Chair.

Mrs. EMERSON. Mr. Serrano.

Mr. SERRANO. I just, if I may, with respect to you, Mr. Bonner. What Mr. Diaz-Balart brings up is an issue I brought up when I was chairing this Committee. It is really a serious issue, one we should really concentrate on. I know folks somewhere deal with these numbers, and they tell us it does not work this way. But for us to be leasing makes no sense whatsoever. We should own. It turns out that even when we lease we end up having to take care of the property anyway. If your relationship is like mine with my landlord, it is a big deal.

Mrs. EMERSON. If you will yield just for a second. One thing that you said in your testimony, I think it was on page 14, you are requesting a new obligational authority for $5.3 billion of rental space to provide 201 million rental square feet of lease space makes me very uncomfortable. I will come back to this during my questioning. I think we all tend to agree.

Mr. SERRANO. Yeah. I am really nervous about that. The fact that government leasing tipped over 51 percent, you said, and that should not be. I just sent out a tweet saying we are here with the

biggest landlord and now you are telling me you are the biggest renter.

Mrs. EMERSON. You had better, you are going to have to re-tweet your tweet.

Mr. Bonner.

Mr. BONNER. Madam Administrator, can you give us an update on the Federal courthouses that are on the GSA list for construction? And I say this in full disclosure, that when Mr. Serrano was Chair and Mrs. Emerson was the Ranking Member, this Committee had worked to help put a new Federal courthouse in Mobile, Alabama on their list. And I have thanked the Chairman; it is the Jose Serrano Federal Courthouse in Mobile, Alabama.

But I want to make sure that I understand your testimony. It looks like you have got funding of $199 million for a Federal building and courthouse in Hawaii. Is that the only new project you have got in the budget?

Ms. JOHNSON. Yes, as you can see, our budget is dominated by St. Elizabeths, and some FBI, and some remediation projects. And with regard to courthouses, we have one repair and alteration project for the Federal building in Los Angeles which does include bankruptcy courts. But the only full construction project that we are putting in the budget this year is the one in Hawaii.

[The information follows:]

CONSTRUCTION PROJECTS—FY 2012 BUDGET

GSA, in the FY 2012 President's Budget, is requesting $198,650,000 for a repairs and alterations project at the Prince Jonah Kuhio Kalanianaole (PJKK) Federal Building and Courthouse in Honolulu, Hawaii. This is not a new construction project.

GSA proposes the second of a two-phase modernization project for the PJKK Federal Building and Courthouse located at 300 Ala Moana Blvd., Honolulu. The PJKK Federal complex was constructed in 1977 and consists of a nine-story Federal Building connected by an enclosed bridge to a five-story courthouse. The complex houses approximately 70 agencies in 862,269 gross square feet (GSF) and serves as the main Federal center in the Hawaii and Southern Pacific areas.

Phase I was funded under the American Recovery and Reinvestment Act of 2009. Phase I includes design services for the entire two-phased project (each phase was designed as independent projects) and multiple construction components including: repair/replacement of HVAC, fire and life safety, plumbing, and electrical systems in the courthouse; renovation of the courthouse and Federal Building second floor including public lobbies, common area corridors, and restrooms.

Phase II construction components include: additional repair/replacement HVAC, electrical, communication, fire protection, plumbing, and conveyance systems; sealing the building envelope and replacing the windows with energy efficient, blast protective glazing; realignment of the building layout to allow for the expansion and consolidation of multiple tenant agencies' space; conversion of portions of occupied and vacant space into mechanical rooms and an atrium for day lighting and air return; improvements to the interior tenant space; plaza repairs; and site security improvements.

Phase II Design ($13,500 thousand) was funded by the American Recovery and Reinvestment Act of 2009. This request is for Phase II Construction ($185,050 thousand) and Management and Inspection ($13,600 thousand). The estimated total project cost for Phase I and Phase II is $319,650 thousand.

Ms. JOHNSON. Now, obviously the list from the courts is long and they have put their priorities forward, and we do our best to work with that in the constraints we operate in.

Mr. BONNER. Well, my question is based, really, from an informational standpoint. We have had a healthy, robust debate over the last few years about what role Congress should play in directing

agencies with earmarks. And earmarks are a bad name in much of America. If you could tell us, and the people back home throughout the country, how GSA determines that project A has greater value than project B, and especially if we are restricted in terms of self-restriction, but we are restricted nonetheless, in terms of the advice and encouragement we can give you. How do you make those decisions?

Ms. JOHNSON. First of all, with respect to courthouses, we work very closely with the administrative office of the courts. And they have a priority list that they have to work on months themselves, which truly helps us. You really do not want to be the mediator of all your customers and their particular petitions. But working within that, then we need to make the trade-offs in our budget between the judiciary, and then, of course, the other significant and important projects in the rest of the federal portfolio, notably, now, as I have said, the Department of Homeland Security, the land ports of entry, the FBI, a number of security-related repairs and alterations. And that is also crowding the agenda, if you will.

So we do this in part by trying to understand where an invested dollar will receive the most value. Where is the need the greatest; where are there other solutions? And, of course, we look across our portfolio in many of these cases and try to find out how we can be working within the portfolio we have.

I do think the security issues, and those are some of the demands by the court, they really are in need of being assured that they are working in a safe environment. Those make buildings rather distinguished, unique, and that means we end up, I think, investing, perhaps more.

We are trying to work with the courts more and more, using steady conversation, and other techniques for being sure that they are secure and safe. And there are other ways that we can go about this as well, within a tight budget.

Mr. BONNER. So the project would have been on the court's list for years to get to this point?

Ms. JOHNSON. It could be, yes. I would be happy to supply you with the encyclopedia on that. But no, I would be happy to give you the listing of the courthouse projects.

[The information follows:]

COURTHOUSE PROJECT PLAN

The Prince Jonah Kuhio Kalanianaole (PJKK) Federal Building and Courthouse in Honolulu, Hawaii that is in the FY 2012 President's Budget is a repairs and alterations project, not a new construction project.

The Courthouse Project Plan, as approved by the Executive Committee on behalf of the Judicial Conference of the United States, includes only new construction projects. With that said, the PJKK Federal Building and Courthouse repairs and alterations project would not be listed on the Courthouse Project Plan.

Mr. BONNER. I know years ago, when the courthouse in Mobile was of interest, a courthouse in Little Rock all of a sudden jumped to the forefront, and it just so happened that we had a President from Arkansas, and the fact that we have got a courthouse in Hawaii, I just wanted to make sure that it has been on the list as a priority for a long time.

Ms. JOHNSON. Yes, it has been. And we are in the process of doing a fair amount of construction of other courthouses. So each year is just a snapshot.

Mr. BONNER. The other thing that would be of interest to me would be, how much of your request for new funding is going to be centered in Washington, DC, versus how much is going to be centered elsewhere, even if you count Homeland Security as a part of that, I am sure that is going to weigh it heavily.

Ms. JOHNSON. I do not have the numbers. I can do the percentages, but our projects are St. Elizabeths, the request for 2012, the State Department Headquarters, and the Interior Department; and work on those three buildings. The rest is around the country, ranging from the land ports of entry on the northern and southern borders, data centers for the FBI in Virginia, upgrades to the Los Angeles federal building. And so it is dispersed around the country. I can get you those exact percentages.

[The information follows:]

CONSTRUCTION AND ACQUSITION PROGRAM
AND
MAJOR REPAIRS AND ALTERATIONS PROGRAM

GSA's FY 2012 budget request totals $1,244,156 thousand for the Construction and Acquisition Program and the Major Repairs and Alterations Program. Of this funding request, 27% is centered in Washington, DC and 73% is centered elsewhere.

The request would provide for the following projects:

CONSTRUCTION AND ACQUISITION Program *(in priority order, dollars in thousands)*:

Executive Agencies:	
Washington, DC, St. Elizabeths Highway Interchange	$ 55,400
Washington, DC, St. Elizabeths West Campus Infrastructure	41,906
Washington, DC, St. Elizabeths Activities	100,000
Washington, DC, St. Elizabeths East Campus Road Development	20,400
Lakewood, CO, Denver Federal Center Remediation	9,307
San Juan, PR, FBI Consolidation	145,506
Frederick County, VA, FBI Central Records Center	97,060
Subtotal, Executive Agencies	**$ 469,579**
Land Ports of Entry:	
Columbus, NM, U.S. LPOE	$ 59,598
Alexandria Bay, NY, U.S. LPOE	173,565
Laredo, TX, Convent Street U.S. LPOE	74,947
Dunseith, ND, U.S. LPOE	35,863
Brownsville, TX, Gateway U.S. LPOE	26,090
Subtotal, Land Ports of Entry	**$ 370,063**
CONSTRUCTION AND ACQUISITION Program	**$ 839,642**

MAJOR REPAIRS AND ALTERATIONS Program *(in priority order, dollars in thousands)*:

Washington, DC, Main Interior Building	$ 50,400
Washington, DC, Harry S. Truman Building	54,700
Honolulu, HI, Prince J. Kuhio Kalanianaole Federal Building and Courthouse	198,650
San Francisco, CA, Phillip Burton FBI Consolidation	49,900
Overland, MO, Prevedel Federal Building	24,386
Washington, DC, EEOB Pennsylvania Avenue Screening Facility	17,000
Los Angeles, CA, Federal Building (ICE)	9,478
MAJOR REPAIRS AND ALTERATIONS Program	**$ 404,514**
TOTAL	**$1,244,156**

Mr. BONNER. Okay. And then, lastly, could you, and I apologize, this may be in your testimony, I just did not see it at the top, the Chairman of the Full Committee brought to our attention, a few days ago, in another hearing, that the discretionary amount of spending, including the stimulus, we have an increase of 84 percent over the last couple of years; again, including the stimulus. How much of the stimulus, if any, did GSA occupy? And how does your budget request compare with five years ago and 10 years ago?

[The information follows:]

BUDGET REQUEST HISTORY

How does your budget request compare with 5 years ago and 10 years ago?

GSA response: The FY 2012 President's Budget requests $617 million in net budget authority for GSA. GSA net budget authority was $759 million in FY 2006 and $457 million in FY 2001.

Ms. JOHNSON. You mean the Recovery Act Stimulus Bill?

Mr. BONNER. Yes.

Ms. JOHNSON. The Recovery Act gave us about $5.5 billion, divided across investment in our fleet and preponderance in our building. It was a tremendous boost. It did a number of things. It really rejuvenated a great deal of our inventory, it greened it, it made it much more efficient, across the board. We have been able to upgrade buildings and start other buildings. We had a long list of projects that were ready to go.

In fact, what was really interesting about it was that, as we worked down the list, the market was such that we were able to get much more competitive bids and the dollar went farther. So we were able to work down our list quite a bit.

So 18,000 jobs is what the tally is so far for that stimulus work, and we are really shovels in the ground now. A lot of that is in major construction, now, so we are going to be continuing to see some real stimulus as a result of it.

I have heard all kinds of numbers about the sort of backlog that we were working with before that, in the range up to 20 billion, in terms of what we needed to do to revitalize the inventory. And it is like a car, if you do not do preventative maintenance it just begins to hiccup. And I think our buildings have been long in the tooth, and needed that. So we were able to do upgrades, and we were able to do the sustainability investments that have made them much more efficient, operationally, so I can get you the actual 10 years ago, 5 year ago numbers.

Mr. BONNER. It would be interesting. Mr. Serrano, again, made a point with his questioning about H.R. 1. And while H.R. 1 passed the House, it did not pass the Senate, and so therefore, in some ways, it is still a number that is in flux, if you will, as negotiations go forward this week in terms of whether we can avoid a government shutdown.

Senator Kyl and I have long believed that Washington is disconnected from real America because we talk about trillions or billions, and most families cannot really put their arms around that amount of money. And yet, Senator Kyl came up with an analogy on H.R. 1 that you would be looking at a budget of $10,000, not billions or trillions, but if you had a $10,000 budget, you would be looking to try to cut $28 out of that.

I think if most American families were given the opportunity, they could find $28 in savings of a $10,000 budget. That is the equivalency of the amount of money we are talking about. And yet, when we get into it, whether it is $61 billion, or $100 billion, or however you look at it, it seems like an impossible task to cut that much money.

So as the largest landlord, and as someone who has responsibilities the GSA does, and we all benefit from that with our district offices, and depend on the professionalism of your staff, it would be helpful for us to make sure that we understand that everyone is looking to try to find ways to save money at a time where we are not going to get out of this hole this year, or next year, or probably in the next couple decades. And that is the thing that a lot of people have not focused on: The hole is so deep it is going to be a long time getting out of it. But everyone, including GSA, is going to have to do their part. Thank you, Madam Chair.

Mrs. EMERSON. Thank you, Mr. Bonner. I have got a lot of questions; I do not even know where to begin. Let me just go back to the courthouse issue for process purposes only. So you all have the Hawaii courthouse on your request list. And Mr. Bonner said his Mobile, Alabama courthouse was ahead of the Hawaii courthouse. Yet all of the funds have not been appropriated yet for it, so why would you not just want to finish up the one, before we get started on another?

Mr. SERRANO. Can I interject something, Madam Chair?

Mrs. EMERSON. Yes, sir.

Mr. SERRANO. You and I take very seriously, and I think it is important to say this: Notwithstanding what you hear these days, every member of Congress, if they could have a brand new courthouse in their district, would have it. But in addition to that there are areas where it is very much needed. When I was Chair, and I realize that being Chair is totally different from being Ranking Member, we took seriously the need for Mobile, Alabama courthouse. And I am surprised that it would have disappeared from the list, and a new one would appear. Granted that the Chairman of Appropriations and the Senator is from Hawaii; and granted that the President was born in Hawaii; notice how I got that in?

Mrs. EMERSON. We all know that, Joe.

Mr. SERRANO. Right. Okay. So I can understand. If I was President, Puerto Rico and the Bronx would be in good shape. But I take this very seriously. I do not know why his courthouse disappeared from the list, and I am concerned. And I think we should know, and I think we make serious points when we say this, because we took very seriously, we just did not hand down a courthouse here and there to make people happy. This was done in a very studious way.

Mrs. EMERSON. It is a problem; how does that happen? And if Mr. Bonner was not sitting here I would still ask the same question, because I cannot figure out how that process works.

Ms. JOHNSON. Let me give you a little bit, and then I will probably need to give you some more afterwards. But first of all, the Hawaii courthouse is not a new construction; it is a rehab, so that puts it on a slightly different list. It is a competing bid for, not for

new construction money, but repairs and alterations; if I have got that right. So those are two different buckets.

I can explain what I understand to be the process, which is, you get a tranche of money, and you are trying to move down the list and if something is so big that it does not fit in, you need to move to the next one so the priorities and the money are two moving lists.

Mrs. EMERSON. Right, I understand that.

Ms. JOHNSON. And I will provide you more detail on the particulars of the Mobile, Alabama case.

[The information follows:]

MOBILE, AL COURTHOUSE PROJECT

The Administrator committed to provide more detail on why GSA is not asking for additional funds for the new Courthouse project in Mobile, AL.

GSA response: The initial design for the new U.S. Courthouse in Mobile, AL was completed in December 2004. Since then, design requirements have changed because of reduced space needs from courtroom sharing, other tenant changes, increased focus on energy performance, and the need to better mitigate potential threats from severe coastal storms. As a result, GSA now needs to redesign the courthouse before proceeding with construction. GSA is planning to start the redesign and proceed to the completion of concept stage. Once the concept stage is completed, GSA will have a better cost estimate and in the future will request the necessary funds for construction.

Mrs. EMERSON. In all the stove piping, it just seems to me that there just needed to be another round of funds provided for this courthouse, and then there would be enough and you could get it done. But to drag it out makes it cost more; we all know that, yet perhaps not if it was being done this year because you would still get a lot of bids. The construction industry is still in very dire straits. So that would be an opportunity to do that. I just worry about how that whole thing works.

Mr. BONNER. Well, Madam Chair, if I might add that I appreciate you raising it, and I appreciated the Ranking Member's comments as well. I really was hesitant to even bring it up, quite frankly, because we are in a very vulnerable position. If it looks like we are advocating and directing you to do something, then we get in a lot of hot water in newspaper editorials, and back home. We are in a very awkward position, though, and that is why I was asking the question. Just to understand the process of how one goes to the top of the list. I know there are different pools of money, and different buckets, if you will, but I appreciate the Chair and the Ranking Member.

Mrs. EMERSON. Well, and it was not just to benefit you, it was really to understand the process, just because of when Hawaii popped up on there, I am thinking, wait a minute, we just did this other one, but we have not got it all figured out yet, and so for our clarification.

Mr. SERRANO. And I want to clarify that, also. This is not about telling you what to do. It is about the Committee had made a decision, that decision was well-received by everyone, and then, all of a sudden, it drops out of the list. So I would like to know, just in terms of what I did in the past. What success did I have? Why would it go off the list?

Mrs. EMERSON. Exactly.

Ms. JOHNSON. Yes, I think the process should be transparent.

Mrs. EMERSON. Yes, and we could have another meeting on that sometime, post this hearing; that would be great.

Mr. BONNER. Madam Chair, one more thing.

Mrs. EMERSON. Yes, sir.

Mr. BONNER. The seats in the courthouse in Mobile are going to be coming from the old Yankee Stadium. I do not know if that means anything or not to the former Chairman.

Mrs. EMERSON. They are not going to be very comfortable, then.

Mr. SERRANO. I cannot afford one; they are selling for $750 apiece.

Mrs. EMERSON. They are not worth it. Well, they are, for historic purposes. For historic purposes, they are.

The old St. Louis seats, when we got our new stadium there, are very uncomfortable, I just want you to know.

Mr. SERRANO. When was the last time somebody in St. Louis sat in a seat and celebrated a World Series Victory?

Mrs. EMERSON. Thank you, in 2006.

So, let me come back to property disposal. Thank you, Mr. Bonner. Of the $15 billion in estimated savings that we were talking about in the civilian property BRAC, is the three billion from when the President issued the memorandum directing agencies to produce no less than three billion in cost savings by the end of fiscal year 2012, from assets, sale, proceeds, et cetera, is this three billion part of your $15 billion?

Ms. JOHNSON. Yes, well, the $15 billion is not all ours. I mean, GSA is only one piece.

Mrs. EMERSON. Right, okay.

Ms. JOHNSON. Yes. That is all additive.

Mrs. EMERSON. That is an easy question, yes or no. Perfect. Thank you. Let me ask you about independent leasing, in particular some issues we have had with the Securities and Exchange Commission, and the fact that they have leased hundreds of thousands of square feet in anticipation of something that has not yet been stood up, if you will. And the incredible cost, waste of money that was.

But we have got the SEC, we have the Federal Deposit Insurance Corporation, FDIC, and other financial regulatory agencies who do have independent leasing authority, so they do not have to go through you.

Would there be any benefit from those agencies requesting a proposal from you all before soliciting a lease of their own, if only to, number one, depend on the expertise that you all have developed, but, number two, to serve as a point of reference?

And since lease negotiation and management is not really the primary mission of those agencies, how does independent leasing authority ensure the safety and soundness of the financial market?

Ms. JOHNSON. Let me begin by saying that we are quite proud of our expertise, and we are more than willing to offer it to any agency that is requesting it. We do look at the whole federal government as our customer, and they certainly have the right to exercise their independent leasing authority.

We feel, frankly, the business case that we need to make to agencies, particularly when it comes to office buildings, that we can probably get the best deals and be smooth about doing it and that

agencies insist on using their own leasing authority speaks something to their feelings that they know their mission more and want to move in that direction. We can be even more aggressive with agencies, being sure that they know our value.

Mrs. EMERSON. I would think that it would just make sense; having worked in the private sector and, at least, been a part of a senior staff that was involved in negotiation, I was not directly doing it. I mean, it was laborious, and nitpicky, and certainly, we were fortunate to have someone working for us, because none of us had the expertise to be doing this.

Ms. JOHNSON. Well, it does require huge expertise. And sometimes people lose sight of that, and do not appreciate that, and see that as more bureaucratic than actually just the curlicues you need to go through. But I think it is that balance between their really wanting to be on top of what they have, and what they control, and what their mission is, and their delivery, and understanding that they have a lot of services they can avail themselves of.

Mrs. EMERSON. Yes, and it might be helpful for you to give us some recommendations.

Ms. JOHNSON. Showcase what we could do for them.

Mrs. EMERSON. Yes, that would be helpful. And perhaps it would be helpful for you to be a little bit more aggressive on that front.

Ms. JOHNSON. Well, that is really a top priority for me, to be sure, that we are out with customers. I talk about customer intimacy, and it is true. We need to visit people, know that they know what we can do.

Mrs. EMERSON. All right. And it helps you as an agency prove your worth, if you will. Let me just ask something really quick here because this is something I am not quite sure I understand. It was brought to my attention and it was one part of GSA I was not familiar with previously. And that has to do with the services that you give to other agencies with regard to financial advice. I think there are six little agencies for whom you provide that advice. What kind of education or professional credentials do GSA's financial advisers have? Are they chartered financial analysts, or Series 7 license holders, or risk managers? I am just a little curious about this.

Ms. JOHNSON. There are a handful of agencies for whom we provide financial administrative services. And it is truly a mechanical service of being sure that they are recording what interest they are getting and receiving it. It is not financial advice, so we do not provide that kind of training. This is not about going to a financial adviser the way I would as an individual. I think those organizations are usually limited in government securities anyway, so there is a fairly tight range, and so we are completely and only a gearshift mechanism so that they do not have to do the administration. That is what we offer. It is not advice. It is not advice.

Mrs. EMERSON. It is not advice whatsoever. Okay. Is that something that you want to continue doing?

Ms. JOHNSON. Well, we offer a lot of administrative services to agencies. And there are many small agencies that need all kinds of things. And I think it again positions GSA to sort of have to do everything for everybody. I am happy to do that, and I think it continues to demonstrate our value. When it is completely administra-

tive like that, it is not a burden to us, but it would be to them. It is well within our capacity.

Mrs. EMERSON. How many people do you have in that office?

Ms. JOHNSON. Oh, I do not even know. I will find out.

Mrs. EMERSON. I am just curious, because there is no way in your budget that I could figure that out.

Ms. JOHNSON. I think it must be part of our financial services.

Mrs. EMERSON. Okay. I appreciate that. I have a few more questions, but go ahead, Mr. Serrano.

[The information follows:]

FINANCIAL ADVISORY SERVICES

How many people are in the office that provides financial advisory services?

GSA response: GSA provides a full range of accounting and financial services for 52 small Federal agencies and commissions. GSA services include: Accounts Payable, Accounts Receivable, Payroll, Travel Payments, Travel Relocation Audits and Payments, Collection of Debts, Billing, and Preparation of Daily Cash Deposits. In conjunction with these services, GSA also provides standard general ledger reconciliation, payment processing, systems analysis, training, and financial reporting.

GSA services include trust fund accounting. When requested by customer agencies, GSA will also request that Treasury withdraw earned interest and deposit it in spending accounts. GSA transmits requests on a regular schedule that is determined by Treasury and the customer agency. GSA does not make decisions about what investments to make or when to make them. GSA provides this service for six customer Federal agencies: the Barry Goldwater Scholarship Foundation, Christopher Columbus Fellowship Foundation, Japan-United States Friendship Commission, Morris K. Udall Foundation, US Institute for Environmental Conflict Resolution, and the Eisenhower Exchange Fellowship.

GSA provides accounting and financial services to all agencies and commissions with 23 accountants and accounting technicians. GSA accountants require a bachelor's degree in accounting. GSA accounting technicians require specialized experience in accounting or bookkeeping but do not have an educational requirement.

Mr. SERRANO. Thank you. You could not tell me a job loss figure. So I want to give you a number based on some information I have gotten. I have been told that the effect of H.R. 1 would amount to about 16,000 jobs lost through the economy through your agency. Is that wrong? Is it near the number?

Ms. JOHNSON. That sounds high to me.

Mr. SERRANO. Well, what sounds right to you then?

Ms. JOHNSON. Well, 16,000 jobs, that is, we have created 18,000 jobs with our Recovery Act money, which is in the billions. So it just does not quite sound proportional. But I certainly will record that and double check.

Mr. SERRANO. Well, I would like you to double check it and maybe, at a later time, tell us how many, because whenever people come before us and we discuss the impact of the cuts that are taking place, and this H.R.1, while Mr. Obama said it was just a number that was floating out there, it does not get better every day. That number actually gets worse every day in terms of cuts. So I would really appreciate if you could, at one time soon, maybe before this hearing ends, but I do not think that will happen, just give me a sense of how many jobs you are going to lose. Every other agency that comes before us tells us that they are going to lose jobs. Are you going to leave here today telling me you are the only agency that is not going to lose jobs?

Ms. JOHNSON. I am sorry, were you asking about the number of GSA employees that would lose jobs?

Mr. SERRANO. Private sector construction jobs.

Ms. JOHNSON. Oh, yeah, that is what I thought you meant.

Mr. SERRANO. But you do not know?

Ms. JOHNSON. Not right off the top of my head.

Mr. SERRANO. Okay, will you find that for us? Could you give us an estimate? Something we hear a lot about on this subcommittee is cost overruns and poor performance by contractors. Often these are the reasons cited when big IT contracts fail. What is GSA doing to provide more transparency and accountability on the part of contractors, and how will the upcoming contractor performance database help agencies make more informed choices about awarding contracts?

Ms. JOHNSON. This is an important project. Its nickname is FAPIIS, F-A-P-I-I-S, and it is about taking the database that we have for internal uses to monitor contractors and what kind of record they have of performance. And to now turn it into a public-facing database. Clearly, you do not just turn a switch and have the public looking at your internal contracting database directly, so it is something that we have been working on. It will be released in April. And there are a couple of things: I think it is very important for the public to be able to see, and have much more of a transparent view of our contracting. And in fact, one of the things that I needed to elaborate on earlier with Mr. Womack's question, is that the Office of Government-Wide Policy is embarking on it, and some of the budget money that we are requesting is for the integrated acquisition environment, which is to put all the contracting data in a place that is together and easy to get to and connects with the same tag number, so that people can track through the numbers stated. So, first of all, we need to be more transparent altogether, and this FAPIIS database is part of that effort to allow people to see into the database. But for the most part, we have an Inspector General capacity, we have contract managers, and I must say that our contractors are honest and have integrity, and are solid performing. It is important to them to know we have an eye on them, but I want to be careful not to disparage the tremendous work of the construction industry management and the whole surrounding contracting database that the contractors are setting up with the government.

Mr. SERRANO. Okay. Now, we touched on this subject before, but I just want to take you there again on this whole issue of leasing versus construction. What factors does GSA take into account in deciding whether a particular facility should be matched with the right federal construction, ultimately, because I think you heard from all of us, and we are concerned that you are now 51 percent leasing. We should own the property instead. It is the American Dream and it affects federal government, too.

Ms. JOHNSON. There are, of course, many considerations, and these are probably no surprise to you. For agility reasons, there are agencies that, at times, need short-term space. The census is the great example of that. They are not ones for which we would think about having permanent facilities. On the other end, we have the judiciary, which we know is going to be around for hundreds of years.

And so, we do want to be sure that wherever possible we are building for them and securing that kind of facility. And then there

is a retaining level. So the trade-offs are the need for flexibility, the amount of people that need to be in and out, and oftentimes this is in conjunction with a built space, like with the Department of Homeland Security. We have a number of people in a number of lease spaces. We are trying to consolidate them into an owned space, and so they are temporary quarters. In many cases in cities where there are lots of available office space, and office space does not have special security, it does not need all the kinds of things that some federal missions require, then it is strictly a financial trade-off, what makes the most sense. And then the fundamental issue is getting the money ahead of time and altogether to be able to build the building and to be able to put the case forward, and go through that whole process. So sometimes there is just plain agility in terms of delivering space to people.

Mr. SERRANO. Let me ask you something further on this. At every agency and every corporation and any group, there are always decisions being made through a lot of in-house lobbying, as we have it here in Congress, about budget funding. And we have stated, we believe in consolidating, we believe in cutting waste, but cutting for the sake of cutting, just to reach a bottom line does not make any sense. On this issue, inside GSA, is there a leasing lobby versus a construction lobby? I mean, people who are giggling in the background here, are they broken into two different groups?

Ms. JOHNSON. Not in my office. Not in my office.

Mr. SERRANO. Because I am trying to figure out how these things are decided. Because we obviously went too much into leasing in the opinion of this committee, and so how did that happen? Was it just a coincidence? Were some decisions made and no one paid attention to where that was going, and it did not matter? Or was there a group inside saying, leasing is the way to go?

Ms. JOHNSON. No. There is not an inside lobby. These are a matter of business decisions constrained by the amount of appropriations and the schedule we have. I do want to tell you one story, because I want you to understand that I believe in this deeply, that we should be in federal space wherever possible, and that we need to be inventive and innovative about how to get there, because the workspace is changing. We are no longer in a world where everybody needs their ten square-feet of office cube. We are more able to work virtually; we are more able to work in a number of different places. So GSA is committing in the renovation of its headquarters, which typically houses about 2,000 people. As we go through the renovations, and we are dispersed into some swing space, and when we return to that building, we are taking all of GSA in the D.C. area into that building so that we can house 6,000 people, and we can give up all the leases. We want to demonstrate that it is possible not to just consolidate by squeezing, but to maximize the use of our space because work is changing. And it is a real Judo, this is a whole new way of working, and I think this, of course, is an opportunity to use our property much more wisely, and in our case, get out the number of leases. So I am trying to set that example, too. I just want you to know my heart is in this. There is no leasing lobby.

Mr. SERRANO. Okay, thank you. Madam Chair, the Cardinals Park, is that leased from the city, or is that owned by the Cardinals?

Mrs. EMERSON. I guess it is owned by the taxpayers, Mr. Serrano, because we had to pass a bond issue to pay for part of it.

Mr. SERRANO. They will pay it back. Thank you.

Mrs. EMERSON. Not affordable, but yes. Yet they are all sold, so what can I tell you? Ms. Lee.

Ms. LEE. Thanks very much. Let me ask you a couple things about how the rental rates are determined for, say, the federal building. Many of us choose to have our Congressional offices, in the Federal Building, or in the GSA building. However, the rents seem to be a bit exorbitant compared to what the rents are in commercial space. I have resisted moving into commercial space, because I like being in the Federal Building. But every time this comes up, I have to look at this very closely, because I do not know how you all determine whether you go up, or down, or base your rates on fair market fluctuations, in-rates, rental-rates in the region, and city. How is that determined?

Ms. JOHNSON. I am going to summarize, and then I need to get you more information, because it is not a simple question, if you will, and there is a lot of process underneath it.

[The information follows:]

GSA RENTAL RATES

How is rent determined in Federal buildings?

GSA response: By law, GSA rental rates must approximate commercial charges for comparable space and services. GSA calculates rental charges for Federally-owned space based on independent appraisals, and rental rates for leased space are based on actual lease costs, plus a fee.

GSA calculates rental charges for Federally-owned space based on the appraised value of the building. Rental rates are established for five-year periods, and include a "shell rate", which remains constant during the five-year period, and a "base year operating rent", which increases each year. GSA appraises space at least every five years; however, GSA may appraise space more frequently, to reflect changing market conditions, new tenants, varying schedules in the occupancy agreement expirations, or for backfill of vacant space.

Rent for leased space is a pass-through of the underlying lease contract, plus the cost of any building services not performed through the lease and a lease fee. Both the operating costs and the real estate taxes that GSA pays to the lessor are passed through to the tenant agency.

Ms. JOHNSON. Federal buildings where we have 5,000, 10,000 employees, and how we charge rent to those agencies is based on a number of factors. It is obviously about the cost of the building itself. But when we own a building, and we are not paying a mortgage and interest on it; it is sort of an interesting business case calculus.

When we are putting people in the leased space, those rates are directly paid to the lessor, and so those are also market, those are what we have been able to negotiate, and hopefully as good and as competitive as possible. So it depends on whether you are in leased or owned space, and then how that owned structure is managed through the building fund, in order to build the building fund and cope with the business case where the building is already paid for and we are not trying to rebuild it, but we do need to keep an eye on building out further inventory across the federal government. So

it is an integrated set of issues when it is a Federal building, when it is an owned building.

Ms. LEE. Leased.

Ms. JOHNSON. Leased buildings are market set, we are on the market, and we are leasing space on the market. They are negotiating with us, we get a deal.

Ms. LEE. Okay. I think then, just for the ninth Congressional District, I believe we are federal, it is owned by the Feds.

Ms. JOHNSON. Okay.

Ms. LEE. I think we own it, the Federal government.

Ms. JOHNSON. Okay.

Ms. LEE. And we are paying you the money.

Ms. JOHNSON. Yes, those rents are not as easily traceable to an individual negotiation in market and there are a lot of pieces to it. There are a lot of pieces to it.

Ms. LEE. Okay. Yeah, I would like to, at some point, see it.

Ms. JOHNSON. Like the Marshals Service.

Ms. LEE. Yeah.

Ms. JOHNSON. And the security, and all of that.

Ms. LEE. Security, I mean, I know all that.

Ms. JOHNSON. They are huge expenses.

Ms. LEE. I also know there is other space where the security would be almost comparable, and other kinds of services that are lower. But, again, I would just like to kind of understand a little bit better.

Ms. JOHNSON. Of course. Of course.

Ms. LEE. Thank you.

Mrs. EMERSON. I might say we have the same sort of issue with which we are dealing right now, so I understand that. I want to talk about a new subject. No more leasing. Well, actually, I take that back. No more building leases. But you talk, in your testimony here, about, you say GSA also plans to pilot plug-in hybrid electric motor vehicles in the federal fleet, but lacks statutory authority to purchase them. So, why do you not talk to us a little bit about this, it is of great interest to me, given the fact that we do now, actually, have companies in the United States who produce, not that they are getting ready to produce, but they do produce electric trucks, electric cars, and why is it not possible for you to purchase these?

Ms. JOHNSON. It is not that we cannot purchase them, it is that the pricing level is arbitrarily low.

Mrs. EMERSON. So why do you not explain this?

Ms. JOHNSON. So what we need to do and what we are asking for is a rising of the statutory price limitation on what we can spend on vehicles. We have over 450 types and models of vehicles. So there is a lot of complexity to the fleet. We buy our fleet, for the most part, and then lease them to agencies. So an agency would lease a car, a truck, or runaround from us. So we are seeking to buy electric vehicles. Now, we are also exploring the possibility of leasing them to see if that is a better business case. Electric plug-ins are a new item on the market. OEMs, at this point in our conversations, are not interested in a leasing conversation. And I personally think it is part of the fact that it is a new product, and they want to negotiate and then have them just move on through the cycle. They do not want to reclaim them, for the most

part, there might be other instances. But we are looking at whether we should be buying them or leasing them, but the price limitation is keeping us from buying them.

Mrs. EMERSON. Okay, so say there was, the price limitation was lifted, given the new technology, you would be able to consider leasing them. I understand there is the whole issue of how do you determine the residuals on an electric vehicle versus how it works on a regular, traditional car or truck, whether it is gas or diesel. But the wear and tear is much less on an electric vehicle, at least as far as the pieces inside go. Not that there are too many, you just need to pop new batteries in there, and put new tires on, and maybe change a hose or two. So what precisely do you need? You say you need to have the price limit lifted. And then, do you have to have special legislation enabling you to do a lease versus the purchase?

Ms. JOHNSON. No.

Mrs. EMERSON. Okay.

Ms. JOHNSON. What we have to do is figure out if the OEMs will do a deal like that, and figure out if it is the better business option.

Mrs. EMERSON. Okay.

Ms. JOHNSON. So we are going to be looking at that, and when you are doing that pilot, and there are sort of distortions to a business case, that we would then obviously redo it, if we went into any kind of volume purchasing.

Mrs. EMERSON. Okay.

Ms. JOHNSON. Or leasing.

Mrs. EMERSON. Because I would think that, based on projecting out, the higher cost at the front end saves you money at the back end, especially with the price of fuel right now, whether it is gas or diesel. I mean, it is getting a little bit out of hand.

Ms. JOHNSON. Well, we are delighted that our fleet is as efficient as it is, and we are saving a tremendous amount on fuel because we have so many alternative fuel vehicles. Two thirds of the fleet purchases are in that direction. And that is why we want to experiment with the hybrids. See how they function in altitudes, see how they function in muggy climate, in cold climate, all that.

Mrs. EMERSON. Sure, sure.

Ms. JOHNSON. And we certainly want to get the best value we can, and right now it would be about a hundred, but I think we could command a deal. But we have got to figure out what that is.

Mrs. EMERSON. And, but you have to have the statutory authority?

Ms. JOHNSON. For the pricing, yes, we are a little bit caught there.

Mrs. EMERSON. What is the upper limit?

Ms. JOHNSON. I do not know. I do not remember.

Mrs. EMERSON. I do not know what it is.

Ms. JOHNSON. Do you know?

Mrs. EMERSON. Okay. No, that would be, I would be interested.

Ms. JOHNSON. I would be happy to keep you up on that.

Mrs. EMERSON. If you can get some more information on that. It could, in the long run, end up saving an awful lot of money.

[The information follows:]

GSA MOTOR VEHICLE PRICING

What is the amount of the Statutory Price Limitation on motor vehicles?

GSA response: The statutory price limitation, established by section 702 of Division C of Public Law 111–117, limits the price a Federal agency may pay for a new motor vehicle to no more than $13,197 for a passenger vehicle (excluding buses, ambulances, law enforcement, and undercover surveillance vehicles) and excluding station wagons, which have a maximum price of $13,631. Law enforcement vehicles may exceed the statutory cap by $3,700 and special heavy-duty vehicles may exceed the cap by $4,000.

Section 1575 of the FY 2011 Appropriations Act (P. L. 112–10) created an exception to the Statutory Price Limitation for any vehicle that is a commercial item and which operates on emerging motor vehicle technology, including but not limited to electric, plug-in hybrid electric, and hydrogen fuel cell vehicles. However, unless extended, this exception will expire on September 30, 2011.

Ms. JOHNSON. Yes.

Mrs. EMERSON. In an urban or metro environment. Those electric vehicles cannot pay for themselves in a rural area, like where I live. But certainly where Joe lives, you would be able to save a lot of money, I believe.

Mr. SERRANO. Some folks in my district, in the Hunts Point Produce Market, it is important to the northeast and beginning to move in that direction. You are right, the problem is the initial cost. It is not like buying a Chevy.

Mrs. EMERSON. Right, it is interesting, there is a company in Missouri, in Kansas City, I live diagonally across the state from there. But a company that got some Recovery Act monies, and instead of building the factory there, they had the factory and they used it to encourage the private sector to purchase these vehicles, and gave them a discount. And so now Frito Lay, for example, has every single one of its medium box trucks all electric now.

Mr. SERRANO. That was a great program, the Recovery Act.

Mrs. EMERSON. Well, I am not saying that it was, I am just saying that this was an innovative use of stimulus funds.

Mr. SERRANO. I could not help myself.

Mrs. EMERSON. I know you could not, I know you could not. But I will say this about you guys got a new stadium in New York and we got a new one in St. Louis, but it still costs $175 to get a ticket to go to a Yankees game. It is ridiculous.

Mr. SERRANO. That is in the bleachers.

Mrs. EMERSON. Bleachers. Yeah, that is pretty high up there.

Mr. SERRANO. Yeah.

Mrs. EMERSON. One-hundred and seventy-five dollars. I know, because, but, needless to say, it is not something a normal family could do. Anyway, let me ask you about the Federal Food Donation Act, which is kind of near and dear to my heart. The final regulations were incorporated into the Federal Acquisition Rules in 2009. Do you all monitor how many times the food donation clause is exercised by other agencies?

Ms. JOHNSON. I am not sure we do, but I will double check. I do know that we are monitoring, when we are letting another concession, whether or not they are giving us a business plan that would show some sort of sensitivity to donate.

Mrs. EMERSON. Okay. So how do you work with the vendor community to encourage the donation of the food that otherwise gets trucked in a landfill or what have you?

Ms. JOHNSON. Well, a couple of different ways. Because there are no cost contracts it is more by example than by people being eager and interested. But I think that is where, by requesting a business plan that incorporates that, we are signaling it is important to us. And therefore, we are going to be paying attention to that as we let the contracts. And I think that is a good place to have some leverage.

I will also say that there is a lot of interest on the part of the federal workers, and the administration is very keen on wellness. So there is this whole notion of, let us look at the cafeterias and get some better food and better processes for environmental sensitivity to them.

Mrs. EMERSON. Well, I am just curious because I had been talking, a couple years ago, to the Commander of Fort Leonard Wood which is an Army post in Missouri, again not my district, but with regard to the Federal Food Donation Act. They have so many catering opportunities there and otherwise the food just goes to waste. So they have actually taken it upon themselves to go into some kind of memo of understanding with a couple of our food banks in that particular part of the state, and it is working really well. It just seems so sad, and particularly with so many people hurting during the economy we need to take advantage of every opportunity to save good food, and not waste it.

Ms. JOHNSON. I agree, and I think it is through our model in our profile on this that people can see it is important to us.

Mrs. EMERSON. Yes, and thank you. I just hope you all will keep promoting this because it is very important.

Okay, I have one last question then I have several for the record that I would like to ask you all to try to reply within 30 days. I hope that is not pushing it too much.

The Dodd-Frank Act created numerous new offices and among those are the Consumer Financial Protection Bureau, the Office of Financial Research and the Federal Insurance Office. Have these offices, to the best of your knowledge, do you know if those offices have approached GSA for assistance with leasing space or contracting for administrative services such as personnel or accounting?

Ms. JOHNSON. Yes, we have been, from the front, trying to be supportive and helpful in getting them up and going, and I believe we are moving forward on some leasing work with them. And we have also been advising them about technology and how to think about setting up an office in these days. There are so many more ways of doing it in thinking about cloud computing, and the technology available, so we have been doing a fair amount of discussion with them about possibilities.

Mrs. EMERSON It is interesting because we have parts of all these other existing regulatory agencies that are going to move into that Consumer Financial Protection Bureau, and so it is going to have some kind of an impact, I should think, on space requirements of the existing agencies. So I do not know how you juggle everybody, but have you been approached by the other agencies, not by the Consumer Financial Protection Bureau, but the agencies that have large chunks of personnel who would be moving into that?

Ms. JOHNSON. I am not briefed on that. I will get that to you.

Mrs. EMERSON. Okay.

[The information follows:]

CONSUMER FINANCIAL PROTECTION BOARD SPACE NEEDS

Has GSA been approached by agencies other than the Consumer Financial Protection Board (CFPB) who will be required to transfer large numbers of personnel to the CFPB for assistance with space or other administrative services?

GSA response: The Treasury Department has requested that GSA obtain space for the Consumer Financial Protection Bureau (CFPB). GSA is not aware of any contacts from any other agencies for space needs resulting from the establishment of the CFPB.

Ms. JOHNSON. But I certainly know we have been working with the Consumer Financial Protection agency specifically.

Mrs. EMERSON. All right. Because part of the Comptroller of the Currency goes there.

Ms. JOHNSON. It would normally be part of our regular routine to support agencies as they are freeing up space and identifying that and continuing to move people around.

Mrs. EMERSON. Right, but since they are moving large chunks of people it seems that you would now have extra space available, and I do not know if it is an owned building or a leased building. So any more information that you would be able to provide, I would be grateful.

Ms. JOHNSON. I would be happy to.

Mrs. EMERSON. All right thanks. Mr. Serrano.

Mr. SERRANO. Thank you. I have just one more question, but I do have a bill that gives tax breaks for businesses in areas that do not meet the clean air standards to purchase electric vehicles.

Mrs. EMERSON. Well, let me take a look at that.

Mr. SERRANO. See how we do business, it is amazing. Thank you for bringing us together.

Ms. JOHNSON. My pleasure.

Mr. SERRANO. One last question. The budget request contains $34 million for electronic government projects. We heard from Commissioner Steven Kempf about GSA's efforts in this area, along with GAO, and OMB. H.R. 1 cuts this request to $2 million which would ensure the projects like the IT-dashboard stop operating. What is the impact of H.R. 1 on these projects and how does GSA anticipate that these projects will eventually return money to the American taxpayer? What is the rate of return on these projects?

Ms. JOHNSON. These projects are near and dear to my heart and they are in jeopardy with the current budget situation. The open government, the publishing of data, the USAspending.gov on some of the other dashboards, and so on, are, I think, incredibly critical new tools for the American public to know what is happening with their government. And the public is getting accustomed to this; we have millions of people coming to USA.gov. In the course of a year it jumped 30 percent in one year so it is beginning to be viral, how many people are depending upon understanding their government online. So I am quite concerned that our dashboards and our public facing services are in jeopardy.

I do not have an exact ROI, I do not know how you would calculate an ROI for the value of open government, but I can speculate that the confidence that people will have in the government

will only increase if they can see what is happening. And they will provide us the feedback and the raised hands when they see things funny in the data and they can raise questions. It just makes us so much more interactive and it gives us the power of the citizenry to help us to view what is going on. The ROI for that I do not know how to put it in dollars and cents to give you some understanding of the expenditures.

Mr. SERRANO. Right.

Ms. JOHNSON. But for relatively little money to be that transparent is huge.

Mr. SERRANO. Yeah, we appreciate that transparency is important. There seems to be a contradiction here and again, that is where the budget cuts get in the way. A lot of folks of this country on both sides of the political spectrum are saying we need to know more about what government is doing and how it is doing it. And yet you see committee meetings, and committee hearings, and in all honesty not the Chairwoman, but other people on this committee say we got to cut that. Why do you need that website? For instance we had this website for the Consumer Product Safety Commission where you could put up a complaint and the private industry would come on and say, No that is not true, or that never existed, or that report is not true. We think that is good, but some people do not want that information out there so it is very confusing. I want to thank you for your testimony for my part, but remind you of three things. One, I still think we are going to lose jobs to the private sector; I wish you could get back and tell us. I realize that federal agencies now find themselves in a little difficulty with a Republican House and, I think, a Democratic Senate.

Mrs. EMERSON. Most Republicans would vote Democratic.

Mr. SERRANO. Right. Sarcasm is not my strength; I do not know about the Senate. You do not have to comment on this, but I know that people are kind of balancing their comments but I think Republicans and Democrats want to know if 16,000 jobs would be lost or 10,000 jobs or 5,000 jobs; that helps both sides.

Secondly, I hope that you can begin to show us that owning is better than leasing. And lastly, and very carefully because we do not tell you folks what to do, but I am interested to find out why the Mobile Alabama courthouse dropped out of sight. I am all for Hawaii. Thank you so much.

Mrs. EMERSON. Thank you, Administrator Johnson for being here today and I look forward to following up on several items. I understand we all are trying to live in a climate where we are using every dollar as wisely as possible, and I appreciate the work that you all are doing to become more efficient and less unwieldy, if you will.

Anyway, please always know that you can call upon us, and I certainly will look forward to you getting back to us on several items not the least of which is, not only to answer our questions that we submit, but also on things that we can be helpful with regardless of the subject matter.

Ms. JOHNSON. Did you have questions for the record?

Mrs. EMERSON. We do have questions for the record so they will be given to you, and then if you could get back to us in 30 days.

Mr. SERRANO. I have questions for the record.

Mrs. EMERSON. And Mr. Serrano has questions for the record. My guess is that my other colleagues will also have questions for the record.

Mr. SERRANO. Mine will be in Spanish, try that.

Mrs. EMERSON. And, anyway, we also appreciate the fact that your regional administrators are here, and I can certainly say that our regional administrator from Kansas City is very well liked by our office and has gotten off to a very good start.

Mr. SERRANO. Can I ask a quick question? Is the New York region still New York, New Jersey, Puerto Rico, and the Virgin Islands? That has to be one of the greatest, shall we say, political decisions made in the 1950s.

Mrs. EMERSON. So, Mr. Serrano wants to know if you will take them on a field trip when you go.

Mr. SERRANO. I mean, if you look at the map right? I mean we are all for it in New York we think it had to do with a certain community in growing numbers in the 1940s and 1950s. But when that decision was made people said, It makes sense to us, in New York. But does it make sense in the rest of the world? New York, New Jersey, Puerto Rico, Virgin Islands, I love it.

Ms. JOHNSON. Well, you are very fortunate.

Mr. SERRANO. I am sure Florida wanted it.

Mrs. EMERSON. Anyway, thank you again, very much.

[The information follows:]

Financial Services and General Government Subcommittee
Hearing on the General Services Administration FY 2012 Budget

Questions for the Record submitted by Chairwoman Jo Ann Emerson

1. E-GOV TRAVEL. GSA is conducting a major government-wide acquisition of its travel management service (E-Gov Travel Services 2.0), but there is a protest pending with GAO.

   a. Please provide the Committee with a copy of the plans GSA has in place to assure continuity of travel services should GAO's response result in a cancellation of or significant delay in the acquisition.

      GSA response: GSA is making every effort to ensure that agencies are prepared to deploy and successfully transition to ETS2 before the ETS1 contract expires in November 2013. GSA has contingency plans in the event of a delay and is working with the current ETS1 vendors to extend ETS1 services beyond November 2013. GSA is exploring three options with ETS1 vendors: (1) an extension to the existing ETS1 contract; (2) development of bridge contracts; or (3) some combination of the two approaches. GSA expects that the extension/bridge contracts will be completed in calendar year 2011. The extension/bridge contracts will provide continued services for the minimum period necessary for all agencies to transition to ETS2. GSA also has supplemental contracting vehicles and acquisition solutions in place for continuity of travel services.

      GSA contingency plans are dependent on the outcome of the on-going ETS2 procurement and are procurement sensitive. GSA would welcome the opportunity to brief the Committee or your staff.

   b. E-Gov Travel Service reportedly realized cost savings through consolidation and the elimination of capital investment costs. What are the estimated government-wide cost savings associated with E-Gov Travel Service 2.0 above and beyond the original E-Gov Travel Service, and what steps is GSA taking to assure these cost savings are realized?

      GSA response: GSA estimates that the Federal government could save more than $260 million per year once all agencies have transitioned to ETS2. Of that amount, GSA estimates that as much as $60 million could be saved from the centralized program management that is provided by GSA as a part of ETS2, including managing agency requirements and consolidated contracting, technical, security, and program support. GSA anticipates that the remaining $200 million in annual savings would be generated by improving demand management, point of sale controls, and supplier agreements for government airfares, lodging rates, and rental car rates. These factors will allow for strategic sourcing of travel, which will drive down costs and generate significant cost savings for Federal agencies. ETS2 also will generate cost savings by providing alternatives to travel and reducing administrative costs by increasing the use of on-line reservations.

      The GSA ETS Program Management Office has an established plan to assure vendor performance and management which will deliver the transparency and performance measurement that agencies need in order to realize significant cost savings.

Financial Services and General Government Subcommittee
Hearing on the General Services Administration FY 2012 Budget

Questions for the Record submitted by Chairwoman Jo Ann Emerson

c. According to GSA's Request for Proposals (RFP), the acquisition of E-Gov Travel Service 2.0 will result in fewer awards than the original E-Gov Travel Service, presumably requiring many agencies to implement a new travel system. What are the anticipated government-wide implementation costs, and what are GSA's plans to manage cost, implementation risk, and change management with the agencies relative to their transitions?

GSA response: GSA expects that agencies will collectively incur approximately $57 million in one-time costs staggered throughout the transition to ETS2. These costs primarily will be for training, change management, and initial systems configuration.

GSA has taken several steps to manage cost, implementation risk, and change management:

- GSA is using the existing travel governance structure to leverage ETS1 lessons learned, establish budget and performance benchmarks for ETS2, and implement best model templates to optimize agency ETS2 deployment plans. The travel governance structure is a collaborative, government-wide process established by GSA that includes an Executive Governance Council and regular meetings of interagency working groups of ETS Transition Managers and Travel System Users. Each agency is responsible for its own ETS2 deployment, and the travel governance structure supports this approach by providing opportunities for information sharing and a forum for agencies to provide feedback and concerns directly to GSA.

- GSA will provide comprehensive acquisition support service, including streamlined contracting, design, implementation, and program support. GSA is developing templates and supporting documentation to assist agencies in preparing project plans, interface and integration handbooks, and change management templates.

- After deployment and transition, GSA will continue to manage cost and risk by providing strong vendor management and a new model for customer collaboration and engagement.

Financial Services and General Government Subcommittee
Hearing on the General Services Administration FY 2012 Budget

Questions for the Record submitted by Chairwoman Jo Ann Emerson

2. CIVILIAN PROPERTY BRAC. In your testimony, you mentioned the Administration's budget proposal for civilian property BRAC. OMB is the lead agency, but GSA will undoubtedly be deeply involved in the development and execution of the BRAC-like Board's recommendation.

   a. Is the current statutory process for disposing property unworkable?

      GSA response: The current process for disposing of Federal civilian real property is an iterative and deliberate process with a number of statutory requirements that seek to strike a balance between social and economic policy objectives. These requirements ensure properties are disposed of consistently and in the best interest of the American taxpayer. This process, however, can be time consuming, as the landholding agency must work through a variety of political interests, community expectations, environmental factors, and regulatory reviews. There are numerous stakeholders affected by the disposition of an underutilized or unneeded Federal real property, including the Federal agency, the applicable State and local government, members of Congress, the local community, and the broader public. These interests often promote conflicting uses for properties in the disposal process, which can create inefficiencies and increase disposal time and costs.

      For many years, competing interests slowed or stalled the realignment of military bases. These barriers were not overcome until the formation of the independent Base Realignment and Closure (BRAC) Commission and process. The BRAC process allowed the government to conduct appropriate downsizing activities and generated significant savings for the taxpayer. GSA views a similar process for Federal civilian real property as the most effective approach to overcoming similar barriers in the disposal of excess and underutilized Federal civilian properties.

      The President's FY 2012 budget request includes the Administration's proposal to accelerate the disposal and consolidation of Federal civilian properties using an approach similar to BRAC. This initiative anticipates working in partnership with Congress to increase the number of properties available for disposal and streamline the disposal process to help the Government realize financial savings. The President's proposed Civilian Property Realignment Act (CPRA) would streamline and accelerate the disposal process by reducing the administrative burden and eliminating political and funding obstacles associated with disposing of unneeded and underutilized real property assets.

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Questions for the Record submitted by Chairwoman Jo Ann Emerson

b. Could changing the statutory process be as effective as creating a new BRAC-like board?

GSA response: The Civilian Property Realignment Board proposed in CPRA would be more effective than changing the statutory screening process. The Board would have greater flexibility to determine which properties would be directed to sale based on a balancing of factors, rather than a one-size-fits-all approach.

c. The Administration requests $88 million in total for the civilian property BRAC in fiscal year 2012, identifies 14,000 properties as excess, and estimates $15 billion in savings over 3 years. Were those estimates made in consultation with GSA?

GSA response: Yes, GSA was consulted in the formulation of these estimates.

d. As proposed by the Budget, GSA is not a member of the Board. Should GSA be a Board member?

GSA response: GSA is not a member of the Board proposed in CPRA, but will share its expertise in real property management and workspace utilization to support the Board as it formulates strategies for consolidating Federal properties. GSA also will support the Board by providing data from the Federal Real Property Profile -- the government-wide database of all non-security, Executive Branch real property -- which GSA operates on behalf of the Federal Real Property Council. In addition, GSA expects to act as a disposal agent for some of the properties identified by the Board and approved for disposal by Congress.

GSA's role in supporting the Board will be similar to the role established for GSA in support of the new Real Property Advisory Committee, established by Office of Management and Budget (OMB) Memorandum M-11-22, "Realignment of Federal Real Estate". This memorandum establishes a Committee of Federal agency Senior Real Property Officers and Chief Financial Officers, which will "work closely with the OMB Controller and the Administrator of General Services to identify short- and long-term opportunities to realign and consolidate the real property inventory."

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3. PROPERTY DISPOSAL. On June 10, 2010, President Obama issued a Presidential Memorandum directing agencies to produce no less than $3 billion in cost savings by the end of fiscal year 2012 from asset sale proceeds, cost avoidance, and lease terminations.

   a. How much progress have agencies made to date towards the $3 billion goal?

      GSA response: OMB is working with agencies to more routinely track progress in meeting this goal. Beginning this summer, OMB will add a dashboard to Performance.gov, which will display agency progress in meeting the $3 billion goal.

      The Federal Real Property Profile database (FRPP) captures some data on agency disposals through sales and lease terminations; however, this data does not capture savings from cost avoidance and operating cost reductions resulting from these disposals. FRPP indicates that the Federal government disposed of 2,767 properties in FY 2010, through sales and lease terminations, for total cost savings of $365 million. Of that amount, $35 million represents proceeds from sales and $330 million represents costs avoided from lease terminations.

   b. What specific assets have been sold or are expected to be sold?

      GSA response: GSA can only provide data on the properties that GSA disposed of for itself and for other Federal agencies. GSA sold 92 properties for itself and other Federal agencies in FY 2010, collecting over $27 million in proceeds. In FY 2011, GSA has sold 22 properties under the custody and control of GSA or other Federal properties to date, collecting over $9.5 million in proceeds. GSA expects to sell over 100 properties by the end of FY 2012.

   c. Are the properties being eliminated under the $3 billion a subset of the properties being eliminated under the $15 billion Civilian Property BRAC?

      GSA response: GSA does not have the information to respond to this question.

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4. INTEGRATED ACQUISITION ENVIRONMENT. The Integrated Acquisition Environment is GSA's highest and most expensive budget priority at $38 million.

   a. Why is IAE so important? What benefits accrue to agencies, vendors, and, ultimately, to taxpayers?

      GSA response: IAE is important because it provides agencies with a common, standardized approach and shared systems that support Federal acquisition and transparency in the Federal procurement process. IAE is a collection of procurement systems that support agencies, businesses, and taxpayers in each step of the acquisition life cycle, from market research that includes small businesses, to ordering, publicizing solicitations, and evaluating contractor past performance and integrity prior to award. IAE has increased government efficiency and effectiveness by eliminating stand-alone information systems and paper-based procurement process in Federal agencies; eliminating duplication of effort by standardizing Federal acquisition transactions, policy, and business processes; and centralizing resources to minimize the costs of maintaining IAE component systems.

      IAE makes it easier to find business opportunities with the Federal government by displaying opportunities and upcoming needs, centralizing public-facing applications, standardizing processes for Federal contractors, and providing customer service to assist the public and government users. IAE includes new features at www.fbo.gov that make it easier for small businesses to find outreach events that will increase their understanding of requirements and procedures for doing business with the government. IAE systems promote transparency and accountability by making it easier for the public to track Federal procurement spending and providing tools for Federal contracting personnel and the public to review information on contract awards and certain information on Federal contractors.

      The FY 2012 President's Budget requests $38 million to modernize and integrate systems included in the IAE. The FY 2012 funding request will build on efforts initiated with the $7 million provided for this project in FY 2011. The FY 2012 request would allow GSA to build a single data source for all Federal acquisition and award data information. Currently, IAE is a set of eight separate systems that are siloed, redundant, and expensive to maintain and operate.

      - Siloed systems.—Each of the eight IAE systems requires separate user accounts, different reporting capabilities, and requires separate data entry. This creates a burden on companies who do business with the government and increases the risk of data inaccuracies.

      - Redundant systems.—The eight systems of IAE capture overlapping data, requiring duplicative data entry by Federal contracting personnel and the vendor community.

      - Separate hosting.—Each IAE system has different software, operates on different hardware platforms run by different contractors, and is hosted at a different location.

The current configuration increases both security risks and the risk of system failure, and is also expensive to operate and maintain.

The investment of $38 million into a modernized IAE, to be called the System of Award Management (SAM), will improve operating capabilities, eliminate redundancy, increase data accuracy, and improve agility of the application for future expansion. SAM will consolidate the eight procurement systems into one database, which will greatly reduce the burden of using SAM systems and entering data, reduce operations and maintenance costs, and improve data quality to promote transparency for the public. Benefits include:

1. Reduced operations and maintenance costs.—While the eight systems of IAE have provided great value, in some cases the technology is twenty years old and it is now very expensive to maintain. SAM is expected to reduce operating costs once the integration is complete. Cost savings come from improved management of help desk operation and IT hosting, re-competing contracts through the life of the project, and by using open source software and development methodologies. These features of the project will increase competition and make software enhancement contracts more accessible to small companies.

2. Increased transparency through improved data quality.—SAM will have only one portal for data entry which will reduce data entry errors. For example, there will only be one input for a vendor's name and address, which will be used to support multiple functions and appear in multiple reports. A unified system will make it possible to have a single log on and single reporting system that enables the acquisition workforce and the public to retrieve and analyze procurement data and ensure accurate data from the vendors who do business with the Federal government.

3. Reduced burden for contractors and Federal contracting personnel.—SAM simplifies and reduces the number of interfaces that each agency must maintain, and reduces the number of separate systems where vendors must enter similar data. For example, today a vendor has to enter socioeconomic data in two systems. Nextyear, the data will only be entered once under SAM. IAE processes are currently being analyzed to identify and remove additional redundancies.

4. Simple, secure, and agile systems.—SAM will consolidate hosting for multiple websites. Consistent with the Administration's "Cloud First" policy, GSA will host the SAM system using cloud computing technologies that are inherently more reliable and flexible. The consolidation will also bring immediate benefits from a security and accreditation standpoint since SAM systems will share common physical and internet security, improving security and reducing costs.

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b. How much will IAE cost to develop in total? How much is the expected annual Operations and Maintenance?

GSA response: GSA estimates that IAE modernization / SAM will require appropriations of $115 million over four years, from FY 2011 through FY 2014. Once fully implemented, SAM total operations and maintenance costs will be approximately $68 million per year, $23 million less than the projected annual cost of maintaining the current configuration.

SAM will deliver cost savings throughout the life of the project and will avoid costly contract renewals or extensions which will drive up the cost of maintaining the current configuration. GSA expects that the current configuration of IAE could cost as much as $91 million to maintain in FY 2018, 25 percent more than the projected operations and maintenance costs of SAM in the same year.

c. Are agencies currently contributing funding to GSA to support IAE legacy systems? Will they continue contributing funding to GSA after IAE is deployed?

GSA response: Yes, all Federal agencies (including GSA) contribute approximately $50 million per year and will continue to contribute after SAM is deployed.

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5. FEDERAL FOOD DONATION ACT. The final regulations for the Federal Food Donation Act were incorporated into the Federal Acquisition Rules in December 2009. The Act requires all Federal contracts above $25,000 for the provision, service, or sale of food in the United States, to include a clause encouraging the donation of excess food to nonprofit organizations.

   a. Does GSA monitor how many times the food donation clause is exercised?

      GSA response: In FY 2009, GSA amended the Federal Acquisition Regulation (FAR) to add subpart 26.4, "Food Donations to Nonprofit Organizations". This clause requires all solicitations and contracts greater than $25,000 for the provision, service, or sale of food in the United States to include a clause encouraging the donation of excess food to non-profit organizations.

      All GSA food service contracts for cafeterias in Federal buildings under GSA jurisdiction, custody, and control are in compliance and include the clause where applicable. It is important to note that GSA food service contracts in Federal buildings are typically no-cost contracts and are not required to include this clause. GSA does not monitor how many times the food donation clause is exercised in other agencies' contracts.

   b. Is GSA working with the vendor community to encourage the donation of food that would otherwise be trucked to a landfill?

      GSA response: GSA actively works with its cafeteria contractors to promote food donation. Since 2009, all GSA Requests For Proposals (RFP) for concessions contracts have required vendors to explain their food bank donation program in their proposal; to date, GSA has awarded ten contracts based on the new RFP language. In addition, GSA encourages concessions contractors to work with advocacy programs and local homeless programs to promote food donation.

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6. GREEN BUILDINGS. The budget request for Repair and Alterations includes $40 million for Energy and Water Retrofit and Conservation Measures. The stimulus provided $4.5 billion for greening Federal buildings.

   a. What does the $40 million pay for?

      GSA response: The Energy and Water Retrofit and Conservation Measures program provides for necessary upgrades and improvements to building systems in Federal buildings under GSA's jurisdiction, custody, and control, to improve energy efficiency, reduce consumption, or generate on-site renewable energy. Projects funded under this program include installing "intelligent lighting systems" that adjust ambient light to maximize the use of natural light in workspace; water reduction measures; improvements to exterior facades to improve energy efficiency; and installing advanced utility meters, which provide instantaneous data on building energy consumption, allowing building managers to immediately adjust building conditions to reduce energy and water consumption.

      The investments funded by this program are critical to achieving the goals of the Energy Independence and Security Act of 2007 (EISA, P.L. 110-140) and Executive Orders 13423 and 13514, which require agencies to reduce energy intensity by 3 percent per year for a total 30 percent reduction by 2015 (compared to a 2003 baseline) and reduce water consumption by two percent per year to achieve a 16 percent reduction by 2015 (compared to a 2007 baseline). The sustained investments in Energy and Water Retrofit and Conservation Measures program provided in previous appropriations Acts have allowed GSA to achieve a cumulative 16 percent decrease in energy consumption and a nine percent decrease in water consumption through FY 2010.

      GSA's FY 2012 budget request includes $40 million for critical projects necessary to continue progress towards meeting the long-term energy and water consumption reduction targets in EISA and related regulations. GSA identifies and selects energy and water consumption reduction projects based on return-on-investment, payback periods, and the ratio of expected reduction in greenhouse gas emissions per dollar invested. GSA expects that, if fully funded, the FY 2012 request for this program would realize estimated savings of $6.4 million per year. The average payback period of these projects is 6.25 years. GSA would begin realizing some savings from FY 2012 projects in FY 2013.

   b. When will savings from greening activities be reflected in the budget request?

      GSA response: Savings from energy and water consumption projects are generally realized in reduced utility consumption in the buildings in which they occur; however, any cost savings that would be realized by utility systems improvements are offset by utility cost increases in non-improved buildings. Savings from energy and water consumption projects reduce the amounts that GSA would otherwise request for utility costs in its annual budget.

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7. DEPARTMENT OF HOMELAND SECURITY HEADQUARTERS. GSA has requested nearly $600 million in fiscal years 2011 and 2012 for the consolidation of Department of Homeland Security headquarters at St. Elizabeth's campus in Washington, DC. To date, GSA and DHS have invested over $1.1 billion in this project, including Recovery Act funds.

   a. What is the estimated total cost of this project, including DHS' share? What is the estimated completion date?

      GSA response: GSA had previously estimated $3.6 billion for the St. Elizabeths project, with GSA requiring $2.2 billion and the remaining $1.4 billion to be funded by the Department of Homeland Security (DHS). The project was scheduled for completion in FY 2018. However, these estimates assumed full funding of the President's request in FY 2011.

      Because of the limited funding provided to GSA for new construction projects in FY 2011, GSA will not be able to fund the St. Elizabeths project at the level required to meet the previous schedule and cost estimates. GSA is currently re-evaluating project phasing options and schedules. The resulting project delays will result in cost increases due to inflation and the loss of construction sequencing efficiencies. GSA will provide updated schedules once the information is available.

   b. How much is needed by GSA and DHS in fiscal years 2011 and 2012 to move the US Coast Guard to St. Elizabeth's?

      GSA response: GSA needs approximately $30 million in FY 2011 and an additional $40 million in FY 2012 to move the US Coast Guard to St. Elizabeths Campus.

      DHS requires $159 million in FY 2012 to complete construction and move the US Coast Guard to St. Elizabeths.

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8. FOOD AND DRUG ADMINISTRATION HEADQUARTERS. Since 1996, this Committee has provided $984 million for the consolidation of Food and Drug Administration headquarters in White Oak, MD. GSA requests an additional $173 million for this project in FY 2011.

   a. Will the $173 million request complete the project?

      GSA response: The FY 2011 request of $173.7 million would complete this project. GSA's FY 2011 request includes:

      - Phase IV: Remaining funding needed for Phase IV to construct the Center for Biological Evaluation and Research (CBER) Office, Biological Terror Lab and Office, Southeast Parking ($106.7 million); and Phase IV management and inspection ($3.5 million).

      - Phase VI: Remaining funding needed for Phase VI to construct the Remote Delivery Building ($18.5 million); landscaping ($11.8 million); Center for Veterinary Medicine standard energy equipment ($30.9 million); and Phase 6 management and inspection ($2.3 million)

   b. Is GSA considering adding more buildings or more work to this project?

      GSA response: GSA is not requesting additional funds to add more buildings or work to this project. GSA and FDA are currently studying future development options for the approximately 530 acres that remain undeveloped on the White Oak campus.

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9. IMPACT OF HR 1 ON GSA. HR 1, as passed by the House, proposed no funding for construction or acquisition of facilities, a cut of $676 million from the FY11 request, and very little funding for repairs and alterations – a cut of $423 million.

   a. If HR 1 had been enacted, what would the impact have been on federal buildings, current projects, and construction jobs?

   GSA response: The HR 1 funding level for the Federal Buildings Fund (FBF) was $1.7 billion less than the FY 2011 President's request. HR 1 essentially eliminated new construction and line-item repairs and alterations projects, and held basic (non-prospectus) repairs and alterations to the FY 2010 level, which was the lowest level for this program in the past ten years. The amount provided for the FBF operating program (the combination of the Installment Acquisition Payments, Rental of Space, and Building Operations budget activities) was $85 million below the amount provided in the FY 2010 consolidated appropriations Act (P.L. 111-117). In addition, HR 1 proposed rescinding all unobligated balances of the American Recovery and Reinvestment Act (P.L. 111-5), which would have required the FBF to absorb additional, unplanned costs needed to complete on-going GSA Recovery Act projects and associated project administrative costs.

   The funding levels proposed in HR 1 jeopardized tenants of Federally-owned and leased buildings, prospective tenants of GSA construction projects that are currently underway, and private sector lessors and construction contractors. GSA estimates that the funding levels in HR 1 could cost as many as 16,000 private sector jobs in construction and related trades, when compared to full funding of the FY 2011 President's request.

   FBF Operating Program:

   The funding level provided in HR 1 was not sufficient to maintain GSA's operating program, even if all unobligated balances were exhausted.

   - Rental of Space.—HR 1 would not provide sufficient funding to honor the $5.2 billion in leases that GSA has already entered into with private sector lessors. GSA lease agreements do not typically include termination for convenience clauses found in contracts for other services. Without sufficient funds to pay private sector landlords for space occupied by the Federal government, GSA would be forced to terminate leases where applicable and relocate tenants or condemn the property and continue occupancy. Both options incur additional costs for the government because they require up-front funding and both options disrupt operations for tenant agencies. Defaulting on payments due to the private sector would also have a profoundly negative impact on GSA's ability to continue to procure workspace and other goods and services from the business community that has traditionally interacted with GSA.

   - Building Operations.—HR 1 would not provide sufficient funds to continue the cleaning, utilities, and maintenance activities funded by this account. GSA could not continue to provide building services at the levels provided in FY 2010 and would need to reduce service levels or eliminate service contracts that maintain a clean and

comfortable work environment for Federal tenants. The rescission of Recovery Act funds that was included in HR 1 would place additional pressure on building operations, as GSA would be forced to absorb the administrative costs of Recovery Act projects in this account.

FBF Capital Program:

The funding level provided in HR 1 did not provide funds necessary to adequately maintain existing Federal buildings or provide for new Federal buildings necessary to maximize space utilization and move agencies out of more expensive leased space.

- Basic (Non-prospectus) Repairs and Alterations.—HR 1 would provide $260 million for basic repairs and alterations, the same as the FY 2010 enacted level. However, the FY 2010 level was the lowest funding for this activity in the past ten years, and $80 million lower than the ten-year average ($342 million). Fund at this level recognized the significant investment that GSA was making in its Federal buildings as a result of the Recovery Act. Funding at this level would require GSA to postpone necessary repairs, increasing operating costs and requiring more costly repairs or replacements in the future. Minor repair and alterations funds also facilitate work in advance of new occupancy in previously-vacant space, increasing utilization and decreasing vacant space.

- Major General Emmett J. Bean Federal Building, Indianapolis, IN.—GSA requested funding for this project to address critical security concerns and major drainage deficiencies. This building houses the Defense Finance and Accounting Service (DFAS) and lacks DoD required security countermeasures. DFAS has indicated that it will require interim security measures if construction funding is not provided in FY 2011. Without additional funding to address drainage issues, GSA expects to invest between $500,000 and $1 million in temporary parking lot repairs over the next five years to address safety concerns.

- James C. Corman Federal Building, Van Nuys, CA.—This building is in poor condition and is rapidly deteriorating. The fourth floor is vacant due to water infiltration; the building is subject to several code violations; and the restrooms do not comply with applicable accessibility standards. As a result, the costs to operate the building exceed the revenues GSA earns from rent. GSA must renovate the building and re-stack the tenants (IRS and State) to make the most efficient use of the space. In addition, the renovation of this building must be completed to begin the FBI consolidation project in 11000 Wilshire Blvd, meaning that three agencies will be impacted by a delay in funding for this renovation project.

- Daniel Patrick Moynihan U.S. Courthouse, New York, NY.—This building currently serves as swing space for the renovation of the Thurgood Marshall Courthouse in New York, NY. Once the renovation is completed in calendar year 2012, the tenants will return to Thurgood Marshall, leaving 95,000 square feet of vacant space in the Moynihan Courthouse. GSA cannot fill this space without additional funds to re-fit the Moynihan Courthouse for its new tenants, who are currently in leased space.

This will lead to underutilization of a viable asset and cost an additional $7 million per year as long as the prospective tenants must remain in leased space.

- Frank Hagel Federal Building, Richmond, CA.—This building requires seismic structural upgrades and its building systems are at or have exceeded their life expectancies. Improvements must be made to provide appropriate levels of service and safety for the occupants. The building also requires security improvements to address security concerns and must be reconfigured to provide expansion space for its occupant, the Social Security Administration.

- Edward J. Schwartz Federal Building and U.S. Courthouse, San Diego, CA.—This building will be vacated when the District Court occupies the new Courthouse Annex that is currently under construction. Once the new Annex is completed, GSA plans to consolidate US Immigration and Customs Enforcement (ICE) regional operations into the Schwartz Federal Building. ICE is currently housed in four different locations, three of which are leased. A delay in reconfiguring the space for ICE would leave 194,000 square feet of space vacant, disrupting ICE operations and increasing costs for the government as ICE remains in leased space.

- Denver Federal Center Remediation, Lakewood, CO.—The Denver Federal Center has soil and water contamination and all parts of the facility are in some stage of investigation and cleanup under the Resources Conservation and Recovery Act (RCRA) Consent Order Program. The Denver Federal Center is under three consent orders that require GSA to remediate the site. Penalties under RCRA allow the State of Colorado to fine GSA $25,000 per day, per incident if GSA fails to comply with a consent order.

- P.V. McNamara Federal Building, Detroit, MI.—This project is an Annex to provide space for special operations and high security parking for FBI vehicles. This project aligns with a major renovation project at the Federal Building which is due to be complete in September 2013. Both projects together will provide FBI with contiguous office and expansion space. If the Annex project is not completed in Fall 2013, agents will be forced to travel significant distances between the Federal building and current leased locations on a daily basis, incurring an additional $439,000 per year for lease renewals.

- IRS Annex Purchase, Martinsburg, WV.—GSA currently leases the Martinsburg IRS Annex at an annual cost of $3,025,000. The government has an option to purchase the building for $24,767,000. The IRS has a continued long-term requirement for this location, and the operations in this facility are heavily integrated with the adjacent government owned facility, the Martinsburg Computer Center. Any delay in funding will require annual lease payments of $3,025,000.

In addition to these critical projects, the funding level in HR 1 does not provide for the consolidation of Food and Drug Administration headquarters at White Oak, MD and the continued development of the St. Elizabeths Campus in Washington, DC, both of which are discussed below.

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b. What would have happened to projects that are near completion – for example, buildings that are almost ready for occupation, but would not receive the final installment of construction funds?

GSA response: GSA's FY 2011 budget requested funding for three multi-phase new construction projects: environmental remediation at the Denver Federal Center in Lakewood, CO (addressed above), the development of the St. Elizabeths Campus in Washington, DC (addressed below), and the consolidation of Food and Drug Administration headquarters at White Oak, MD.

GSA has received funding for consolidation activities for Food and Drug Administration headquarters at White Oak, MD since 1992. The funds requested in FY 2011 would have completed this project. A delay in funding would have delayed the project completion and increased costs by an estimated $74 million. Delaying the procurement would require GSA to re-procure work built into the current contract and incur additional design costs and construction delays, incurring an additional cost of $39 million. GSA cannot occupy the completed CBER laboratory until the CBER office building is complete, because both buildings share utility and fire and life safety systems that would be housed in the CBER office building; without funding for the CBER office building in FY 2011, GSA would incur $5 million per year to maintain the vacant CBER labs until the CBER office building is complete and ready for occupancy. The prospective tenants will remain in leased space, incurring an additional $30 million in annual lease costs and exacerbating operational inefficiencies currently experienced by FDA. In addition, failure to fund this project in FY 2011 would have resulted in the loss of work for approximately 500 construction workers currently on site.

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c. What would the impact have been on the St. Elizabeth's campus in Southeast DC and the proposed consolidation of the Department of Homeland Security?

GSA response: The funding reductions included in the HR 1 level would have stalled completion of the US Coast Guard (USCG) Headquarters on the St. Elizabeths Campus and would delay all future phases of construction of the Department of Homeland Security headquarters consolidation.

The FY 2011 President's Budget request would have provided for construction of the National Operations Center (NOC) and the Office of DHS Headquarters, West Campus Infrastructure, Historic Preservation Mitigation, and the Highway Interchange. A delay in funding would have delayed project completion and increased project costs by an estimated $81 million. Delaying the procurement would require GSA to re-procure work built into the current contract and incur additional design costs and construction delays, incurring an additional cost of $28 million. Without funding for necessary infrastructure improvements, GSA would have to construct temporary facilities to provide heat, power, and water, including water for fire suppression, at an additional cost of $17 million. The USCG cannot occupy their headquarters until the NOC is complete; GSA would incur an additional $3.3 million to maintain the vacant USCG headquarters building until the NOC is constructed. The prospective tenants will remain in leased space, incurring an additional $32.3 million in annual lease costs and exacerbating operational inefficiencies currently experienced by DHS.

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10. CONTRACTOR PERFORMANCE DATABASE. Something we hear a lot about on this Subcommittee is cost overruns and poor performance by contractors. Often, these are the reasons cited when big IT contracts fail.

    a. What is GSA doing to provide more transparency and accountability on the part of contractors?

    GSA response: GSA is taking a number of steps to provide more transparency and accountability for contractor performance within GSA and for the entire government.

    - In April 2010, GSA implemented the government-wide Federal Awardee Performance and Integrity Information System (FAPIIS), as required by the 2009 National Defense Authorization Act (P.L. 110-417, Section 872, codified as 41 U.S.C. § 2313). FAPIIS provides detailed information on contractor performance history for contracting personnel to use when making contractor responsibility determinations. On April 15, 2011, GSA made extracts of FAPIIS data publicly available on the internet, in accordance with P.L. 111-212, Section 3010.

    - Internally, GSA is making a concerted effort to minimize cost, time and materials, and labor hour contracts in favor of fixed-price contracts that shift the performance burden and risk to contractors and away from the government. GSA reinforces contractor accountability by using performance-based Work Statements or, for services (excluding construction and architect/engineer services under FAR Part 36), Statements of Objectives. These documents establish contractor performance measures and targets and create a mechanism to document expectations and gauge outcomes.

    - GSA has redefined the GSA acquisition workforce to clarify and expand the number of Federal employees who need training to effectively manage contractor performance. In particular, GSA has included program and project managers and contracting officer's Technical Representatives (COTR) to ensure that all employees who oversee contractor performance are appropriately trained and certified.

    - Other methods GSA uses to hold its own contractors accountable include: Procurement Management Reviews, which measure the effectiveness of agency contract administration; active monitoring of contractor performance against performance measures; and taking early action to improve performance when needed.

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b. How will the upcoming Contractor Performance Database help agencies make more informed choices about awarding contracts?

GSA response: The Federal Awardee Performance and Integrity Information System (FAPIIS) is the one-stop shop for contracting and grant officials to access information that will help them make informed decisions about the responsibility of an entity prior to award of a contract or grant. Before FAPIIS, contracting officials had to separately check the Past Performance Information Retrieval System (PPIRS) for past performance information and the Excluded Party List System (EPLS) for suspended and debarred vendors.

FAPIIS integrates PPIRS and EPLS and provides the following additional information to aid in making responsibility determinations:

- Terminations for default (contracts);
- Terminations for cause (commercial contracts);
- Terminations for Material Failure to Comply (grants);
- Defective pricing determinations (contracts);
- Non-responsibility determinations (contracts);
- Recipient Not-Qualified determinations (grants);
- Administrative agreements (in lieu of actual debarment/suspension, action does not prohibit other awards); and
- Vendor information about criminal, civil, and administrative proceedings on vendors for which there has been a finding of fault.

Awardees are provided an opportunity to comment on the information about them, and the data are maintained for five years from the date of action.

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11. CONSTRUCTION VS. LEASING DECISION. One of the ongoing issues for GSA's budget has been the question of leasing versus direct Federal construction. A couple of years ago GAO studied that question and concluded that leasing is often more expensive for the government in the long run. I understand that your rent to own ratio is now over 50% in favor of leasing. What factors does GSA take into account in deciding whether a particular facility need should be met through direct Federal construction or through leasing? Which do you tend to prefer?

    GSA response: GSA prefers ownership to leasing, as ownership is typically the less expensive alternative when there is a large, long-term requirement (15 years or longer) in a strong real estate market.

    Leasing, however, is generally the most responsive and flexible solution for meeting small or short-term agency requirements. GSA has a large amount of leased space in its inventory because over 70 percent of requirements are less than 10,000 square feet and generally for 5-10 year terms.

    GSA's ability to fund Federal construction projects is limited. There are times where, because of funds limitations, GSA may turn to the construction of leased space that we would have preferred to own. Although it is more expensive than Federal construction, leasing is more preferable than failing to meet customer requirements.

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12. ELECTRONIC GOVERNMENT PROJECTS. The Budget Request contains $34 million for Electronic Government Projects. We heard from Commissioner Steven Kempf about GSA's efforts in this area, along with GAO and OMB.

    a. How does GSA anticipate that these projects will eventually return money to the American taxpayer?

    GSA response: The projects funded by the Electronic Government Fund increase transparency, improve access to Government information, and enhance communications with citizens. The return to the taxpayer for these projects includes increased government effectiveness, increased accountability, and improved citizen engagement that help Federal agencies deliver more value through their services.

    E-Gov projects such as USAspending.gov promote accountability by giving citizens access to Federal contract and grants data. The IT Dashboards provide citizens access to information necessary to assess Federal IT projects, including project plans, metrics, contracts, spending, schedules and accomplishments. The IT Dashboards provide citizens insight into the management of approximately $80 billion in Federal IT spending. The Office of Management and Budget (OMB) has used the IT Dashboards to identify at-risk Federal IT projects, augment rigorous reviews, and help reduce overall IT budgets by terminating or turning around underperforming projects, resulting in billions of dollars in IT project spending being saved.

    Another project, Data.gov, provides the public with Federal government data that was previously unavailable. Citizens can access the data to provide oversight, for research, or to develop new applications. Public participation in Data.gov has been high with a steady use of approximately 160,000 users per month. To date, private citizens and universities have developed over 270 applications using the information from Data.gov.

    In addition, many of the E-Gov projects focus on improving efficiency in government by creating tools that follow the "build once, use many times" model. Challenge.gov, the Citizens Services Platform, and other projects provide critical tools, services, and training that agencies need to meet their mission and to fulfill government mandates. EGov project on mobile apps makes it easier for the public to access government services anytime, anywhere, from an app that gives consumers instant information on safety recalls of products such as toys and food to an app that provides travelers with real-time information on wait times at airport security lines across the country. Simplifying access to government services can significantly improve citizen experiences with the government.

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b. What is the rate of return of these projects?

GSA response: GSA has not calculated a rate of return for Electronic Government projects; however, these projects have delivered significant benefits to the taxpayer. The IT Dashboard is supported by $1.36 million in FY 2011 and provides oversight and management for agency IT spending of approximately $80 billion per year. OMB and agencies use the IT Dashboards to identify underperforming IT projects to halt, terminate, or turn around which can save millions of dollars for the taxpayer. GAO has reviewed the IT Dashboard several times and provided positive remarks on the program and its benefits.

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Questions for the Record submitted by Congressman Yoder

13. EPA FACILITY RELOCATION. With the latest announcement by GSA to move the EPA Region VII headquarters from Kansas City, KS to Lenexa, there has been some discussion about whether this was the best financial decision for the American taxpayers.

    a. Specifically, it has been mentioned that the long-term costs of the new lease will be more expensive than staying at the current location. Can you confirm or deny this, taking LEED certification off the table?

       GSA response: The long-term costs of the new lease will not be more expensive than staying at the current location. The selected offer was both the lowest priced and the highest technically rated.

    b. The point has also been raised that the Kansas City, KS building was built just over 10 years ago specifically for the EPA. What benefits would this new building have over the current location?

       GSA response: The selected offer was both the lowest priced and highest technically rated.

Financial Services and General Government Subcommittee
Hearing on the General Services Administration FY 2012 Budget

Questions for the Record submitted by Congressman Yoder

14. BANISTER FEDERAL COMPLEX. I understand that the GSA is working with the Marines to select a new facility to house the Marine data center currently operating at the Bannister Federal Complex (KCITC).

    a. What are the issues with the current site that prompted this new site selection?

    GSA response: The US Marine Corps (USMC) occupancy at Bannister was originally a temporary solution to a need for a new data center location. The USMC is evaluating multiple options for a permanent solution.

    b. What is the process for selecting a new site?

    GSA response: The USMC is reviewing a number of locations, including the Bannister Complex, and will make a decision in Spring 2012.

    c. What criteria will be used to compare alternative locations?

    GSA response: Representatives from the USMC IT Center have indicated that they are considering the following factors: facility cost, workforce relocation, transition costs, and suitability of a facility to meet information technology security and force protection requirements.

    d. Will and to what extent will our office and local stake holders be included in the process?

    GSA response: The USMC will continue to keep all stakeholders involved in this process and share information as it becomes available.

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Questions for the Record submitted by Congressman Yoder

15. ENVIRONMENT, ENERGY AND ECONOMIC DEVELOPMENT – ELECTRIC TRUCKS. Based on information contained in the GSA Federal Fleet report, there are more than 7 million medium to heavy duty trucks used by the federal agencies.

    a. For the record, what is the total number?

    GSA response: The FY 2010 Federal Fleet report states that the Federal fleet consists of 89,253 medium duty and 32,760 heavy duty trucks, a total of 122,013 vehicles. This represents 18 percent of the overall Federal fleet.

    b. Of the total number, how many and what percentage of vehicles in this category are electric plug-in or zero emission vehicles (ZEV)?

    GSA response: In FY 2010, Federal agencies reported one heavy duty and 40 medium duty electric trucks. Agency reporting does not specify whether the reported vehicles are electric plug-in, hybrid, or some other configuration. The data also do not distinguish zero emission vehicles.

    c. To what extent has GSA taken steps to work with the federal agencies and vendors to increase awareness and availability of medium to heavy duty plug-in electric trucks?

    GSA response: GSA highlights the availability of advanced technology vehicles at every opportunity. The availability and capabilities of these vehicles have been included in presentations to Department of Energy working groups, Federal Motor Vehicle Executives, fleet managers, as well as to GSA's nationwide fleet management team. This information is also included in the annual Alternative Fueled Vehicle Guides published on GSA's vehicle buying and vehicle leasing websites.

    In FY 2011, GSA offered one model of heavy-duty (greater than 16,000lbs GVWR) plug-in electric truck for purchase. One truck heavy-duty plug-in electric truck was purchased in FY 2011.

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Questions for the Record submitted by Congressman Yoder

16. BLUEPRINT FOR A SECURE ENERGY FUTURE. The commercial movement of goods using medium to heavy-duty trucks is a major contributor to petroleum consumption. What steps will GSA undertake to upgrade the federal fleet to include existing vehicle plug-in technologies that do not require petroleum?

    GSA response: GSA is pursuing new plug-in electric vehicles from manufacturers and firms with licensing agreements (e.g. dealers) so that these vehicles can be added to the 2012 Federal Vehicle Standards. In addition, GSA understands the need for charging infrastructure to support a new fleet of plug-in electric vehicles and is working with industry to make this equipment available through GSA Multiple Award Schedules.

TUESDAY, MARCH 1, 2011.

INTERNAL REVENUE SERVICE

WITNESS

DOUGLAS H. SHULMAN, COMMISSIONER, INTERNAL REVENUE SERVICE

Mrs. EMERSON. The hearing will come to order.

Thank you so much, Joe, for being here today, and I want to thank Commissioner Douglas Shulman of the Internal Revenue Service. I would like to also say, and I guess we will have other Members come in, but consider yourself lucky. It is just us today, a nice intimate setting. But we are going to have to adjourn this hearing before floor debate begins on the continuing resolution at noon because we are not supposed to conflict with it.

Last month we had two very productive hearings with agency inspector generals, but this is our first agency budget hearing. So you are number one, and so we really appreciate so much you being here today.

As my colleagues have heard me say before, and when H.R. 1 was considered on the floor, the Federal Government's $14 trillion debt compels the Appropriations Committee to reduce Federal spending to fiscal year 2008 levels. This will require a 17 percent reduction in spending from fiscal year 2010 for this subcommittee, and I am committed to holding as many hearings as possible and learning as much as we can so that we can make informed and the most judicious recommendations and reductions possible.

When I think of the IRS, I guess when everyone thinks of the IRS, I am both deeply appreciative of the work that you all do, but I am also very concerned. The 24-hour/7-day work that you do around the clock to assist taxpayers comply with their obligations and the work that you all do to pursue tax cheats who undermine our voluntary system is very good. You have really improved and I am very pleased with that. I know you are proud of the work that your staff has done.

On the other hand, I am concerned quite a lot about the growing number of social programs being implemented through the Tax Code. These programs significantly increase the IRS' expenses and reach into the private lives of Americans. For example, the fiscal year 2012 budget includes nearly half a billion dollars to implement the health care law. Say what you will about the health care law, but half a billion dollars is a lot of taxpayer money; and future requests for more funding are forthcoming, I have no doubt.

So, once again, I want to thank you so much, Commissioner Shulman, for being here. I appreciate the good work that you are doing, and I look forward to your testimony.

With that, let me ask my brother and cochair here Mr. Serrano for his comments.

Mr. SERRANO. Well, thank you. And this wouldn't be a proper hearing if I didn't say something about the Cardinals.

Mrs. EMERSON. Okay. I am ready.

Mr. SERRANO. People will be paying a lot of taxes in the next 10 years.

Mrs. EMERSON. I don't know, what do you think about the idea of a 10-year contract, though? When you are 31 years old, that is a bit much.

Mr. SERRANO. You should only get a 10-year contract when you are in Congress.

I would also like to welcome Commissioner Shulman to today's hearing. He has testified before us several times before, and I look forward to hearing what he has to say about both the fiscal year 2012 budget request for the IRS and the impact on the IRS of the numerous remaining funding issues for fiscal year 2011.

At the outset I must note that we are in a very strange situation here today. We are here to review the proposed 2012 budget request without having finished the fiscal year 2011 appropriations process. Moreover, there is a stark contrast between the levels included in the House Republican CR for 2011 and the President's fiscal year 2012 budget.

The President's budget robustly funds the IRS for fiscal year 2012 for what I believe are good reasons: The IRS collects the vast majority of revenue that allows our government, the Department of Defense, and the Department of Education to operate. It helps to ensure that our Tax Code, which everyone agrees is extremely complicated, is administered in a fair manner, and it helps to prosecute those who seek to cheat the United States Government. Unfortunately, we must compare this robust request with the funding level provided in the House-passed continuing resolution. That resolution cuts IRS funding by approximately $600 million from last fiscal year.

While I appreciate the sincerity of the belief among my friends on the other side of the aisle in their desire to reduce spending, I think such cuts to the IRS budget are very misplaced. It makes little to no sense to impose harsh budget reductions on the very agency that raises the vast majority of revenue. Should the House-passed funding level actually become law, I think the end result will be fewer taxes collected from tax cheats, fewer services for taxpayers, an increase in the tax gap, and ultimately an increase in our deficit over the next year.

Finally, I would be remiss if I did not discuss the other possibility should the House and Senate not come to an agreement on a continuing resolution. It should not be news to anyone here that we are now 3 days away from a possible government shutdown. Even with the potential of a 2-week continuing resolution, we are likely to be in the same place in the near future. Any shutdown would have a serious impact on the numerous services and activities that Federal agencies normally engage in.

Should such an event come to pass, I am interested to find out what services the IRS will have to shutter and what the impact

will be on tax enforcement, tax returns processing, and taxpayer refunds.

Mr. Shulman, I put a lot before your plate, but we have worked together for a few years now, and I know of your commitment and your talent and your ability. So we stand ready to listen to your testimony.

Mrs. EMERSON. Thank you, Joe.

I would like to recognize you, Commissioner Shulman, for 5 minutes. If you can keep it at that, and then we will have lots of questions for you. Thanks.

Mr. SHULMAN. Thank you, Chairwoman Emerson, Ranking Member Serrano, Ms. Lee, for having me before the Subcommittee to talk about the budget environment and the 2012 Budget Submission by the President in particular.

The 2012 budget was crafted during a time of fiscal austerity and belt tightening. What that means to me and this Agency, and in our dialogue with OMB, is finding savings where we can, and then investing in strategic priorities that will help the tax system improve.

Against this backdrop I think the budget makes clear that the IRS is vital to the functioning of the government and keeping our Nation and our economy strong. In 2010, we collected $2.3 trillion in revenue. For every dollar the IRS spends, about $200 comes in to the Federal Government. We processed 140 million returns and put $312 billion of refunds into the economy.

I think it is in recognition of this critical role that we play that the 2012 budget has judicious investments in our core programs, as well as funding for new provisions in the Tax Code.

The budget also tries to keep the balance between service and enforcement, and makes sure we administer the law in a fair way.

I will also note the budget has the necessary funding to finish our core taxpayer account database, our centerpiece of our modernization program, for this upcoming 2012 filing season. If we finish this core database and get funding for it, it will mean faster processing of all returns, expedited refunds for 140 million individual taxpayers, and enhanced data security.

I want to emphasize that, because of our unique revenue-raising functions, the investments in our budget more than pay for themselves and directly contribute to deficit reduction.

I also want to point out that this budget, like last year's budget and the budget before that, includes significant efficiency savings. So even though we are asking for a net increase, in this budget we have $190 million of targeted efficiency savings. In this current environment, I challenged our leadership and everyone at the IRS to find savings where they can, recognizing the situation we are in.

Let me briefly turn, before I conclude, to a related matter, which is H.R. 1, the continuing resolution to fund the government. Under the House version, the total fiscal year 2011 funding would be $603 million below the 2010 enacted level. I would be remiss in my responsibilities as IRS Commissioner if I didn't spell out the effects that such a large reduction would have on our ability to carry out our mission, to the fiscal health of the Nation, and the integrity of the tax system.

If H.R. 1 were enacted, the IRS would need to make substantial, immediate cuts to its enforcement programs. We estimate that an action of this magnitude would reduce direct enforcement revenue this year by about $4 billion. In other words, a dramatic reduction in IRS funding would actually increase the deficit by about seven times the magnitude of the proposed reduction. Moreover, such a conspicuous drop in enforcement activities could have an impact on longer-term voluntary compliance.

We would also be forced to dramatically reduce the resources to taxpayer services, leading to millions of unanswered telephone calls, delayed processing of correspondence, and potentially delayed processing of refunds.

With that said, I want to be clear that I recognize the challenging environment that we are in. I appreciate that this Committee has to make difficult choices on behalf of the American people. And so, I look forward to a constructive dialogue over the coming weeks and months, and I very much appreciate the continued support that this committee has shown the IRS.

So that concludes my testimony. I think I kept it under 5 minutes.

[The prepared statement follows:]

WRITTEN TESTIMONY OF
DOUGLAS H. SHULMAN
COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
HOUSE APPROPRIATIONS COMMITTEE
SUBCOMMITTEE ON FINANCIAL SERVICES
AND GENERAL GOVERNMENT
ON FY 2012 IRS BUDGET
MARCH 1, 2011

INTRODUCTION & SUMMARY

Chairwoman Emerson, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to appear today to discuss the President's FY 2012 Budget Request for the Internal Revenue Service (IRS).

This Budget was crafted during a time of fiscal austerity and belt tightening for the nation and it is incumbent upon all of us in government to be as efficient as possible and spend taxpayer dollars wisely. That means finding savings where we can, and continuing to invest in strategic priorities that allow us to continuously improve.

Against this backdrop, it is clear that the IRS is vital both to the functioning of government and keeping our nation and economy strong. In FY 2010, the IRS collected $2.345 trillion in gross revenue to fund the federal government, approximately 93 percent of all federal receipts. Moreover, for Fiscal Year 2010, we processed more than 140 million individual income tax returns and issued 109.5 million refunds to individual taxpayers totaling $366 billion.

A Record of Success

The IRS is proud of its implementation track record over the past few years.

We have run smooth filing seasons for the last several years, despite new tasks being added to our agenda and late passage of legislation.

We have also made good strides in cracking down on international tax evasion. We struck a landmark deal with the government of Switzerland, and for the first time received information on thousands of Americans hiding assets in Swiss bank accounts. As we turned up the pressure on those not paying taxes on overseas assets, we had approximately 15,000 voluntary disclosures from individuals who came in under our special Voluntary Disclosure Program (VDP). Since the special program closed, we received an additional 3,000 voluntary disclosures from individuals with bank accounts from around the world.

Many of these voluntary disclosure cases involve significant amounts of previously unpaid tax.

However, collecting such substantial additional revenue for past misdeeds is not the only important consideration here. Regardless of dollar size, it is important that we are bringing thousands of US taxpayers back into the system so they properly report and pay their taxes for years to come on their offshore accounts.

Last month, the IRS announced a new special voluntary disclosure program designed to help people with undisclosed income from hidden offshore accounts get current with their taxes.

In 2010, the IRS also took a major step towards transparency with Announcement 2010-9 to require business taxpayers to report basic information regarding their uncertain tax positions (UTP) when they filed their tax returns.

This new requirement helps to achieve what most taxpayers and the IRS strive for: certainty, consistent treatment and the efficient use of government and taxpayer resources by focusing on issues and taxpayers that pose the greatest risk of tax noncompliance.

One of the most important initiatives that the IRS has undertaken in recent memory is the return preparer initiative, which is now being implemented. In September 2010, we launched the new online PTIN (Preparer Tax Identification Number) application system. It is up and running with hundreds of thousands of preparers already registered in the system.

More than just an identification number, the PTIN registration process gives the IRS an important and better line of sight into the return preparer community than we have ever had before. We can leverage that information to help us better communicate, analyze trends, spot anomalies and potentially detect fraud.

The registration process will help us build in several years a publicly-accessible database of preparers who are authorized to prepare returns. This is an extremely important tool for consumers as they will be able to search the database to ensure that their preparer is registered. It will also make it easier to find and track the bad actors out there. They will not be able to pull up stakes and move around anonymously.

The IRS is also very proud of its work in implementing the tax-related provisions of the American Recovery and Reinvestment Act (ARRA) and other economic recovery legislation. We put billions of dollars to help people buy homes and stabilize the housing market through the First-time Homebuyer Credit, and we added $400 to $800 to families' paychecks through the Making Work Pay Credit, just to name two provisions.

The IRS continues to provide taxpayers with quality customer service and different service channels and products. They run the gamut from traditional walk-in sites for those who need to see an IRS representative face-to-face, to toll-free automated and assistor telephone service, to web-based applications and social media. All make it easier for taxpayers to file and pay their taxes.

Telephone level of service is recovering after several challenging years. Toll-free assistor level of service (LOS) increased by 4 percent over the previous year to 74 percent. Toll-free tax law accuracy remained at 93 percent, and the overall toll-free customer satisfaction rating stood at 92 percent. Last year, we also saw a 70 percent e-file rate for individuals as compared to a mere 10 percent 15 years ago. As noted in the next section, this translates into a huge savings.

IRS.gov has become the favorite source of information for millions of taxpayers. For FY 2010, there were almost 305 million web page visits to IRS.gov –a 14 percent increase over the same time period in FY 2009. Use of the "Where's My Refund" electronic tracking tool continued to post double-digit yearly gains.

The IRS is increasingly communicating with taxpayers who may not get their information from traditional sources, such as newspapers and broadcast and cable news. By employing social and new media, such as YouTube, Twitter and even iTunes, we are able to reach these taxpayers with important service and compliance messages.

In January 2011, the IRS also unveiled IRS2Go, its first smartphone application that lets taxpayers check on the status of their tax refund and obtain helpful tax information. This new smartphone app reflects our commitment to modernizing the agency and engaging taxpayers where and when they want.

Finally, the IRS continues to run robust compliance programs. We continue to have appropriate and balanced audit coverage rates across taxpayers and to innovate in our collection programs.

In short, despite a quickly evolving taxpayer base and unprecedented demands on IRS resources, the IRS continues to deliver for the American people.

Working Smarter and Greater Efficiencies

The IRS continues to reap the financial benefits of the E-File program, one of the most successful modernization programs in government. Today we receive nearly 100 million tax returns electronically. In the past these returns had to be opened, sorted, and transcribed manually. The efficiency savings have allowed us to reduce our submission processing sites in half. This year we are closing our 5th of the original 10 sites.

The FY 2012 Budget Request includes almost $190 million in efficiency savings, reductions, and non-recurs. While these targets are substantial, I am confident that we will meet them and more, by finding cost-savings in our operations wherever we can.

I have also challenged the IRS leadership and indeed, all IRS employees, to take a hard look at their operations and look for potential savings and efficiencies.

Even in a tough budget environment, I am confident that the IRS will continue to deliver value for the American taxpayer and will emerge as a stronger agency in the years to come.

I am particularly pleased with the progress that we are making in achieving efficiencies in our technology operations. The IRS has embarked on a multi-year effort to streamline and standardize processes that will allow for substantial efficiency gains. For example, the Information Technology Infrastructure Library is a collection of best practices used to aid in the implementation of a lifecycle framework for IT Service Management. In September 2010, an independent third party found that the IRS recently reached Capability Maturity Model (CMM) Level 2 based on established criteria.

Achieving this level allows standardized project management practices across projects. This will improve our agility and quality in delivering software to our business customers and the taxpaying public, as well as reduce the cost of developing and maintaining products, and improve the cost of engineering services.

Investing in Core Programs

Indeed, it is in recognition of the critical role that the IRS plays in the economy that the FY 2012 Request includes a judicious investment in the IRS' core service and enforcement programs and initiatives. Enforcement and customer service are not an either/or proposition. Accomplishing our mission requires that we do both well.

The Request also includes the necessary funding for completing on time for the 2012 filing season the core taxpayer account database. A fully operational customer account database will mean faster processing of returns, expedited refunds for 140 million individual taxpayers and enhanced data security.

The funding in the President's Budget Request will be used to carry out the IRS' strategic and balanced agenda that includes:

- Improved service to taxpayers, including enhancements to the IRS.gov website to meet taxpayer needs and growing demand for more e-services:
- Robust and targeted enforcement programs to address offshore tax evasion and improve tax compliance for corporate and high-income taxpayers;
- Completion of the new taxpayer account database and enhancements to our electronic filing platforms;
- Leveraging the Return Preparer Program to reduce non-compliance;
- Implementation of our Uncertain Tax Position reporting requirements;

- Combat errors and fraud for refundable tax credits, such as the Earned Income Tax Credit.
- Better use of data, such as credit card and securities basis information reporting;
- Implementation of new tax provisions, such as the Affordable Care Act (ACA);
- Workforce development to ensure that we have a talented and capable workforce for the foreseeable future; and
- Enhance workplace/physical security for IRS employees.

The IRS will also administer those portions of ARRA that were extended into 2011. These include the expanded Earned Income Tax Credit for families with three or more children, and the American Opportunity tax credit to help pay tuition and other expense for individuals enrolled in institutions of higher education. In addition, we continue to administer the Health Coverage Tax Credit (HCTC) that was enacted as part of the Trade Adjustment Assistance Reform Act of 2002.

The new enforcement personnel included in the request will generate more than $1.3 billion in additional annual enforcement revenue once the new hires reach full potential in FY 2014. The return on investment (ROI) estimate does not include the indirect revenue effect of the deterrence value of these investments and other IRS enforcement programs, which is conservatively estimated to be at least three times the direct revenue impact.

THE ADMINISTRATION'S FY 2012 BUDGET REQUEST FUNDS KEY PRIORITIES

The IRS funding level for FY 2012 is $13,283,907,000, which includes $85,754,000 for maintaining current levels, a decrease of $22,090,000 from non-recurring activities, a decrease of $167,867,000 from efficiencies and savings, and a program increase of $838,836,000 to improve taxpayer service, implement enacted legislation, strengthen enforcement, and continue migration of applications to the new taxpayer account database, CADE 2. By FY 2014, the revenue-producing enforcement investments are projected to increase annual enforcement revenue by more than $1.3 billion annually.

The Budget Request supports these activities by providing:

- $114,307,000 to improve taxpayer service and the IRS.gov website;

- $605,671,000 to implement legislative mandates, handle new information reporting requirements, increase compliance efforts to address offshore tax evasion, focus on corporate and high-wealth returns, increase examination and collection coverage, and enforce tax return preparer compliance; and
- $118,858,000 to enhance employee security, develop disaster recovery systems capability, and develop the information technology, infrastructure, and systems to implement the various ACA provisions.

Building on the FY 2010 Enacted Level

The FY 2010 enacted level for the IRS was $12,146,123,000, supporting an estimated 94,766 FTE.

Maintaining Current Levels

- ***Adjustment to Reach FY 2011 President's Policy Level +$401,665,000 / +1,653 FTE*** Adjustment from the FY 2011 Annualized Continuing Resolution Rate to reach the FY 2011 President's Policy Level. The President's Policy Level is equal to the FY 2011 President's Budget Request as adjusted for the proposed pay freeze.

- ***Adjustments Necessary to Maintain Current Levels +$85,754,000 / 0 FTE*** Funds are requested for inflation adjustments in non-labor expenses such as GSA rent adjustments, postage, supplies and equipment and health benefits and the increase in Federal Employee Retirement System participation. No inflation adjustment is requested for pay in FY 2012.

Base Adjustments

- ***Technical FTE Adjustments $0 / +501 FTE*** This adjustment reflects permanent changes made to ensure FTE levels are fully funded in the base budget.

Efficiencies and Savings

- ***Non-Recur Savings -$22,090,000 / 0 FTE*** This is the net of reductions of non-recurring, one-time costs associated with the IRS FY 2011 enforcement initiatives (e.g., IT equipment and training).

- ***Increase e-File Savings -$22,444,000 / -416 FTE*** This decrease is a result of savings from increased electronic filing (e-file). Savings are based on e-file projected growth, modernization, and the completion of the phased implementation of the Worker, Homeowner, and Business Assistance Act of 2009 (Public Law 111-92), which requires all paid tax return preparers who expect to

file more than 10 tax returns to file such returns electronically. electronic filing by tax return preparers.

- ***Reduce IT Infrastructure -$75,000,000 / 0 FTE*** The IRS will reduce the unit costs of infrastructure through use of the Capability Maturity Model (i.e., a process improvement approach that yields efficiencies in software engineering); the Information Technology Infrastructure Library (ITIL) that will allow the IRS to improve the quality of IT services; and the further consolidation of security activities in the Cybersecurity organization to leverage security best practices.

- ***Reduce Contracts -$20,754,000 / 0 FTE*** In accordance with Presidential guidance on controlling contracting costs, the IRS will achieve targeted savings through reduced contracting expenses.

- ***Reduce Administrative Expenses -$14,331,000 / -66 FTE*** The IRS will reduce administrative expenses, including targeted attrition through hiring freezes.

- ***Eliminate Lockbox Fees -$4,000,000 /0 FTE*** The IRS will eliminate lockbox fees that now will be paid by taxpayers in installment agreements.

- ***Reduce Certain Mailings -$4,000,000 /0 FTE*** The IRS will eliminate printing and mailing of certain forms and publications and reduce the number of inserts in mailings.

- ***Reduce Training, Travel and Programs -$27,338,000 / -41 FTE*** The IRS will reduce agency-wide non-technical training, non-case related travel, and the taxpayer communication and education program.

Program Reinvestment

- ***Submission Processing Consolidation (Atlanta) +$1,486,000 / 0 FTE*** Increased use of e-file has led to consolidation of individual return processing sites. A portion of the increased e-File savings will be reinvested to fund the one-time separation costs associated with the September 30, 2011 closure of the Atlanta submission processing site. As the Atlanta consolidation approaches, the IRS will assist employees to find employment either in or outside the organization.

Program Increases

- ***Improve Taxpayer Service +$81,307,000 / +519 FTE*** Funding for this initiative and the $25.9 million increase from the FY 2011 President's Policy level will provide staffing to address rising demand and This initiative also includes funding to assist taxpayers in understanding ACA provisions and to make related call center and infrastructure changes to handle anticipated ACA-related service inquires.

- ***Expand Online Options through IRS.gov Improvements +$33,000,000 / +15 FTE*** This initiative will continue the multi-year effort to replace the outdated web portal environment and provide additional online services to taxpayers. The Taxpayer Assistance Blueprint, Phase 2, targeted migration to the electronic channel and services as one of the five areas for improvement of IRS service delivery. IRS will achieve efficiencies by moving high-volume transactions to IRS.gov, improving taxpayer self-service, reducing taxpayer burden, increasing compliance, reducing costs, improving security, and these improvements will position IRS.gov as the preferred delivery channel of choice for taxpayer service.

- ***Increase International Service and Enforcement +$72,596,000 / +377 FTE*** The IRS will implement reporting, disclosure and withholding requirements and expand coverage of international filings, conduct more in-depth international compliance work, strengthen compliance efforts related to offshore activity and grow the Global High-Wealth compliance group. This initiative will increase examinations of employment tax specialty program audits, individual audits, business audits; and criminal investigation case closures. As part of this overall effort, IRS will also implement changes contained in the Foreign Account Tax Compliance Act (FATCA).

- ***Increase Collection Coverage +$52,000,000 / +413 FTE*** This initiative will expand work on the collection inventory and improve collection processes to bring taxpayers who fail to pay their tax debt into compliance. This funding will expand the Automated Collection Systems (ACS) program, address the increased workload for the Offers in Compromise (OIC) program due to program improvements and to more taxpayers experiencing economic hardship, and improve efficiency through innovative approaches to inventory selection. The additional staff will resolve an additional 144,300 tax delinquency accounts (TDA) (i.e., balance due accounts where returns were filed, but the taxes have not been paid) and 25,200 tax delinquency investigations (TDI) (i.e., investigations of taxpayers with unfiled returns who have not responded to a notice).

- ***Implement Merchant Card and Basis Reporting +$35,730,000 / +415 FTE*** This initiative will staff programs to implement information reporting on merchant payment card and third party reimbursements enacted in the Housing and Economic Recovery Act of 2008 (Public Law 110-289) and basis reporting on security sales enacted in the Emergency Economic Stabilization Act of 2008 (Public Law 110-343).

- ***Increase Coverage to Address Tax Law Changes and Other Compliance Issues +$96,718,000 / +497 FTE*** This initiative addresses compliance issues and new responsibilities arising from recent tax law changes included in major legislation such as ARRA and the ACA. This initiative will fund compliance programs needed for new provisions such as direct-pay bonds, new requirements on tax-exempt hospitals, a new fee on manufacturers and importers of branded prescription drugs, the excise tax on indoor tanning, and will also increase the

number of specialty program (i.e., employment tax, excise tax, and estate and gift tax) audits.

- ***Ensure Accurate Delivery of Tax Credits +$260,293,000 / +834 FTE*** This initiative recognizes the important role IRS plays in delivering economic incentives through tax credits by improving the delivery of existing credits through a combination of improved technology tools and increased enforcement staffing. The initiative largely funds the information technology and other systems required to implement the new ACA premium assistance tax credit, which becomes effective in 2014. IRS must build new systems to support eligibility determination based on household income, and modify existing tax processing systems to support reconciliation of advance payments of the credit. The initiative also funds the appropriate compliance resources for the small employer tax credit that came into effect in 2010.

- ***Administer New Statutory Reporting Requirements +$58,505,000 / +187 FTE*** Recent legislation establishes significant new information reporting and sharing requirements from third parties (such as employers, health insurance providers), and the Health Insurance Exchanges (the "Exchanges") to administer the premium assistance tax credit, the individual coverage requirement, and the employer responsibility payment. Effective implementation will require significant enhancements to existing information returns systems to handle the additional volumes and new information reporting categories. The ACA also includes provisions that allow the IRS to share tax data with state and federal entities for the purpose of determining eligibility for the advance premium credit. This request also includes resources to ensure secure exchange of information and provides the initial staffing to establish the program to handle the additional inventory of non-filer assessments expected because of the expanded 2012 information reporting requirement for businesses to report all aggregate purchases of services or property greater than $600.

- ***Leverage Return Preparer Program to Reduce Noncompliance +$16,600,000 / +108 FTE*** The IRS is increasing tax return preparer oversight to ensure that tax return preparers are competent and to help ensure that the IRS collects the right amount of taxes. This initiative will ensure uniform and high ethical standards of conduct for tax return preparers by enforcing preparer compliance with IRS rules, increasing preparer examinations, and pursuing preparers engaged in fraudulent activities. This initiative is key to the IRS's tax gap strategy and will increase government revenue.

- ***Address Appeals Workload Growth +$9,100,000 / +66 FTE*** This initiative will allow the IRS to increase Appeals staffing. Despite improvements in cycle time and increased efficiency in working cases, Appeals continues to experience rising inventories, and because of the nature of Appeals work, the cases must be processed manually. The funding in this initiative will reduce, but not eliminate,

the stress put on the appeals process because of increased caseload. In addition, Appeals settlements generate increased revenues for the federal government.

- ***Implement Uncertain Tax Position Reporting Requirements +$4,129,000 / +20 FTE*** This initiative will allow the IRS to provide guidance and certainty on UTPs and meet increasing taxpayer demands for this service. This increased workload is expected as a result of changes IRS has proposed for certain large business taxpayers to report information about their uncertain tax positions. It is a critical part of IRS's work to gain greater transparency into large corporate tax returns

- ***Enhance Security and Disaster Recovery Systems Capability +$12,000,000 / +5 FTE*** This initiative is part of a multi-year improvement strategy to support the continued deployment of critical disaster recovery capabilities. It supports two critical business processes: Processing Remittances and Processing Tax Returns by reducing the recovery time dramatically for the critical applications supporting these processes.

- ***Update Integrated Financial System (IFS) +$27,500,000 / +5 FTE*** This initiative provides funds to complete the first phase of an initiative to update IFS. This request will ensure IRS compliance with future federal accounting requirements and allow implementation of standard interfaces and communication with other federal systems. The IRS current financial system is more than ten years old and SAP software no longer provides updates or changes to accommodate new legislative or other federal accounting requirements. Without a system that will allow implementation of new federal accounting requirements, IRS compliance with federal financial management standards could be jeopardized.

- ***Leveraging Data to Improve Compliance +$1,400,000 / +5 FTE*** The IRS is focused on using a data-driven approach to continually innovate and improve its programs. This investment will capitalize on the significant increase in data reported to the IRS, with the goal of increasing compliance. Funding will increase compliance through leveraging such data and/or evaluating the effectiveness of tax-related programs.

- ***Enhance Physical Security for Federal Employees +$15,481,000 / +10 FTE*** The February 2010 attack against the IRS in Austin, Texas killed one IRS employee and injured several others. This initiative will provide investments needed to update and/or upgrade the physical security of IRS facilities. The investments will enhance the overall security of IRS employees in the work place, while maintaining open access for the taxpayers that they serve.

- ***Implement Individual Coverage Requirement and Employer Responsibility Payments +$62,477,000 / +65 FTE*** This initiative will fund the development of the information technology, infrastructure, and systems to implement the ACA provision that establishes shared responsibility payments for both individuals and employers. Beginning in 2014, the ACA requires individuals who are able to

afford health insurance to obtain minimum essential coverage or pay a penalty, and large employers – those with 50 or more full-time employees – to make a shared responsibility payment if they do not provide affordable coverage to their employees, and at least one of their employees benefits from the premium assistance tax credit.

ENFORCEMENT PROGRAM

The FY 2012 President's Budget Request is $5,966,619,000 in direct appropriations and an estimated $75,902,000 from reimbursable programs for a total operating level of $6,042,521,000. The total direct appropriations level includes an additional appropriation for tax enforcement and compliance activities funded through a program integrity allocation adjustment totaling $1,257,000,000, of which $936,000,000 will be funded from the Enforcement account. The allocation adjustment increases the Financial Services Committee's 302(b) level by the amount of the allocation adjustment. Congress used such an allocation adjustment mechanism to fund IRS enforcement initiatives in both FY 2009 and FY 2010 and the Administration proposed an adjustment of $1,115,000,000 for FY 2011. This appropriation funds the following budget activities. This appropriation funds the following budget activities.

- **Investigations ($678,849,000 from direct appropriations and an estimated $66,567,000 from reimbursable programs)** This budget activity funds the criminal investigations programs that uncover criminal violations of the internal revenue tax laws and other financial crimes; enforces criminal statutes relating to these violations; and recommends prosecution as warranted. These programs identify and document the movement of both legal and illegal sources of income to identify and document cases of suspected intent to defraud. It provides resources for international investigations involving U.S. citizens residing abroad, non-resident aliens and expatriates and includes investigation and prosecution of tax and money-laundering violations associated with narcotics organizations.

- **Exam and Collections ($5,103,420,000 from direct appropriations and an estimated $8,761,000 from reimbursable programs)** This budget activity funds programs that enforce the tax laws and increase compliance through examination and collection programs that ensure proper payment and tax reporting. It also includes programs such as specialty program examinations (employment tax, excise tax and estate and gift exams), international collections and international examinations. The budget activity also supports appeals and litigation activities associated with exam and collection.

- **Regulatory ($184,350,000 from direct appropriations and an estimated $574,000 from reimbursable programs)** This budget activity funds the development and printing of published IRS guidance materials; interpretation of tax laws; advice on general legal servicing, ruling and agreements; enforcement of regulatory rules, laws, and approved business practices; and supporting taxpayers in the areas of pre-filing agreements, determination letters, and advance pricing

agreements. The Return Preparer Strategy initiative is funded within this activity in addition to the Office of Professional Responsibility which is responsible for identifying, communicating, and enforcing the Treasury Circular 230 standards of competence, integrity, and conduct of professionals representing taxpayers before the IRS.

TAXPAYER SERVICE

The FY 2012 President's Budget Request is $2,345,133,000 in direct appropriations, an estimated $22,924,000 from reimbursable programs, and an estimated $130,962,000 from user fees, for a total operating level of $2,499,019,000. This appropriation funds the following budget activities:

- **Pre-Filing Taxpayer Assistance and Education ($701,035,000 from direct appropriations and an estimated $863,000 from reimbursable programs)** This budget activity funds services to assist with tax return preparation, including tax law interpretation, publication, production, and advocate services. In addition, funding for these programs continues to emphasize taxpayer education, outreach, increased volunteer support time and locations, and enhancing pre-filing taxpayer support through electronic media.

- **Filing and Account Services ($1,644,098,000 from direct appropriations, an estimated $22,061,000 from reimbursable programs, and an estimated $130,962,000 from user fees)** This budget activity funds programs that provide filing and account services to taxpayers, process paper and electronically-submitted tax returns, issue refunds, and maintain taxpayer accounts. The IRS continues to make progress in decreasing paper returns and increasing the use of electronic filing and payment methods.

BUSINESS SYSTEMS MODERNIZATION

The FY 2012 President's Budget Request is $333,600,000 in direct appropriations. This appropriation funds the following budget activity:

- **BSM ($333,600,000 from direct appropriations)** This budget activity funds the planning and capital asset acquisition of information technology (IT) to continue the modernization of IT systems, including labor and related contractual costs. The completion of the core database is the cornerstone of modernization and is a prerequisite to developing the next generation of IRS service and enforcement initiatives. The integration strategy includes a particular focus on enhanced information technology security practices and robust accounting and financial management controls. This activity also funds the ongoing development of the Modernized e-File platform for filing tax returns electronically.

OPERATIONS SUPPORT

The FY 2012 President's Budget Request is $4,620,526,000 in direct appropriations, an estimated $39,446,000 from reimbursable programs, and an estimated $73,466,000 from user fees, for a total operating level of $4,733,438,000. The total direct appropriations level includes an additional appropriation for tax enforcement and compliance activities funded through a program integrity allocation adjustment totaling $1,257,000,000, of which $312,000,000 will be funded from the Operations Support Account. The allocation adjustment increases the Financial Services Committee's 302(b) level by the amount of the allocation adjustment. Congress used such an allocation adjustment mechanism to fund IRS enforcement initiatives in both FY 2009 and FY 2010 and the Administration proposed an adjustment of $1,115,000,000 for FY 2011. This appropriation funds the following budget activities. This appropriation funds the following budget activities:

- **Infrastructure ($986,045,000 from direct appropriations, an estimated $516,000 from reimbursable programs, and an estimated $22,095,000 from user fees)** This budget activity funds administrative services related to space and housing, rent and space alterations, building services, maintenance, guard services, and non-IT equipment.

- **Shared Services and Support ($1,313,050,000 from direct appropriations and an estimated $20,577,000 from reimbursable programs)** This budget activity funds policy management, IRS-wide support for research, strategic planning, communications and liaison, finance, human resources, and equal employment opportunity and diversity services and programs. It also funds printing and postage, business systems planning, security, corporate training, legal services, procurement, and specific employee benefits programs.

- **Information Services ($2,321,431,000 from direct appropriations, an estimated $18,353,000 from reimbursable programs, and an estimated $51,371,000 from user fees)** This budget activity funds staffing, equipment, and related costs to manage, maintain and operate the information systems critical to the support of tax administration programs. This includes the design and operation of security controls and disaster recovery planning. This budget activity also funds the development and maintenance of the millions of lines of programming code that support all aspects and phases of tax processing and the operation and administration of the mainframes, servers, personal computers, networks, and a variety of management information systems.

Health Coverage Tax Credit (HCTC) Administration

The FY 2012 President's Budget request is $18,029,000 in direct appropriations. This appropriation funds the following budget activity.

- **HTCA ($18,029,000 from direct appropriations)** This budget activity funds costs to administer a refundable tax credit for health insurance to qualified

individuals, which was enacted as part of the Trade Adjustment Assistance Reform Act of 2002.

AFFORDABLE CARE ACT

The IRS will need to implement and administer the tax provisions of the Affordable Care Act (ACA) (Public Law 111-148) in 2012. IRS seeks to be helpful to families and businesses that will benefit from ACA. In fact, some benefits have already begun. For example, upon enactment of the ACA, the IRS immediately began to make sure that small employers were aware of a significant new tax credit to help them provide health coverage to their workers.

Because the tax credit was enacted mid-year, and was effective immediately, the IRS conducted a significant outreach campaign to small businesses. In addition to mailing postcards to millions of employers alerting them to the new credit, the IRS held or attended more than 1,000 outreach events targeted at small businesses, and the tax practitioners who serve them.

Working with the Department of Health and Human Services, we also administered a program to provide $1 billion in tax credits and grants to qualifying therapeutic discovery projects.

In addition, we have implemented or have begun to implement changes that expanded the tax credit for adoptive parents, a new exclusion for loan forgiveness programs for certain health professionals, and a new tax on indoor tanning services.

We are also working diligently to implement the tax law components of the changes made to the health insurance marketplace that will begin in 2014. Let me put these efforts in context by describing the activities that we are undertaking to plan for these upcoming changes.

The IRS also has significant information technology development work that must be completed in order to administer these provisions. The vast majority of the resources that IRS will require between now and 2014 will be dedicated to technology and the associated business process design required to effectively administer these new provisions.

Exchanges and Medicaid Health Coverage

Individuals seeking subsidized coverage will interact with the IRS at a few discrete points in the process:

1. Obtaining coverage through exchanges and/or Medicaid

The ACA outlines eligibility rules for the premium assistance tax credit, as well as Medicaid. In both cases, the household income as reported to the IRS by approximately 140 million taxpayers on the 2012 tax returns will be relevant to

eligibility determination. The IRS will alter its systems to take account of the new concept of household income, and is planning to provide significant educational tools to help individuals understand what household income represents. Furthermore, planning is underway to determine the best way to provide this information to taxpayers via the Web, telephone, and other channels.

2. Receiving advance premium tax credits

Individuals who are determined to be eligible for the premium assistance tax credit can receive the benefit through advance monthly payments that are made directly to the plan provider. Working with the Treasury Financial Management Service, the IRS will develop new systems to administer these advance payments. In addition the IRS will work with the exchanges, as appropriate, to conduct significant outreach and education to make taxpayers who are receiving the advance payments aware of the importance of reporting mid-year changes in circumstance that could affect their eligibility for, or the amount of the credit.

3. Reconciling the premium assistance tax credit with advance payments made through the year

The ACA provides that individuals will reconcile the amount of advance payments of the premium credit with the actual amount as computed on the tax return. In other words, advance payments made throughout 2014 will be reconciled with individuals' tax returns that are filed in the spring of 2015. To the extent that the ultimate credit amount is larger than the sum of the advance payments, the additional amount will be added to the taxpayer's refund. If the ultimate credit amount is lower than the sum of the advance credit, the taxpayer will owe additional tax on the return. The amount owed may be capped, subject to the schedule outlined in the Medicare and Medicaid Extenders Act of 2010.

Individual Coverage Requirement

The IRS will also be responsible for administering the requirement that individuals who can afford health coverage either obtain it, or make a payment to the IRS. While implementation of this requirement does not come into effect until 2014, and will appear on the 2014 tax forms that will be filed in the spring of 2015, we have nonetheless received a number of questions about how this provision will be implemented.

First, we anticipate providing significant outreach and education on this provision. This will come directly from IRS and in partnership with state and federal agencies, employers, tax return preparers, and others. Our experience in administering new tax laws suggests that the vast majority of individuals will successfully incorporate this provision into their tax year 2014 returns, filed in 2015.

The forms will provide instructions on how individuals can determine if they met the coverage requirement, and if not, how to compute the payment and include it in that

year's tax liability. We also plan to work closely with the tax return preparation industry to ensure that the professionals who advise taxpayers are fully informed about this provision. Today, approximately 60 percent of taxpayers use a return preparer; another 25 percent use software to prepare their own returns.

For the remaining minority who do not get it right, the IRS will follow up with the taxpayer. While it is early in the planning process, I can describe for you the general parameters of how this will work.

Employer Provisions

Finally, the IRS will administer the employer responsibility payment for large employers who do not offer affordable coverage, and have at least one employee who receives subsidized coverage through the exchange. This provision closely intersects with the rest of the exchange provisions, and we are working closely with the Department of Health and Human Services and the Department of Labor to reach out to the employer community; understand what questions and issues they foresee; and incorporate the feedback that we get into the upfront program design and regulatory guidance.

Tax Law Changes

The IRS is also working diligently to implement other tax law changes that come into effect over the next several years. Earlier in my testimony, I mentioned several that we are already implementing, and would be happy to answer any questions that you have on those, or the provisions coming into effect in the months and years ahead.

CONCLUSION

In conclusion, let me thank the subcommittee again for this opportunity to discuss the IRS Budget Request for FY 2012. It is fiscally prudent and makes wise investments in strategic priorities in enforcement, service, and business modernization. It will help ensure that the IRS will continue its vital role in keeping our nation and economy healthy and strong.

Biography for Commissioner of Internal Revenue Douglas H. Shulman

Douglas H. Shulman is the 47th Commissioner of Internal Revenue. As Commissioner, he presides over the nation's tax system, which collects approximately $2.4 trillion in tax revenue that funds most government operations and public services. Shulman manages an agency of about 100,000 employees and a budget of more than $12 billion. The agency touches every facet of American society, including individual taxpayers, the tax-exempt sector, small businesses and large corporations.

As Commissioner, Shulman has emphasized the necessity of maintaining a balance between taxpayer service and tax enforcement. His goals for the IRS are improving service to make voluntary compliance easier for taxpayers while at the same time enforcing the law to make sure everyone meets their obligation to pay the taxes they owe.

During Commissioner Shulman's tenure, the IRS played a major role in the economic recovery efforts by delivering 119 million economic stimulus payments, implementing a significant portion of the American Recovery and Reinvestment Act and designing IRS programs to assist individuals and businesses struggling through difficult economic times. In the face of increasing globalization of tax administration, Shulman has stepped up IRS activity on a variety of international and corporate tax issues, including offshore tax evasion. He is serving as the Chair of the Organisation for Economic Co-operation and Development's Forum on Tax Administration. Also under Shulman's direction, the IRS launched the Return Preparer Initiative to ensure high standards of ethics and service across the tax preparation industry. Other major initiatives launched during his tenure include expanded use of data and third-party information to enhance compliance and preparing the IRS workforce for the next decade.

Commissioner Shulman came to the IRS from the Financial Industry Regulatory Authority (FINRA), the private-sector regulator of all securities firms doing business in the United States, where he served as Vice Chairman. He served in the same role at the National Association of Securities Dealers (NASD) before its 2007 consolidation with New York Stock Exchange Member Regulation, which resulted in the formation of FINRA. After joining NASD in 2000, Commissioner Shulman played an integral role in restructuring the company, led the negotiations of the sale of the NASDAQ stock market and American Stock Exchange, oversaw the launch of industry-wide bond market transparency and modernized NASD's technology operations.

Earlier in his career, Commissioner Shulman helped to co-found Teach for America, was involved with several start-up organizations, was a vice president of a private investment firm and served as Senior Policy Advisor and then Chief of Staff of the National Commission on Restructuring the Internal Revenue Service.

Commissioner Shulman holds a B.A. from Williams College, an M.P.A. from Harvard University's John F. Kennedy School of Government and a J.D. from Georgetown University Law Center.

AFFORDABLE CARE ACT

Mrs. EMERSON. You did great. Thank you very much. And I appreciate the fact that you have broken down for every dollar spent, this is how much you bring in. That is helpful for all of us to know.

My first set of questions is going to be about the health care law. This is the first request that the IRS has made to Congress for it. You say in your written testimony, that some of the provisions of the bill went into effect immediately upon enactment, such as the small business health care tax credit, the qualifying therapeutic discovery credit and expanded adoption credit. Consequently, you all must have already spent some funds on health care in both fiscal years 2010 and 2011. So can you tell me how much you all have already spent, and how many employees worked on health care in fiscal years 2010 and 2011, and what source of funding you used for that first question?

And then, second—well, anyway, why don't you go ahead and answer that.

Mr. SHULMAN. Sure. As you mentioned, there were a number of immediately effective provisions: a tax on tanning services, a credit for small businesses to help them ensure that their employees have health care, $1 billion in tax credits for therapeutic discovery grants to help innovation in health care, and a branded pharmaceutical manufacturers annual fee. There is also the need, because we have until 2014 for full implementation to build a lot of infrastructure, as reflected in our 2012 budget. We need to immediately start planning, looking at our core systems, trying to figure out things like how we reconcile the concept of household income, which will be the trigger for credits, et cetera.

So we did begin immediate implementation. During 2010 and 2011, up to this time, we have planned about $60 million, and the funds came from the authorizing legislation. There were funds in that. The exact number of people I would have to get back to you on. I don't have that number.

[The ACA personnel information follows:]

ACA PERSONNEL

During Fiscal Years 2010 and 2011, the IRS has spent approximately $60 million in Affordable Care Act implementation costs. The Department of Health and Human Services (HHS) allocated these funds to the IRS out of the funds provided in the authorizing legislation (PL 111–148). As of February 28, 2011, the IRS hired 428 additional personnel (cumulative for FY 2010 and 2011) to implement the tax law provisions of the ACA. In addition to people specifically hired for ACA implementation, existing program staff have spent time managing the implementation of various tax law provisions in the ACA.

Mrs. EMERSON. Okay. Was there any money transferred, say, from HHS or——

Mr. SHULMAN. There were funds in the authorizing legislation for implementation.

Mrs. EMERSON. So are there any HHS funds included in part of the 2012 budget?

Mr. SHULMAN. No. The 2012 budget submission is all IRS.

Mrs. EMERSON. You referred to H.R. 1 in your testimony, and you outlined all of the negative ramifications should it ever become law. Let me ask you, because of the prohibitions that would not allow the IRS to expend any funds to implement the new health

care law, what other budgetary resources then would you have to implement and enforce health care, and do you know how much more HHS could actually transfer?

AFFORDABLE CARE ACT FUNDING

Mr. SHULMAN. Well, I think you are referring to some language, which has been brought to my attention, forbidding us from spending money in that bill for implementation.

Mrs. EMERSON. Correct.

Mr. SHULMAN. First, I would note I think the President has been pretty strong about his commitment to this law, and so that prohibition obviously would have to be passed by both Chambers of Congress and signed by the President. So we haven't really done contingency planning around that, at this point.

I should just state it up front, I have been very clear that we should run as a nonpartisan, nonpolitical agency. We don't write the laws, we implement the laws on the books. If we weren't allowed to spend funds on, or if we weren't given funds for health reform, I think of it the same way that I think about not getting funds for any other law that is passed, and we have to make a set of difficult trade-offs. We really haven't done that kind of contingency planning.

Mrs. EMERSON. This will be the last set of questions I ask, and then I will turn it over to Mr. Serrano.

Requesting $473 million and over 1,200 new employees for the health care implementation is a fairly significant increase. I note you have broken it down in the submitted testimony very nicely and very specifically. But this is before the individual mandate even goes into effect in 2014, and, I believe, the last provision of the health care law doesn't go into effect until 2018. Have you all done the calculation yet to determine exactly how much funding and how many FTEs you are going to need to fully implement health care probably through 2020?

Mr. SHULMAN. I don't have those numbers. What I would point out is 82 percent of the money we ask for is technology and infrastructure. 2012, 2013, leading up to 2014, is going to be a big ramp-up, where we have to take our core technology, make it work for the implementation of the ACA. I mentioned the household income. We need to make sure we have the right interfaces with the State exchanges to put out $400 billion of refundable credits in real time, and that the eligibility requirements can work; we must set up the systems for this new concept of reconciliation of those credits at the time people file their returns.

And so I would anticipate that some of the biggest budget numbers you will see will be in 2012, 2013, 2014, as we get up and get operational, and then there won't be as big investments in technology and infrastructure going forward, because that will be in place.

We also have to go into our core tax systems to make sure all this works. Then we have to do back-end testing of those systems to make sure that there aren't any problems.

Mrs. EMERSON. So the answer, though, is you really haven't planned much beyond 2014?

Mr. SHULMAN. We haven't done the kind of specific planning that would allow us to talk about numbers.

Mrs. EMERSON. Do you know when you may get to that point?

AFFORDABLE CARE ACT IMPLEMENTATION

Mr. SHULMAN. CBO put out a 10-year estimate of administrative costs with the bill. If you look at this number, our costs per year are not far off from taking the total and dividing it by 10. And so we will go through detailed planning each year. Some of it will depend on how things evolve. The President yesterday just talked about State flexibility, what States decide to opt in, opt out as we put out guidance. So we are going through it.

I will note there is funding in here for the 1099 provision, which seems to have universal support of repeal. We would pull that funding out if that were repealed. So I think there is a variety of moving pieces.

Mrs. EMERSON. Once you get into the individual mandate piece in 2014, do you envision having to hire a few thousand enforcement folks?

Mr. SHULMAN. Not for the individual mandate. I mean, the individual coverage requirement, as it is called in the bill, is actually a relatively small dollar amount. There are prohibitions in the bill around using levies, seizures, those kinds of things. We would not have any live agents ever talk to someone about that. And so I think most of the money for the individual responsibility requirement is going to be for technology, so we set up the proper billing systems, not for hiring lots of people to go out and check on folks.

Mrs. EMERSON. Okay. We will probably talk more about this.

Mr. Serrano.

Mr. SERRANO. Thank you very much.

It was not my intention to speak about health care at all, but let me make one comment. I don't envy the situation that so many agency heads are finding themselves in, because I think what you are going to see—and I say this not to be nice, but I don't think you are going to see it from Jo Ann Emerson, but I think you are going to see it from some folks who are elected and not elected—which is to sort of try to find a way to intimidate agency heads into not fully implementing on time the health care law or laws they don't like. You do that by using the bully pulpit both if you are elected, and if you are not elected, but have a radio or TV show, you can do that, too, sort of rile the people up to say, don't do it.

For me, it is very simple. And maybe it is because I am not a lawyer. I am not putting lawyers down. But it is the law of the land, and until further notice, it has to be obeyed, and it has to be implemented, and it has to be paid for. And if we don't pay for it—I don't want those wars to be going on, but we keep paying for it. But that is what we live with.

EARNED INCOME TAX CREDIT

Anyway, let me move on to one of my favorite subjects, EITC. You have done a great job in advertising to people that are eligible and to use it, and I have participated in many activities in my district.

The question is, what more can be done both by the IRS and others to ensure that all taxpayers who qualify for the EITC are, in fact, claiming it and receiving it? I believe that may who are eligible are still not using it, not taking advantage of it.

And lastly, again, here is an example of some laws that people go after. It would seem at times that the EITC is the biggest tax issue in the Nation the way it is enforced or how the recipients of it are attacked. And so what can we do to make more people take part in it; and, secondly, perhaps to alleviate some of the concerns other people have about the program?

Mr. SHULMAN. The EITC is a large refundable tax credit which has a set of characteristics. One is it helps lift a lot of people out of poverty. Over twenty-five million people got it last year. Fifty billion dollars was paid out. But when there is a large refundable tax credit, it also becomes a target for people who would perpetrate fraud. And so we run a program that tries to address both ends of that spectrum.

To your question around outreach, we hold EITC awareness days. We try to educate practitioners. And when I say "we hold," we hold thousands of them. We invite Members of Congress. We do a lot to promote it. If we think someone is eligible, and they are not claiming it, we will send a letter to them. There is an automatic letter that goes out, and we work with lots of different groups to advertise it.

I am quite proud of the rate—for a program trying to lift people out of poverty, it has a 75 to 80 percent participation rate. So it is a very high participation rate.

On the other end of the spectrum, there is more fraud and error in it than I would like, and so we have an aggressive set of proposals around reducing fraud and error. In this President's budget, we have proposed to increase the penalty by five times for preparers, tax preparers, who don't do proper due diligence to make sure people meet the eligibility requirements. We run very serious audit programs, and we block a lot of fraud coming in. We block or retrieve about $4 billion annually in error and fraud; and I would note, some of this is error, that people—you know, tough economic times. They take money out of their 401(k), they don't pay taxes on it, they claim the EITC. They didn't know the law. We make an adjustment in just the EITC. So all the numbers aren't fraud.

We also are working with OMB right now to run some experiments with some State data to see if that can be used to decrease fraud. And the list goes on. We have a preparer oversight project, and 66 percent of EITC claims come from preparers. We try to get this balance right by doing extensive outreach, making sure people know that they can get the credit, but we are also very focused on making sure the payments go to the right people, and that we combat any fraud. I think both ends of the spectrum are important.

Mr. SERRANO. I recall at one time that something like 17 percent of the taxpayers were EITC recipients, if you will, and yet 44 percent of the audits have been conducted on them. Are those numbers still the same? Because at that time I claimed that that was unfair. It is a touchy thing. No Member of Congress should be saying, don't go after somebody who is committing fraud. But 44 per-

cent against 17 percent of the taxpaying population or tax-filing population seems to be unfair. What has happened there?

Mr. SHULMAN. The number I carry in my head is 36 percent of audits have some——

Mr. SERRANO. I am not going to argue over that.

Mr. SHULMAN. Tangential, Appropriations Committee-speak. The number had some relation to EITC taxpayers. And, again, it is a difficult balance. We are trying to get it right. So, your average taxpayer has less chance of being audited than an EITC taxpayer because, as I talked to you, it is a big refundable credit. As I said, as you go up the income scale, if you have over $200,000 in income, you have a higher chance of being audited than an EITC taxpayer. And if you have over $1 million of income, you have got four times as much chance of being audited.

So there is more auditing of the EITC than your average taxpayer below $200,000, but because it is a large refundable credit, and we are trying to get this balance right.

VOLUNTARY DISCLOSURE PROGRAM

Mr. SERRANO. Your testimony highlights the success of the voluntary disclosure program for which 15,000 voluntary disclosures were received. What is the IRS's evaluation of the performance of the voluntary disclosure program, and what are the lessons learned? In addition to resources, what else does the IRS need to ensure the success of the international tax enforcement initiative?

Mr. SHULMAN. As you know, as members of the Committee know, I made international tax evasion one of my priorities when I came into the Agency. We had an unprecedented agreement with the Swiss Government, for the first time in American history, to get thousands of accounts turned over from Switzerland, really putting a dent in bank secrecy. We have a variety of other activities. And as we ramped up the jeopardy of people getting caught, we ran a voluntary disclosure program which said, "come in, pay your back taxes, pay your interest on the back taxes, pay a very substantial penalty—in this case 20 percent of your account balance—on top of all this, but you can avoid going to jail."

Frankly, when I started this, I thought maybe 1,000 people would come in. We usually get about 100 people a year through voluntary disclosure. As you mentioned, we had 15,000 come in. Since it closed, we have had another 3,000 or 4,000 come in. We just announced another Voluntary Disclosure program.

And before I get to lessons learned, we are using that information to data mine and then go after other tax cheats, because we see patterns of banks, promoters, advisers who facilitate this. And you have seen some of that start to percolate through the press, so we have now taken that data, and are branching out our investigations to both other banks and other parts of the globe, and we are going to keep the pressure up.

I think lessons learned are, one, you need to be staffed for this. Like I said, we were planning on about 1,000; we got 15,000, so we had to get ramped up for this.

Two, the technique of ramping up pressure and then allowing for people who want to come in and get right is important. I have always said it is great, we have gotten well over 20,000 people back

in the tax system. And they have had to pay the price. But what is more important for our tax system is the next 20,000 or the next 100,000 people don't even think about doing this and are honest, tax-paying citizens for the years to come.

And so I think the real lessons are around how to use your enforcement tool to build long-term compliance in the system. Because that is the most efficient thing we do. There is a huge ripple effect when we find bad actors, bring them in, demonstrate the consequences. And the key is to prevent that action in the future.

DEBT COLLECTION FLEXIBILITY

Mr. SERRANO. I have one more question this round. The whole issue of collecting debt during an economic recession, now, we know that the people who have haven't paid the taxes or who owe taxes no question should pay them, and you should collect them. But the taxpayer advocate feels that there is insufficient guidance available to the tax-collection employees in terms of how best to go about doing it so it doesn't—while collecting taxes, it does not create undue hardships on people who may have lost their jobs during this recession.

What can you tell me? What is happening to both do what your agency is charged with doing, and at the same time taking into consideration that these are not normal times?

Mr. SHULMAN. Similar to what I talked about before. I don't see conflict between collecting the revenue, but making sure we understand the individual circumstances of each taxpayer. I have a theme that I use with our employees, which is everybody should walk a mile in a taxpayer's shoes, and you should really think about each person that comes in. What are their circumstances? How do we best deal with them as the Federal Government in a way that is fair, in a way that is efficient, in a way that has them leave feeling that we are competent, respectful, and all of those things?

And so what we have tried to do is require people who can pay need to pay. But the law allows for a set of flexibilities around people who are struggling, people who aren't in a position to pay, people whose circumstances have changed. And over the last several years we have gotten funding to make sure that we have increased collection coverage, and this funding started before the recession started.

But I put in place a number of measures, trying to walk in taxpayers' shoes. In 2009, we gave our people more discretion around not taking collection actions because somebody missed a payment. We allow people to get liens removed from houses if they were trying to refinance or sell, recognizing that the housing prices are one of the big things dragging the economy down. Last year we held 1,000 open houses for small businesses and individuals around the country. We brought in appeals officers, collection folks, customer service people, the Taxpayer Advocate Service, and tried to work out issues and come to resolutions with them.

FRESH START INITIATIVE

Just last week I announced what I call our "Fresh Start" initiative, where I increased the threshold from which we will file liens,

recognizing inflation. So we will be filing fewer liens going forward. We gave taxpayers the ability—and it was one of the things that the Taxpayer Advocate pointed out—that if they call and request a lien to be withdrawn, we will withdraw it, which erases it from their permanent record. Right now we release it, but a lot of taxpayers have said that a withdrawal actually helps them get on with their life better, get financing, those kinds of things. So once your tax debt is paid, we are fine with that. It is a little extra expense for us, but we have agreed to do that to try to help taxpayers. We have said taxpayers who enter direct deposit arrangement with us—there is very little default with electronic deposit for an installment agreement—we will withdraw liens. So we won't file a lien or we withdraw a lien if you take that extra step of hooking up electronically with us.

And we have dramatically expanded our Offer in Compromise program, which is a program that says if there is no prospect of collecting tax now with your current assets and income, and you don't have prospects for income, we can settle your debt for less. We have loosened the criteria on that to allow more people to come in, get clean, get a fresh start, and move on.

And so I am always trying to balance. If you owe taxes and you can pay taxes, you need to pay taxes. But if you are in a circumstance where you really can't pay, and there is not a prospect of payment, we need to find ways to work with you, again, to keep you in the system for the long term, and to make sure people have faith in the tax system.

Mr. SERRANO. Thank you.

Mrs. EMERSON. Ms. Lee.

Ms. LEE. Thank you very much, Madam Chair.

EFFECT OF BUDGET CUTS

Let me ask you a couple of things. One is following up on my colleague's question with regard to the earned income tax credit. In terms of the budget cuts that are being proposed, how will that impact low-income wage earners, the working poor, and the EITC program? Or will it?

Mr. SHULMAN. I think it will probably impact both ends of the spectrum. Clearly we will have to make cuts in our outreach programs if the kinds of cuts being talked about are severe, and so we won't be able to do as much work with partners, and we won't be able to do as much communication and outreach. We are going to have to look at things like mailings and figure out are we sending out those automatic mailings or other automatic mailings. We already put a freeze on non-case-related travel at the Agency, and that freeze will have to get more severe, without any exceptions, and so we will limit people traveling out to do those outreach events. So I think on the outreach side, it will have an effect.

It also will have a direct effect on compliance. 36 percent of our audits involve EITC cases, so I think you would see fraud and error go up in that, and other programs. So I think you would see change on both ends, both the compliance side, to make sure only people who deserve it or who are qualified get it, as well as on the outreach side.

EARNED INCOME TAX CREDIT OUTREACH

Ms. LEE. I do a lot of these events in my district also to encourage EITC-eligible individuals to apply, and we in no way reach the numbers of people who are eligible, and so we are trying to reach more people who qualify. And it sounds like we will reach less people now if these budget cuts take into effect or go into effect as proposed. Or can you figure out a way to increase the recipients, the eligible people filing with less money? I mean, is there a way to do that? Because we want to make sure everyone files who is eligible for EITC.

Mr. SHULMAN. As I said in my opening comments, if the budget as proposed right now in the House were passed, we would have to make a set of difficult trade-offs. So I can't tell you we have gone to the level of detail around EITC-specific outreach, how it would affect eligible taxpayers or even compliance. But I would tell you it is a big enough program that both ends of the spectrum would be affected.

DIVERSITY OF THE INTERNAL REVENUE SERVICE WORKFORCE

Ms. LEE. Let me ask the next question. As it relates to the diversity of the IRS in terms of people of color and women in your workforce, do you have any data that shows how you are doing, as well as with regard to minority contracting, whatever types of contracts you all let? Are you part of the 8(a) program, and how are you doing on that?

Mr. SHULMAN. Yes on both fronts, on 8(a) and diversity in the workforce. You know, I am a believer in a strong diversity office with a set of requirements. For an agency like us, who interacts with every taxpayer in the Nation, if we are going to be good at service, and, frankly, good at compliance, we need to reflect the population. We must really engage, walking in the taxpayers' shoes.

So, I really emphasize that diversity in the Agency is more than just a legal requirement. We need to meet legal requirements, but it is a strategic imperative for the Agency. I think in everything from diversity of race and gender, diversity of hiring people with disabilities, we stack up quite well against other Federal agencies. For targeted disabilities, we have the highest percentage of hitting the targets, and I am quite proud of that record. I spend a lot of personal time on this issue. Our Director of Diversity reports directly to me, and I am quite proud of where the Agency is in that regard.

As far as 8(a) targets, I can get those to you. What I can tell you is we hit most of them. The ones we don't, we have specific plans to hit, and we have been getting better as an agency. And, again, I spend personal time on this.

Ms. LEE. So you have a Diversity Officer. Do you have the data or the reports that we could access or send them to us?

Mr. SHULMAN. Absolutely.

Ms. LEE. Thank you.

[The information follows:]

TABLE 31 LABOR FORCE DIVERSITY

Table 31. Internal Revenue Service Labor Force, Compared to National Totals for Civilian and Federal Labor Forces, by Gender, Race/Ethnicity, and Disability, Fiscal Year 2010

Gender, race/ethnicity, and disability	Internal Revenue Service, total [1]	Internal Revenue Service labor force [1]	Federal civilian labor force [2]	Civilian labor force [3]
		Percentage of total		
	(1)	(2)	(3)	(4)
Total	**107,621**	**100.0**	**100.0**	**100.0**
Gender:				
Male	36,574	34.0	56.0	53.2
Female	71,047	66.0	44.1	46.8
Race/ethnicity and gender:				
White, not of Hispanic origin	62,750	58.3	66.6	72.7
Male	25,349	23.6	40.2	39.0
Female	37,401	34.8	26.4	33.7
Black, not of Hispanic origin	26,634	24.8	17.3	10.5
Male	5,385	5.0	6.9	4.9
Female	21,249	19.7	10.3	5.7
Hispanic [4]	11,656	10.8	7.8	10.7
Male	3,382	3.1	4.5	6.2
Female	8,274	7.7	3.2	4.5
Asian, Native Hawaiian, or other Pacific Islander	5,290	4.9	5.6	3.8
Male	2,058	1.9	3.0	2.0
Female	3,232	3.0	2.6	1.8
American Indian or Alaska Native	814	0.8	1.9	0.6
Male	233	0.2	0.9	0.3
Female	581	0.5	1.1	0.3
Two or more races [5]	477	0.4	0.7	1.6
Male	167	0.2	0.4	0.8
Female	310	0.3	0.3	0.8
Disabilities:				
Persons with disabilities	9,827	9.1	9.2	n.a.
Persons with targeted disabilities [6]	1,968	1.8	0.9	n.a.

n.a.—Not available.

[1] Includes permanent full-time, part-time, and seasonal personnel employed by the Internal Revenue Service, including Chief Counsel, at any time during Fiscal Year 2010, i.e., October 1, 2009, through September 25, 2010.

[2] Reflects Executive Branch employees as of September 2010, as reported by U.S. Office of Personnel Management. These data include the Internal Revenue Service labor force.

[3] Data from U.S. Department of Commerce, Bureau of the Census (2000 Census Statistics).

[4] Hispanic or Latino persons of any race are included in the Hispanic category.

[5] Data for IRS and other Federal workers of two or more races may be incomplete, as data for this category have been routinely collected only for employees hired after January 1, 2006. The data also reflect information for employees in this category who were hired prior to January 1, 2006, who subsequently updated their official information.

[6] The term "targeted disability" was originally enacted by the Equal Employment Opportunity Commission (EEOC) in 1979 and refers to certain disabilities that have been identified for emphasis in Federal affirmative employment planning. For targeted disabilities, the EEOC established a 2.0 percent Federal goal for all agencies by 2010.

NOTE: Percentages may not add to totals because of rounding.

SOURCE: Office of Equity, Diversity and Inclusion.

The IRS has exceeded the 8(a) Small Business Goal of 2.5% for the past 3 years. In FY 2010, the Service obligated a total of $1,764,415,441.16 with $100,478,485.98 awarded to contractors under the 8(a) Program. This amount equates to a goal achievement of 5.6%. In FY 2009, the Service obligated a total of $1,590,277,169.77 with $77,607,753.78 awarded to 8(a) firms, achieving a goal of 4.8%; and in FY 2008, the Service obligated a total of $1,609,426,135.62 with $65,797,607.64 awarded to 8(a) firms, achieving a goal of 4%.

The IRS uses the 8(a) program to the maximum extent practicable and has various means of identifying 8(a) sources that can meet our needs. We have a history of cultivating relationships with 8(a) firms by way of conducting vendor outreach to locate sources and provide guidance on how to market to the IRS; hosting annual training and showcase events targeting 8(a)/HUBZone and Service Disabled Veteran-Owned Small Business (SDVOSB) firms; updating internal source lists that provide At-A-Glance listings of HUBZone, SDVOSB and 8(a) firms; and having executive level commitments for reaching goals under the various socio-economic programs.

Mrs. EMERSON. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Madam Chair.

Thank you, Commissioner. Good to see you.

Let me first thank Ranking Member Serrano for his statement about making sure that there is no intimidation. We also realize that we have a mandate or oversight which we take very seriously and he takes very seriously, and I know that if there were attempts of intimidation, we would all, including Mr. Serrano, would be as vocal as when he was, for example, when the President called the Director of the CBO to the White House. So I know that, and I thank him for bringing that up, because I know that we would all be as vocal at least as we all were when the President called the CBO Director to the White House. And as the ranking member said, clearly that is not the intention of this chairwoman.

INDIVIDUAL MANDATE

I wasn't going to ask about the individual mandate, but I was kind of hit by a couple of statements. You mentioned before that because if the continuing resolution were passed as is, that you would have—less people would, in essence, means less enforcement, less revenue, correct? In essence. You mentioned about how the continuing resolution would affect your ability, and you would actually lose revenue.

Mr. SHULMAN. That is correct.

Mr. DIAZ-BALART. Because you would have less enforcement people?

Mr. SHULMAN. I think it would be for a variety of circumstances.

Mr. DIAZ-BALART. Yet correct me if I am wrong, but when the chairwoman asked you how many people you are going to be hiring for the individual mandate, you said not a lot of people, mostly technology. Is that also correct? Because if that is the case, then why don't you—if you can enforce with not a lot of people, with just technology, and you are saving money with that. And then why does it hurt you if you have less people from the CR? Which one is it? Why don't you then replicate what you are going to do with the individual mandates in other areas, which is you don't need a lot of people; you are asking money for technology anyway. Which one of the two is it? I am kind of confused.

Mr. SHULMAN. One of my favorite statistics in the world of tax is that the Tax Code is four times as long as *War and Peace.*

We obviously have a huge Tax Code with lots of different provisions, and I think each provision of the Tax Code has different characteristics and different needs as far as how we, as the tax administration arm, implement them. And so we could go line by line through the Code and think through what are the characteristics of it? What are the requirements put on us? What is the lead time against implementing that? How do they interact with other pieces of the Code? Each one would have a little bit of a different answer. And so while I recognize that the individual coverage requirement is a provision in the law that gets a lot of attention, I think taking comments about that and generalizing them to the whole Tax Code is not really apples to apples.

RESEARCH

Mr. DIAZ-BALART. I understand that, Commissioner. You have spent a ton of money on research. Have you looked at where you can replicate what you want to do with the individual mandate, which, according to what you said, is not going to take a lot of people, to where could you replicate that to other parts of the Tax Code? Or are you telling me that there are no other parts of the Tax Code where you can replicate that with less people in order to not lose revenue?

Mr. SHULMAN. I look at that a bit in reverse. When a new provision is put in the Code, like the individual coverage requirement or another one, we look at our core programs and say, "which of our core programs are most suited to that kind of requirement, and how would we do that?"

We have a very big program called our Automated Under Reporter Program, which is basically a document-matching program that has a 22-to-1 return on investment. One of our bedrock principles is we don't send letters to you if we can't answer the phone call when you call and say, "what is this letter about?" And so the Automated Under Reporter Program is our basic W-2 matching program, which is something very similar to what the individual coverage responsibility would have. You say what your income is, we get a W-2. It automatically, if it doesn't match, sends out a bill to you.

The vast majority of things get resolved through mail and correspondence. Depending on dollar amounts, sometimes somebody would show up and do face-to-face audits or do correspondence audits, and sometimes they wouldn't.

The individual responsibility requirement actually starts at a very low dollar amount. I think it is $95; it ramps up to $695; it is 2.5% of annual household income when fully phased in. What I was expressing to the Chairwoman is those aren't the cases that get a lot of face-to-face interaction with the IRS.

And so we are building on lessons learned to try to automate as much as we can. We have lots of document matching. And this one would be pretty simple: you have coverage, or you don't. There is indication you have coverage or you don't, and you get a letter. You think about it like a billing system.

TAX LAW COMPLEXITY

Mr. DIAZ-BALART. In a C–SPAN interview, you admitted that you use a tax preparer for your returns, which makes sense to me. I understand, and I do the same thing. You stated that "I find the Tax Code complex. I use a preparer," which makes sense. I obviously agree with that. Now, it would seem to me that the health care bill would only seem to compound the complexity of the Tax Code.

So how confident are you in your understanding of the health care law and the vast new responsibilities and the powers it is giving to the IRS because of that complexity?

Mr. SHULMAN. I am quite confident that we have got a whole set of lawyers that have looked closely at the bill. We are very familiar with the immediately effective provisions. There are a variety of

ones. There is lots of planning to go. So I think this Agency is incredibly confident at understanding the tax law.

INFORMATION SECURITY

Mr. DIAZ-BALART. There has been a lot of concern, and understandably so, about the new oversight powers of the IRS, given the health care law which would really give unprecedented access to U.S. citizens' information. And so what assurance can you give the American people and give us that that information would be kept secure? Now, that is not an issue with your agency, per se. We have seen the Wikileaks. So what sort of assurances could we have?

Mr. SHULMAN. I think there has been some inaccurate commentary about the access that we will have to health information. I am very clear that as part of this law, the Affordable Care Act, our role is to administer the tax provisions, not to get involved with health care, per se; that you can think of us as the bank, where the money flows to put out credits, to collect money, to interface with insurance companies and get them payment.

The only information we will have is fact of coverage, not health records, not medical treatment, not information about people's health situation. We will have your classic tax information about income. And then the only other piece of information we will have is fact of coverage: Do you have coverage, or don't you?

Regarding how we safeguard that and other things, we spend a lot of money—in our requests every year, we ask for some more—around data security. Some of the money in this health care request is around our data security office and our safeguards office to make sure we not only safeguard the data that is within our four walls, but we go out and do aggressive oversight of the data, the tax data, that we share with anyone else around this law.

I tell everybody, within my first 2 hours on the job, I got sworn in, had a couple of other things happen, and then the person who talks about data security and taxpayer privacy came and gave me an hour briefing. I mean, this agency takes taxpayer privacy and data security very seriously. But it is tax data, and the only new data we will get because of the health care law—there will be a variety of other tax-specific things and financial data at which we are quite adept—will be fact of coverage. We are not getting involved in health care decisions, health care choices, data about people's health.

Mr. DIAZ-BALART. Madam Chairwoman, if I may, just another question. Really it is a two-part question.

Mrs. EMERSON. Certainly.

RESEARCH

Mr. DIAZ-BALART. The IRS spends a vast amount of money on research, I believe, I was told. And I am curious as to if you are doing research and how much you are focusing on the—kind of piggybacking on the previous conversation we just had about the individual mandate, about using technology less, are you doing research into where you can do more of that, if there areas that are applicable that you can do more of that? And really the bulk of my question is are you also doing research, and what kind of research,

to prepare for fundamental tax reform? I mean, for years, I guess for generations, we have been talking about fundamental tax reform. Are you doing any research on that as to what that would mean, how that can be done, et cetera?

Mr. SHULMAN. We have a very robust research operation. We run the statistics of income data operation, which is used across the government and by lots of researchers. It is data about income in the United States, and it is used for a variety of non-tax-related research. Then we have our National Research Program (NRP), which really looks at compliance, what are trends of compliance. It is a very interesting and complicated study about what leads to noncompliance: what is accidental? What is because the Code is so complex? What is advertent? How do you stop people who are purposely doing that? A lot of our planning is informed by that research. I am a big believer in being forward-leaning, being innovative, seeing around corners, trying to position the Agency long term.

Kind of sadly, we have gotten quite adept at quickly implementing tax law changes at the last minute. I think—and you look at fundamental tax reform—I think the President and lots of leaders in Congress, both parties, both Chambers, talk about the need for simplification. You know, we are big cheerleaders for that. The simpler it is, the easier it is for us to engage with the American people. So we do a variety of planning around that as well.

Mr. DIAZ-BALART. Thank you.

Mrs. EMERSON. Thank you.

REFUNDABLE TAX CREDITS

How many people do you think, or do you know specifically, work on refundable tax credit issues or any kind of tax credit, whether it is the earned income, education tax credits, or child-related tax credits? How many people are currently, even approximately, in the IRS are doing that right now?

Mr. SHULMAN. We have a dedicated refundable credit office who spends a lot of time doing outreach, looking at it, et cetera, and I would have to get back to you on the exact numbers in there.

Part of the budget request includes funding for a Refundable Credit Compliance Office, recognizing that we need to keep making sure that we get the right algorithms, et cetera, and we are tightening around that.

A lot of the rest of the credits are very hard to break down because they flow through. It is all part of your tax return. As I mentioned before, your income, the deductions you take, some of them are stand-alone refundable credits at the end of the return, what are called below-the-line items; some of them are above the line and flow through.

We really are organized more around individual taxpayers, business taxpayers. We have a Large Business Division, a Small Business Division, an Individual Division, and a Tax Exempt Division. And then our process flows for both service and compliance are more towards the type of taxpayer, to deal with all of their tax, their income, their deductions, and their credits. We don't really have it broken down that way.

Mrs. EMERSON. But yet when you made your request for the refundable credit compliance office, you very specifically asked for, $473 million. No, that is for all health care. $213 million and 453 FTEs, just to implement the refundable health care premiums assistance tax, right?

Mr. SHULMAN. I was actually referring to something different. We requested, I believe, in the $20 million range for an office that would loop in EITC and some of the refundable education credits, as well as this. As refundable credits become something that there is more of, and because they are refundable, we want to make sure there is not fraud. That is really about research, compliance, filters, technology to stop.

The other thing we are talking about, the infrastructure for refundable credits, is really complicated. To give you the best example, right now every taxpayer focuses on AGI, adjustable gross income. There is no concept of household income. So we actually have to take our database of all taxpayers and figure out how to link households together, which is the eligibility requirement of this new refundable credit. And so that request is not for the Office, per se; that request is just to get the basic infrastructure up and running. The bigger numbers in this budget request are really technology and infrastructure.

Mrs. EMERSON. For the refundable credit compliance office, that is specific to health care, you have asked for $213 million and 453 full-time employees. Then for this new office to administer all the other refundable tax credit programs, you have asked for $31 million and 314 FTEs. So it is kind of weird that you have got $213 million and 453 FTEs, and then $31 million and 314 FTEs in the new office.

I am just a little bit confused how it is all going to work together. And are there not people already working on the refundable tax credit, the EITC?

I will say that I have so many of my own constituents who are eligible for EITC. Joe, you may be interested to know, just kind of an aside, I actually did an event with the IRS free tax file service at a lot of my community hearing organizations over the break. At three different locations, we teleconferenced or videoconferenced the event because so many people and organizations, who help them, want to understand if they qualify for EITC. In my district, we have a large amount of people who are potentially eligible for EITC.

But I guess my concern is if you already have existing staff working on refundable tax credits, can you not just use the same infrastructure? Expand it, if you need to for purposes of this health care-related refundable tax credit; can you not just do that? Or is it going to be a whole new, separate—or does it need to be separate?

Mr. SHULMAN. So, let me try to explain. I probably didn't explain it as well as I could.

The refundable credits office that we are trying to stand up——

Mrs. EMERSON. That is the $31 million one?

Mr. SHULMAN. Yes. That came not as a result of health care; it came as a result of me, as Commissioner, saying that we had spread refundable credits through the Agency. We definitely will

pull people in through outreach, but we didn't have a dedicated office, we didn't have dedicated research, we didn't have dedicated filters, and people who—what they worried about was fraud and abuse in refundable credits going out. We will definitely pull some people in, but we didn't necessarily have—we had a lot more outreach folks spread around. The other people were spread through our compliance functions. They will eventually be assigned to study the $400 billion in refundable credits enacted as part of the Affordable Care Act, to think about compliance trends, et cetera. But that is not necessarily the direct effect. You know, this Refundable Credits office wasn't created as a result of the Affordable Care Act (ACA). It is a subset of the initiative to deliver credits accurately, which includes the funding to implement the new credits from the ACA.

The refundable credit budget request for the Affordable Care Act, which is—the line item is: Ensure accurate delivery of the tax credits. There is a small business tax credit that is in place that we need to make sure we have some coverage around, so we are getting it to the right people and not getting it to the wrong people. That credit is a pretty small chunk of that request. The large number you are pointing at, and I would ask our staffs to reconcile numbers, but I am looking at $227 million which includes some additional downstream ACA implementation costs. And so you had said——

Mrs. EMERSON. $213 million dollars, and with the 453 FTE.

AFFORDABLE CARE ACT CREDITS

Mr. SHULMAN. Okay. That number. That is what I was describing to you, or I tried to describe to you before. That is the funding to implement the $400 billion in refundable credits that are in the ACA that will go out over 10 years through up to 50 State exchanges, maybe less, as the President talked about depending on qualification.

When people show up at the exchange, they are going to figure out whether they are eligible or not right there at the exchange. So we need to build technology to interface with them. First, we need to build the household income database. Then we need to get in real time, and, as Mr. Diaz-Balart talked about, we need to do it in a way that is secure, that has the appropriate safeguards. We need to determine eligibility. We then are going to need to work to have monthly payments going to insurance companies, and so we need interfaces with all the different insurance companies in the country. Then we are going to have to work out protocols with the exchanges around change in circumstances: how we change that, how we verify that through our systems. And then that refundable credit is actually an advanced payment in—take 2014—on your 2014 income. So you will, in 2013, figure out what health coverage you will have for the year based on 2012 or 2013 income. This will happen throughout the year, and then there will be a reconciliation in our systems on the back end to figure out what you actually owe.

That $200-plus million is to do the planning, do the interface work, start to build that system that is going to have all those different complex interchanges with insurance companies, with em-

ployers sending in some money, with the exchanges. So that is actually a technology infrastructure build. It is separate from this data analytics group that is doing pure compliance around refundable credits.

[The Refundable Credit information follows:]

REFUNDABLE CREDIT INFORMATION

The IRS budget has several figures related to credit compliance. The figures discussed include the 453 FTE and $213.5 million budgeted for ensuring compliance with the ACA credit. The bulk of this investment is to expand the IT infrastructure to properly administer the new premium credit to subsidize the cost of health insurance for Americans who do not have access to affordable care. This amount is a subset of the $473.4 million and 1269 FTE requested for implementing all the provisions of the Affordable Care Act (PL 111–148) for which the IRS is responsible.

The FY 2012 budget request also requests 314 FTE and $30 million to establish a Refundable Credits Compliance Office. This office will develop a comprehensive and integrated compliance strategy for administering refundable credits and rapidly address refund schemes through pre- and post-refund enforcement. Establishing an office dedicated to refundable credit work allows the IRS to address non-compliance and fraud trends that emerge from existing and future refundable credits.

The IRS also maintains an Electronic Tax Administration and Refundable Credits Office (ETARC). The current staff dedicated to Refundable Credits has a staff of 43 and provides oversight and strategic direction across twenty-two service-wide program areas across the IRS. These figures only represent dollars and FTE dedicated to refundable credit work. They do not capture the employees who may spend part of their time reviewing and auditing claims for credits, developing forms and instructions for claiming the credits, and programming the necessary systems to deliver the credits, which is a much larger figure. Since the credits are claimed at the time of filing, much of the work is part of the IRS's normal work stream, and not separately captured.

Mrs. EMERSON. So will all 453 full-time employees that you need to at least set up this whole new system—actually will you need all of those people throughout the entire 10 years as you just said?

Mr. SHULMAN. Not necessarily. Our personnel needs will likely decrease as we "stand up", which is why we will use a lot of contractors in addition to IRS personnel, so we will contract some build. This will be program offices, project managers, coders, certain folks. The average number I use from my private sector experience is that the drop-down cost of technology is anywhere from 20 to 30 percent of development cost. So you have your development cost. Then you have got your operating costs and infrastructure.

I don't know how much of this will be in production for the long term, but this set of people we need to do the ramp-up won't be the same set of people we need to run the operating environment long term.

AFFORDABLE CARE ACT RECONCILIATION

Mrs. EMERSON. I can't remember if the language was specific enough in the health care law, even though I actually read it a couple of times, with regard to the reconciliation at the end of the year. I mean, suddenly Joe is going to get a bill here, just hypothetically, for $453 that he is going to end up owing? Have you figured that part out yet? I am just curious.

Mr. SHULMAN. I am very focused on this reconciliation because it is actually a new concept in the tax system, paying this back. And Congress has and is talking about certain caps on it, and those caps have been expanding. Bottom line is you are going to get

money, and then you may owe a chunk back. And if you go over the cliff, the chunk could be relatively substantial. And so we are needing to set up systems around that.

Mrs. EMERSON. And it seems to me that the complexity only gets exacerbated by the fact that your income status could possibly change dramatically, either to the positive or the negative, depending. And then is the onus then on me, the individual, to let you all know that suddenly I got this gigantic bonus, and I have a huge raise, and suddenly I don't qualify for this? I mean, whose responsibility will it be to tell you? Or will it just come at the reconciliation at the end of the year?

Mr. SHULMAN. As I understand, it is a two-step. And so I don't know all the plans because it is the exchange's responsibility to know shift of income, and we will have some interface with that. But I think the first step is when there is a change in income, alerting the exchange and adjusting. But regardless what happens there, it will be on your tax form what your final income is, what tax credits you got, and if there is a delta, there will be an assessment on that.

Mrs. EMERSON. It is going to prove quite interesting, to say the least.

SIMPLE RETURNS

I will shift gears. We have talked several times about the President's campaign pledge to have the IRS perform tax preparation or simple returns. As you know, there still is, and probably more so now, significant bipartisan opposition to this concept, at least in the House. I know we have talked often about it, and you have told me that there are no plans to move forward or spend taxpayer funds to create this program. But I keep hearing, every so often, that the IRS is going to do this. And it is not from conspiracy theorist e-mails. I just hear it around. I also know that this concept comes not from you, but rather from those who are perhaps above you in the chain of command.

I just want to make sure, is it still your position that the IRS is not moving ahead on implementing simple returns?

Mr. SHULMAN. Yes. I get to decide what the IRS does and doesn't do, and we are not working on simple returns. So I will tell you that.

Mrs. EMERSON. Not even as a pilot?

Mr. SHULMAN. We don't have a pilot program. What I always say is, whether you like it or not—compared to places I came from before, which built stock exchanges and did complex surveillance—the money we spend in technology investment money is very small. And so even though for 2011 and 2012 we have asked for an increase, as a percentage of total budget those are still incredibly small, especially if you look at other big financial institutions who move the kind of money we move. We would have a long way to go, even if we wanted to do it, to get our core database done, get the technology done, get the security done, and put all these pieces together. And so it is not something that is in our planning pipeline.

Mrs. EMERSON. I appreciate it.

Joe.

Mr. SERRANO. Thank you.

So you think some people will stop now saying that he is going to do it? Besides, it is not an e-mail; it is on radio. Anyway, and I am going to get a bill at the end of the year, you said?

Mrs. EMERSON. Hypothetically, yes.

Mr. SERRANO. I hope not.

Mrs. EMERSON. Well, I guess you would have to be in the New York exchange, so you won't qualify for any refundable tax credits.

Mr. SERRANO. Okay.

EFFECTS OF BUDGET CUTS AND RETIREMENTS ON THE WORKFORCE

Commissioner, we know that there could be, unfortunately, some very serious cuts coming to every Federal agency, reduction in workforce. But we also know that, according to the Treasury IG for Tax Administration, that they predict that 30 percent of all IRS managers and 47 percent of IRS executives are eligible to retire. So how does one play into the other? And what preparations are you making for the fact that you have this many people that are eligible for retirement? How do they play into each other, I meant do you absorb then some of those cuts through some of the people you hire, or do you cover those and start at the bottom where you would have entry-level people coming in through the system?

Mr. SHULMAN. In general around this retirement issue and 30 percent of people being eligible, I have been very focused on workplace issues. I believe, as a leader of a large institution, if you get people to show up every day engaged with the right skill sets, you promote and create career paths for your good performers and you weed out poor performers. If you take care of those sets of issues, you can execute strategy. If you don't take care of those sets of issues, you can have the best strategy in the world, and you will never execute it.

So I created this Workforce of Tomorrow Task Force. We had a whole program around it. The Agency, over the last 2 years, was the most improved in the Best Places to Work in Government survey, which surveys all Federal agencies. It is something on which I and my senior leadership team spent a lot of time and are quite proud of.

I think this retirement wave creates challenges and opportunities. I think the challenge is really good subject matter experts who know the tax system, who know their specific area, are going to leave. It also creates career opportunities for younger people, some fresh blood to come and keep innovating as an Agency.

We have been working department by department to make sure there is good succession planning, that we challenged our more mature workforce to take it upon themselves to mentor the next generation. And so I view this as it is—a fact. We have got in front of it early, so it is not a crisis. It is one of these things—you deal with the facts on the table and you manage it. And I think we are pretty far in front of it.

I think regarding cuts and layoffs, the first move would be to allow—we wouldn't replace attrition. I can talk about being in a 2010 CR, given that there was inflation increasing the cost of contractors, increasing the cost of real estate, et cetera, we are having to tighten our belt right now. So we have an exception-only attri-

tion freeze, where people are coming to me or my deputies if they want to replace attrition right now. So attrition is your first move, and we will have some people retire. But if the cuts in magnitude we are talking about materialize, we would also need to do RIFs or furloughs. I mean, attrition would not take care of meeting those kinds of cuts.

Mr. SERRANO. So you can deal with it as it is now through attrition, but any more dramatic cuts then would create a problem; is what you are saying?

Mr. SHULMAN. I mean, it is a sliding scale.

Mr. SERRANO. I don't want to get you in trouble.

Mr. SHULMAN. No. What I was going to say is you said "any more dramatic cuts." So cuts of the magnitude that the House is talking about, we would definitely have to do that. There is a scale.

Mr. SERRANO. We are going to get more dramatic cuts. It is no government; just the legislative body. And even that is in question.

INFORMATION SECURITY

Let me ask you about the issue of identity and the security behind that. I know you spoke about the health care bill and the law and how that plays into it, so that you would have some information, but not all information. There is always an ongoing issue of how much the IRS knows about you and how much should it know. So what are we doing to deal with this fact and trying to make sure that the IRS is where it should be, an agency that has certain information, but not harmful information?

Mr. SHULMAN. I guess the first thing I would say is the information that we have is the information that Congress prescribes in the laws it passes. So Congress tells us what the tax law is, and we collect the information as appropriate. So——

Mr. SERRANO. You wouldn't be the first agency to have more information than Congress told them to get. I am old enough to go back to the 1960s on those issues.

Mr. SHULMAN. And the second is, as I mentioned earlier, one of the fundamental tenets of tax administration is data privacy, taxpayer privacy. It drives some Members of Congress crazy, frankly. I get calls and letters asking for information on taxpayers and what we did with them. The law prohibits it. It is a felony to share that information. We, every year, educate our people on that. Every year we fire people who breach or look at information.

Everyone in the agency knows that we take security of data and taxpayer data very, very, very seriously. And so we have awareness training. When I first got here, and every couple of years after that, we did what we called Code Red, where we stood everybody down for 2 hours to talk about what information do I have access to? What is in technology? What is on desks? What is on e-mail? What can we do to tighten it up? It starts with employee awareness. And we have robust technology and computer security, both on our perimeter, as well as internally, around who has access controls.

I made a commitment, and have been working with our Inspector General to make sure we have detailed logs of technology, and on any new technology we put in the appropriate logs, so we can do oversight of who accesses what technology. It is a big, complicated

task, and I would never tell you we are done. This is just going to be ongoing. And the advent of technology, the kind of information we have, I think it is a challenge for everyone. But there is a culture in the Agency that is very locked down and very serious about data security and about privacy.

Mr. SERRANO. Thank you.

EFFECTS OF GOVERNMENT SHUTDOWN

One other question. We don't want to mention this word too much, but there is a possibility somewhere along the line of a government shutdown. And if it happens during a certain part of the season, and you have seasons more than anyone else, people worry, well, what does that mean? What does that mean for tax collection? What does it mean for tax refunds? And that is a huge issue, because we are not only talking with a shutdown about the fact that people won't be paid or people will not be working. Or I remember in the last shutdown, one of the bills that hadn't been passed was the Interior appropriations bill, and the last thing I expected was important to a lot of people were people coming to our office here in Washington and saying, how come the monuments are closed? Or, I can't go to this particular park. It may not sound important to a lot of folks in terms of the whole picture, but if you planned a trip to Washington and found the monuments not open, you want to know why. And they had no idea what is going on.

But a tax refund is a very serious issue in addition to tax collection. Do you know at all how it would affect you?

Mr. SHULMAN. Let me start where I think where you started, which is the President has been clear that he is optimistic that Members of both parties and both Chambers will avoid a shutdown, because that is not going to be good for anyone.

Mr. SERRANO. By the way, for the record, because I don't want anyone to think that we are being partisan here all the time, we are very little, Jo Ann and I, but I think that 95 percent of Members of Congress of both parties know that this is a dangerous thing, and they don't want to go that way at all.

Mr. SHULMAN. So I start by saying I think I am equally optimistic, and think people recognize a government shutdown is not in the interest of the American people.

Second, the date matters to the tax system and to the definition of essential functions of government. And so we are still looking at this, we are still working with OMB. Our general guidance would be to follow the plan we have had in place since the 1980s. In 1995, we deposited money but didn't process refunds. I think that is what you could expect in something that was short term and close to now. But as we get closer and closer to April, I think this is dynamic, and we are still having discussions and still looking at the issue.

Mr. SERRANO. Thank you.

Mrs. EMERSON. Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Madam Chair.

MULTILINGUAL INITIATIVES

Actually, I have a basic question as a new one here. And I am almost reluctant, I should have asked you this when we met pri-

vately, particularly when we have one of the country's foremost leaders on Hispanic access and empowerment issues, and that is Mr. Serrano. I apologize to you, sir. This is a very basic question, and I could have asked you, or I could have asked you, but I might as well take that.

In south Florida, the IRS has a job in making sure that you have people that speak different languages there. And, by the way, you have some wonderful people who are always accessible, and they will meet with anybody who has an issue, and they will do so in the language of the people who—you know, we have those large communities.

My question really is in other parts of the country, and in particular parts that are—you know, when you look at the census now, the growth of the Hispanic community in places where, frankly, a lot of people didn't know they were there. But I guess you are ahead of the census because you deal with this every single year. What are your challenges in dealing with language minorities? Do you have an issue finding people? Again, I know that in south Florida you do a really good job there, but in other parts of the country, particularly those that are relatively new as far as either Hispanic or minority populations, how do you do there? How are you doing? What sort of programs do you pursue to do that?

I ask that, and I know it is a relatively simple question particularly in front of—a lot of people think that Mr. Serrano and I have great differences, and we do. But there is no doubt that not only I, but everybody in the country recognizes him as one of the great leaders of the Hispanic community.

Mr. SERRANO. Thank you. And I really appreciate those words.

South Carolina was my biggest surprise in Hispanic growth. What was yours?

Mr. DIAZ-BALART. Frankly, everywhere. I mean——

Mr. SERRANO. Now I know why.

Mr. DIAZ-BALART. There are some areas that, frankly, even though numberwise are not huge, but there are areas where you wouldn't expect it at all, and that is really where I was more impressed. And so the point the ranking member was making is the fact that those are the places where it has got to be more difficult because you don't have the synergy of those communities anyway. So with that, I kind of posed that question.

Mr. SHULMAN. It is a great question. I start with the basic premise that we are the one government agency—and I remind our people of this all the time—that interacts with most adult Americans every year. And we really do have an obligation to meet people where they are coming from, right? And so we, I think—I can't compare it to others, but I have been told—have one of the best, if not the best, in government multilingual sets of facilities, programs, and outreach, everything from Spanish speakers to Vietnamese speakers to Chinese speakers, Creole. The list goes on.

I think it would be fair to say that areas of the country—take Spanish speakers as an example. Areas of the country where there are large Spanish-speaking populations, where it is a large percent of the population, we probably, in our in-person sites, staff very well. I am sure there are areas of the country where we are not as well staffed if the numbers aren't as great, because we have to

figure out the cost-benefit of this. But then we always have backups. And so we have a big phone operation that answers 35, 40, up to 50 million calls a year. So if somebody walks in, we make sure we have multilingual literature, all of our outreach materials. We have a Spanish Web site. And then we have the ability to connect somebody over the phone to work through their issue or to connect them to an office.

And so we take it pretty seriously. And I would point out, this year you might have seen we have an iPhone app for "Where's My Refund?" for the younger generation. And so we really do think that as we evolve, we need to figure out how to deal with every taxpayer based on how they walk in or how they want to deal with us, and we are going to be focused on the whole service agenda of the IRS.

Mr. DIAZ-BALART. Thank you.

Mr. SERRANO. Can I comment on that a second? And I want to be careful about this. Mr. Diaz-Balart and I are strong supporters, as are all members of the Hispanic Caucus, of the use of the English language as our language in this country. But there is the fact that there are a lot of people who are older who may have deficiencies in the language. And so this is a service that is very important, and it is to our benefit. We are going to pick up the tax dollars in the long run.

I say that because I know that part of what is happening in Congress now is that a lot—some Members are looking at Web sites that use a language other than English, and they have been targeted to be done away with, and I think that may be in the long run foolish.

As far as the IRS goes, if I make an attempt at a joke, which sometimes I do very badly, it is tough enough dealing with the IRS in English. Try having it as a second language and dealing with the IRS. It can be difficult. So I encourage you and I congratulate you at the same time on this approach because I agree with Mr. Diaz-Balart; it has been a great service, you do it well, and you should continue to do it. Thank you.

Mrs. EMERSON. Mr. Womack.

Mr. WOMACK. Thank you, Madam Chair.

And I enjoyed the dialogue between my colleagues that have tremendous minority populations and deal with that. Let the record reflect, though, that the greater Third District of northwest Arkansas has indeed its own growing share of minority population. And particularly the issues that you espoused about the language barriers, we are experiencing those same things. So I am interested in the ongoing efforts of your agency and other Federal agencies in what we are doing to, shall we say, provide for some assimilation-related activity in that ethnicity.

SIMPLIFICATION OF THE TAX CODE

A couple of very basic questions. Really, how would simplifying the Tax Code, making things a little easier for those of us—as was already mentioned, dealing with the IRS in plain English is somewhat difficult at times, but if we were able to simplify forms and close loopholes, what overall effect would that have on your need

to squeeze more resources out of the taxpayers so that you can prosecute your duties, both on the enforcement and service?

Mr. SHULMAN. We were talking a little bit earlier about simplification of the Code, and I shared with some of your colleagues one of my favorite statistics is that the Tax Code is four times as long as *War and Peace*. And so, clearly, the more complexity there is, the more confusion there is amongst taxpayers, the more we have to answer questions, the more we get into correspondence with people around honest mistakes that they make.

I talked about international before. I would say where there is complexity, there is always more room for noncompliance and evasion. I came from the capital markets regulation before this job, and the international area is a great area where you start getting things complex. It is where people who want to push the envelope can push the envelope.

So the simpler the Tax Code, the more people clearly understand it, the easier the interactions are with us, and the more compliance I think there generally would be.

Mr. WOMACK. I understand before my arrival that the chairwoman and my colleague from Florida talked a little bit about enforcement staffing and spending. It has been argued, somewhat convincingly, that an increase in enforcement spending and staffing has little, if any, effect on enforcement revenues. The larger question is what is the correlation between enforcement spending and staffing and enforcement revenues?

RELATIONSHIP BETWEEN STAFFING AND ENFORCEMENT REVENUE

Mr. SHULMAN. You know, our job is to administer the tax laws, ensure compliance, which has a service element. And while the Congressional folks, the staff who scores things, doesn't put a score on service, I, in my mind, put a score on service. When you answer a phone call, answer a question, you get the proper amount of tax filing. When you get technology that allows you to electronically file, people send it in. There aren't transcription errors, and you don't have issues.

So if you look at our overall budget, you can look at the numbers in a variety of ways. You can say that we affect indirectly all the money that comes in. For every dollar spent on the IRS, about $200 flows in to the Federal Government, which I think is a number that is worth thinking about.

[The information follows:]

Insert for the Record –
FY 12 ROI DATA

The chart below shows the revenue collected versus dollar spent for various IRS functions. To calculate the total effect the IRS (service and enforcement) has on the economy, the entire IRS budget is divided by the estimated amount returned to the US Treasury. That return of 173 to 1 varies based on the size of the budget request, so is rounded to 200 to 1 to reflect the average of several years of IRS funding. The 22 to 1 includes both FY 11 and FY 12 initiatives in AUR.

FY 2012 Initiative (Direct Enforcement Hires)					
Agents-Enterprise	**FTE**	Fully Loaded Cost	Average FTE Cost	Direct Revenue *	Return (Full Perf. FY 2014)
Tax Examiner (TE)	285	$ 18,779,000	$ 65,891	*$ 182,754,052.64*	9.7
Revenue Agent	372	$ 44,278,000	$ 119,027	$ 534,527,479.02	12.1
Revenue Officer	NA	NA	NA	NA	NA
Tax Compliance Officer	35	$ 2,785,000	$ 79,571	$ 5,895,555.14	2.1
ACS (TE)	254	$ 17,224,000	$ 67,811	$ 398,264,181.24	23.1
AUR (TE) **	185	$ 12,580,000	$ 68,000	$ 185,682,840.00	14.8
Total	**1,131**	**$ 95,646,000**	**$ 84,568**	**$ 1,307,124,108**	**13.7**
Corporate Measures					
Enforcement		$ 5,966,600,000		$57,600,000,000	9.7
IRS		$ 13,283,900,000		$2,300,000,000,000	173.1
* Does not include $24.96 million that 3 Specialty - Attorneys (Estate and Gift) will bring in.					
** The AUR initiative is for the new Merchant Credit Card initiative which is different from our normal AUR individual cases.					

I think for direct enforcement, for every dollar spent broadly on IRS enforcement, last year we brought in $57 billion from direct actions: audit adjustments, collection actions, cases in court, et cetera. And then we broke it down by program very specifically, and I would be happy to get you those numbers. Some of our enforcement programs have a 3 to 1 return, and these are returns that GAO and OMB have agreed on. They have looked retroactively back 10 years, about activity and revenue that comes in around them. The 200 to 1 and whether or not answering a phone call brings in money, people will argue about that. Nobody argues about these direct revenue effects. On what we call our Automated Under Reporter, which is our W–2 matching—where you didn't have the right amount of income reported, you file something, the W–2 gets sent out to you, it reports it to us—and that is about a 22 to 1 return.

DIMINISHING RETURNS

Mr. WOMACK. Finally, along that same line, I know our entire Congress, both sides of the aisle, are honed in on the concept of diminishing returns. At some point in time, when does more money thrown at any issue cease to produce the desired results? And so I guess I would leave you with the challenge, and I am sure you do in your capacity, to ensure that we don't ever exceed that point of diminishing returns.

Thank you very much for your testimony.

BUSINESS SYSTEMS MODERNIZATION

Mrs. EMERSON. Let's talk a little bit about something that I know is near and dear to your heart, and that is the business system modernization. For our colleagues who are new to this subcommittee, and because of the critical importance of the whole BSM and the ability for you to venture IT modernization, the cornerstone of this is this CADE–2. I probably need to actually come down and see your operation firsthand, at least this piece. You are going to deploy the CADE–2 in less than a year probably, right? So describe to me how the current CADE is different from CADE–2, first of all.

Mr. SHULMAN. Sure. First, we would love to have you come, as I told you privately, and would love to have any Member of the Committee come to meet the public servants at the IRS.

So I think the best way to describe it is when I started this position 3 years ago, I came in and there was a plan to, year by year, add 5 to 10 million taxpayers into the core database, and at the same time update all of our different downstream systems. So, take the system that is pulled up before our phone operators, and plug that into the database incrementally; the system that feeds into our collection operation, and plug that into the database; our financial systems, and plug that into the database. So it was, the way I would describe it, incrementally getting to a big bang that did both the database and all the technology applications that people use. And the end—I kept saying, "when is the end date" and I got dates like 2020, 2021, 2022.

I came from overseeing big technology. I put some stock exchanges on line and other things, and I had a couple of basic beliefs

about technology. One is you need to have very clear value-added deliverables in a short enough time frame that you could have a team focused, rally around it, plan, work through problems, and deliver. And my time frame is 2 years, 3 years maximum, not 10 years, because there is always going to be turnover of leadership people, teams, et cetera.

Second of all, my belief is that the leader of the organization, not the technology people—I love them, I call them geeks—but it is not the technology people who are going to be accountable at the end of the day to the U.S. Congress and the American people to have wise spending. It is the leader of the organization. So I basically said, I want a plan to deliver value in the time I am here that really gets our modernization over a hump.

And so we went back to the plan because I said I am not going to go to Congress and talk about 2020. We came up with a plan that said the data is key. In this day and age, it is all about the data. So if we can have a core taxpayer database done by the 2012 filing season that has integrity and the information you need for your service, for your enforcement, you get off of what is called the "batch cycle," which runs every week or 2 weeks, and have the data run real time. We could achieve everything that we started and said we wanted to achieve in 1988, when modernization, this concept of IRS modernization, began, which was faster refunds for everyone, integrity of the data in a way that knocked down material weaknesses. No 2-week lag in the data between our database and what a taxpayer actually sent in. Because it used to be you called and said, "I sent you the check." And I said, "well, the data doesn't show that." And then you would have these cycles of—our people called it the death spiral, where we are writing, they are writing back at the same time, and you can't catch up. And so this would achieve all of this.

And so, in short, the thing that was called CADE, and we called this CADE–2, originally was incrementally adding to the database over time while building the systems in. We basically cut and said we will get the database done, and we will have our core service technology, which is our phone support, linked into the database when we go live. But we are not going to have this kind of field of dreams at the end of the day. We are going to have deliverables that get us over the goal lines that deliver real value.

Mrs. EMERSON. So by the time everything is put in place, at least for the foreseeable future, because technology then changes too quickly, but let's just say this is all done by 2012, will that enable you all to have fewer people then within the organization? Does the completion of the business systems modernization mean more efficiency, fewer people? Or does it just mean more efficiency, the same number of people, that you can foresee?

Mr. SHULMAN. So I alluded to my view that we are like the big financial operations. We have 140 million individual customers, tens of millions of businesses, every year another act, a very complex Code, $2.3 trillion running through it. And there is no other financial institution of that magnitude in the country with those exact characteristics and numbers. Big banks, big brokerage firms, all which I seem to be inside of, they have 10 to 20 percent capital investment a year in technology. We went up from 1½ percent. We

are running at 1½ percent because we are running under a 2010 CR, and 2012 our request gets us up to 3 percent. So when I went and talked to some of my colleagues in the Administration, I said, I understand these are big numbers, but from where I come from, and objectively, we have been incredibly underfunded. And so this gets you to a place that is not even that respectable from a private-sector comparison.

What I would say is we need to continue—and I have been very clear about this—being more about data analysis, information matching, and less about feet on the street as the tax system goes forward for the next 5, 10, 15 years. And this just starts to build the infrastructure.

So I wouldn't tell you that once we get this thing done, that the IRS isn't going to have to significantly invest in technology.

Mrs. EMERSON. I appreciate that.

Let me say I have got some questions that I would like to submit for the record.

Mr. SERRANO. I have some, too.

Mrs. EMERSON. And I am sure my other colleagues do, too.

HISTORIC PRESERVATION CREDITS

Mrs. EMERSON. And I just want to mention one thing before we finish up. My office has heard several complaints about the administration of the Federal Historic Tax Credit or the Preservation Tax Incentive program. And I just wondered if you all could look into that for me and get back sometime in the near future? I would really appreciate it.

Mr. SHULMAN. Absolutely.

[The historic easement information follows:]

HISTORIC PRESERVATION EASEMENT

You noted you have heard complaints about the administration of historic easement donations. The IRS recognizes that donations of conservation easements play an important role in preserving historic property. When taxpayers meet statutory requirements and the easement is properly valued, taxpayers can claim a deduction for the charitable contribution on their tax returns.

A historic preservation easement, commonly referred to as a facade easement, is a contribution of a partial interest in real property. The deduction may be permitted if the contribution is: 1) of a qualified real property interest, 2) to a qualified organization, 3) exclusively for conservation purposes. The taxpayer must adequately substantiate the deduction with a qualified appraisal and other documents.

Mrs. EMERSON. With that, then, we will conclude. Thank you very much for coming, and we will look forward to getting the answers to our questions, hopefully within 2 weeks. Okay?

Mr. SHULMAN. Thank you very much.

[The information follows:]

Financial Services and General Government Subcommittee
Hearing on the Internal Revenue Service FY 2012 Budget

Questions for the Record Submitted by Chairwoman Jo Ann Emerson

PATIENT PROTECTION AND AFFORDABLE CARE ACT

Section 9007 of the Patient Protection and Affordable Care Act calls for additional requirements for charitable hospitals. Is the IRS close to issuing regulations or guidance on the new section 501(r)?

The IRS issued Notice 2010-39 on June 14, 2010 (Notice 2010-39; 2010-1 C.B. 756; 2010-24 I.R.B. 756). The Notice solicited written comments on the application of certain requirements imposed by new section 501(r). Even though the official comment period ended on July 22, 2010, we continue to gather comments from interested stakeholders through the electronic comments box at notice.comments@irscounsel.treas.gov.

We received a wide variety of responses and have reviewed more than 100 formal written submissions. The Treasury and the IRS are continuing to work as expeditiously as possible to issue guidance under section 501(r).

Will the IRS permit hospitals to collaborate with other hospitals, community health organizations or hospital associations in a geographic area under the changes made to the Community Health Needs Assessment in the Patient Protection and Affordable Care Act?

Section 501(r)(3) requires a hospital organization to conduct a community health needs assessment (CHNA) every three years and adopt an implementation strategy to meet the community health needs identified through such assessment. The CHNA must (1) take into account input from persons who represent the broad interests of the community served by the hospital facility, including those with special knowledge of or expertise in public health and (2) be made widely available to the public. The IRS received a number of comments with respect to how a hospital organization might go about collaborating with other entities in producing a CHNA. The IRS is considering all of those comments as we develop guidance. The IRS is looking for how it might provide options that would allow for efficient development of the required assessments. The IRS is aware that the Joint Committee on Taxation's Technical Explanation of the Affordable Care Act (Technical Explanation) states the CHNA "may be based on current information collected by a public health agency or non-profit organizations and may be conducted together with one or more organizations, including related organizations" (Joint Committee on Taxation, "Technical Explanation of the Revenue Provisions of the 'Reconciliation Act of 2010,' as amended, in combination with the Patient Protection And Affordable Care Act" (JCX-18-10), March 21, 2010). The IRS will take the comments and the Technical Explanation into account as it develops guidance with respect to CHNAs.

Section 501 (r)(5) requires hospitals to reduce their charges to patients who qualify for financial assistance. In order to know if a patient qualifies for assistance, the hospitals need information from the patients and from time to time, some patients are unwilling or unable to apply or

provide pertinent information to the hospital. Has the IRS concluded that a patient must apply for assistance to be eligible?

Section 501(r)(5)(A) requires a hospital organization to limit amounts charged for emergency or other medically necessary care that is provided to individuals eligible for assistance under the organization's financial assistance policy to not more than the amounts generally billed to individuals who have insurance covering such care.

The IRS received numerous comments with respect to this provision, including comments that described the challenges hospitals face in identifying patients who would qualify for financial assistance. As the IRS develops guidance, it will work with stakeholders to ensure the rules are administrable, for both the hospitals and the IRS.

Questions for the Record Submitted by Ranking Member Serrano

IRS WORKFORCE ISSUES

The Treasury Inspector General for Tax Administration (TIGTA) predicts that 30 percent of all IRS managers, and 47 percent of IRS executives, are eligible to retire. Please describe some of the ways in which the IRS is preparing to cope with its upcoming wave of retirements.

Ensuring a productive Internal Revenue Service (IRS) workforce is a top priority for the agency. Understanding the potential challenges and opportunities presented by a workforce with increasing numbers of retirement-eligible employees, the IRS launched the Workforce of Tomorrow task force in 2008 with the goal of making the Service the best place to work in the Federal government and ensuring that the Service continues to build a strong leadership cadre and workforce over the next 15 years. Two of the task force's six areas of focus relate directly to management: 1) Enhancing the Role of Managers, i.e., resetting expectations of and for managers in order to make the role more attractive and reinforce a culture of leadership at the Service; and 2) Growing Future Leaders, i.e., enhancing leadership development at all levels to ensure the best leaders are identified, developed and placed in the right positions throughout their careers. These efforts are on-going, and the IRS has already made advances that will prepare the agency to cope with the upcoming wave of retirements and draw top talent into the leadership ranks, fully supporting them once they are in place.

The IRS has comprehensive readiness programs for all levels of management, from frontline to senior executive, that focus on the critical skills needed at each level. The IRS is also refining and implementing a more robust succession planning process. The IRS will continue to assess and refine our succession and development processes, as needed.

The IRS has a Senior Executive Service (SES) Candidate Development Program (CDP) that serves as the principal means through which to identify and hire a career executive corps. This program has been informally recognized by OPM as a model. For example, when OPM was preparing to establish the Government-wide CDP, they asked the IRS to come and talk with them about the IRS CDP process. The IRS CDP program is open to IRS and external applicants. The CDP is a minimum of one year and maximum of two years in length, and consists of formal

training (Executive Development Program) and developmental assignments. Its purpose is to identify outstanding persons with demonstrated leadership competencies and to prepare them for Senior Executive positions.

BUSINESS SYSTEMS MODERNIZATION

With regard to Business Systems Modernization (BSM), the IRS is embarking on a new direction with regard to the Customer Account Data Engine, the project aimed at modernizing the taxpayer database. Please describe exactly what BSM schedule changes the IRS is envisioning, and why. Are you confident that full modernization is still on track, and that delays and cost overruns will be avoided?

The Customer Account Data Engine (CADE) is the IRS's top priority technology project at this time and is foundational to the next generation of service and enforcement initiatives. The CADE 2 strategy allows for faster conversion of the taxpayer account database into a modern architecture. As a result, the IRS will be able to deliver faster refunds to taxpayers, and change decades-old business practices that are based on a weekly processing cycle. It will also enhance the IRS's ability to address IT security practices and financial material weaknesses, and assure long term viability of the core processing systems. The IRS's targeted completion for the core taxpayer account database is scheduled for January 2012.

The IRS is on track to deliver the full planned scope of this first phase. It exited Milestones 0 – 2 (planning), and 3 (logical design) on time and without any conditions. The IRS is on schedule to exit Milestone 4a (physical design) on April 18, 2011, two weeks ahead of our original planned target.

As you can see by the milestone deliveries, the agency is confident the work is proceeding on track; however, the current budget environment, which is significantly below the 2011 President's request for BSM, is creating risks for the program.

What benefits will the average taxpayer see from the Business Systems Modernization project?

As CADE 2 becomes the IRS's single authoritative database for all individual taxpayer records, it will provide the foundation for more effective tax administration and move us away from the legacy, flat-file data storage model. With daily processing capability (vs. weekly processing in the current legacy systems) the IRS will improve the taxpayer experience with faster refund processing and timelier, more accurate, and more complete data contained in the key database used by IRS customer service representatives and other service functions. This change will improve taxpayer service through faster resolution of taxpayer account issues, faster account adjustments, quicker updates to web-based applications, and daily mailing of notices, which will reduce spikes in telephone call volumes associated with the current weekly mailing. The CADE 2 database also allows the IRS to consider a wider range of web-based, self-initiated service solutions. For example, this infrastructure is an important prerequisite to any future secure, online tax account transaction the IRS would consider developing. The CAD

E 2 data-centric solution also will support sophisticated, next-generation compliance systems which will allow the IRS to continue to become more efficient and data-driven in allocating compliance resources to the issues that present the greatest risk.

How confident are you that the system will be in place by next year's tax filing season?

The IRS is confident it is on track for the 2012 filing season. As stated above, the IRS has already exited Milestones 0-2 and 3 on time with no conditions, and all indicators are that it will timely exit Milestone 4a in mid-April. As the IRS moves forward through the milestones, confidence is built upon a comprehensive plan which clearly defines the necessary activities, decisions, checkpoints and reviews, with established timeframes, that will lead us up to the Filing Season 2012 deployment date. In addition, key decisions are informed by internal and external independent confidence assessments to confirm readiness, based on a number of key success factors, among them, the state of the technical design and the information technology and business preparedness levels. This effort also includes clarification on how the IRS will use the CADE 2 program's management constructs to drive implementation, with considerations around people, process, and technology. The IRS also manages risks rigorously on the CADE 2 program, using industry best-practice tools and practices to track ongoing risks, including regularly scheduled meetings at the project and program levels to review risks and develop mitigation strategies, clear elevation protocols to ensure risks get appropriate and timely focus, and regular dashboard reporting of risks to all levels of the program management, IRS senior executives and oversight bodies for full transparency.

The IRS is currently executing according to plan, despite funding levels approximately $128 million below the President's FY 2011 budget request. While the IRS has been able to make other resource trade-offs to keep this critical program on track, funding availability continues to be of concern.

Questions for the Record Submitted by Congresswoman Lee

THE TAX GAP

The IRS last identified the tax gap at $345 billion and the international tax gap at a possible high of $123 billion.

Does the IRS have an updated amount for the tax gap?

The $345 billion estimate was for Tax Year 2001, and the IRS released it in 2006. That estimate is the latest available. The IRS plans to update the estimate of the tax gap by the end of calendar year 2011, based, in part, on new compliance data now being compiled for Tax Years 2006 and 2007.

What impact would dramatically cutting funding for the IRS have on efforts to close the tax gap both here and abroad?

Dramatically cutting funding for the IRS surely would result in an increase in the tax gap. Most of what the IRS does helps to promote voluntary compliance (i.e., to minimize future tax gaps) and to recover amounts that contributed to past tax gaps (e.g., through enforcement). Since taxpayer compliance behavior is shaped by many factors, estimating the magnitude of a cut in IRS funding is difficult to do, but it would be significant and the impact would likely grow over time.

How much of the tax gap is owed by large corporations?

Of the $345 billion estimated tax gap for Tax Year 2001, about $30 billion is associated with the underreporting of corporation income tax. Large corporations (those with assets exceeding $10 million) accounted for $25 billion of that. While this is the IRS's best estimate, it is based on data collected in the mid-1980s. Updating this corporate tax gap estimate is exceedingly complex, and there are numerous definitional and practical problems with putting a precise figure on an updated estimate.

How often are judicial or criminal actions taken in cases of tax avoidance?

The Internal Revenue Service publishes this type of information annually in the IRS Data Book by fiscal year. It provides statistical tables and organizational information on collecting the revenue, issuing refunds, enforcing the law and assisting the taxpayer as well as information on the budget and workforce. The following link provides TY 2010 data, the latest information available: http://www.irs.gov/pub/irs-soi/10databk.pdf.

Specifically, Table 18, Criminal Investigation Program, by Status or Disposition, Fiscal Year 2010, provides a summary of all investigations initiated, investigations discontinued, prosecution referrals, indictments and informations, convictions, sentences, and percentage of those sentenced who were incarcerated during FY 2010.

Can the IRS provide a breakdown of the types of enforcement actions taken, with a detailed breakdown by income levels, types of business structure, types of avoidance schemes and amounts recovered, fees levied and criminal convictions linked to these breakdowns?

The Internal Revenue Service publishes this type of information annually in the IRS Data Book by fiscal year. It provides statistical tables and organizational information on collecting the revenue, issuing refunds, enforcing the law and assisting the taxpayer as well as information on the budget and workforce. The following link provides TY 2010 data, the latest information available: http://www.irs.gov/pub/irs-soi/10databk.pdf.

Specifically, Table 9a, Examination Coverage: Recommended and Average Recommended Additional Tax After Examination by type and Size of Return, provides an overview of examinations of income tax returns, estate and gift tax returns, employment tax returns, excise tax returns, and certain other business tax returns.

Can the IRS also post this information on a publicly available website so that the American people can see who is failing to pay their taxes?

The IRS produces numerous publications which outline its civil and criminal enforcement programs. They vary from statistical analyses of non-compliance and summaries of IRS enforcement programs, to overviews of IRS criminal investigations programs. Probably the most comprehensive source if the IRS Data Book and the following link provides Tax Year 2010 data, the latest information available: http://www.irs.gov/pub/irs-soi/10databk.pdf. However, the entire range of materials is available on IRS.gov.

What kinds of resources does the IRS need to get full compliance to close the outstanding corporate tax liability from these corporations?

The IRS continues to expend significant resources to promote voluntary compliance among corporations, and to recover unpaid corporate taxes where they are owed. The President's budget request for FY 2011 and FY 2012 includes targeted investment in corporate programs in the international arena; however, it is important to realize the law and large corporate activities are complex, and under current law there will always be disagreements between corporate taxpayers and the IRS as to what the precise proper tax should be. That reason is why it is equally important that the IRS focus on providing timely guidance to corporate taxpayers to address issues up front, and to provide appropriate channels for efficient dispute resolution.

QUESTIONS ON ENSURING CONTRACTORS PAY TAXES

Do we have a system in place that can block companies being investigated for, or convicted of tax fraud, from competing for federal procurement and service contracts unless their tax liability is fully paid off?

This question is primarily one of contracting standards, which the IRS does not administer. With respect to the question about outstanding tax liabilities, the IRS could only provide that type of information to procurement officials if the taxpayer consents. The Internal Revenue Code (IRC), section 6103(a) establishes the general rule that returns and return information, which includes the fact that a federal contactor has an outstanding tax delinquency, are confidential and may not be disclosed. The absence of any Title 26 authority to provide this return information to procurement officials in other agencies that are considering contract awards means the IRS cannot disclose it. IRC 6103(c) authorizes disclosure upon the taxpayer's consent in accordance with regulations promulgated by the Secretary, which for this purpose may be found at Treas. Reg. 301.6103(c)-1(b).

However, the Central Contractor Registration system, which is available to all Federal agencies, does allow the IRS to validate and verify a company's Taxpayer Identification Number (TIN). By ensuring a good TIN, then the Federal Payment Levy Program (FPLP), operated by the Financial Management Service, can levy the Agency federal contractor payments to satisfy any tax debt that may exist.

Does the IRS provide regular updates to GSA, and all the other procurement agencies throughout the federal government to create a master list of companies with active cases of tax fraud which should be prohibited from being awarded federal contracts?

The General Services Administration (GSA) amended the Federal Acquisition Register (FAR) several years ago to include "violating Federal criminal tax laws" as a basis for suspension of a contractor. The contractor has to self-certify that s/he has not, within a 3 year period, been convicted of violating a Federal criminal tax law (amongst other crimes). Second, the FAR amendments require contractors to self-certify as to tax debts. A contractor must certify that s/he has, or has not, within a 3 year period been notified of any delinquent Federal tax liability in excess of $3000 that remains unsatisfied. Delinquent tax liability is defined to exclude, generally, certain payment plans that are current, as well as disputed tax matters where all avenues to dispute the liability have not been fully exhausted. Contracting Officers are to use the self-certifications in making responsibility determinations regarding the contractor. They may inquire of the contractor about the certification, as well as get consent from the contractor for access to tax return information. However, the IRS cannot share a list of companies with ongoing tax issues without obtaining taxpayer consent.

In effect do we have a single unified "No fly list" for federal contracts? If not, why not? Do you need Congressional authorization to create this system or do you already have the authority to create it?

The IRS does not have such a list. If there were a desire to create such a list, taxpayer privacy laws would have to be amended for the IRS to share it without taxpayer consent. However, as a more general matter, the IRS has worked closely with the Federal Management Service to make sure the appropriate federal payments are subject to the Treasury Offset Program and Federal Payment Levy Program, which is consistent with the President's "Do Not Pay List" memo of June 18, 2010.

QUESTIONS ON FEDERAL SPENDING INFORMATION

Mr. Commissioner, The IRS provides charts and data on how the federal government spends the funds that the IRS collects.

I am concerned that the way in which the IRS presents the data on the federal budget paints a misleading picture of the true impact of the domestic discretionary spending of the federal government.

Too much of what the federal government and the various agencies accomplish on behalf of the American people is obscured by how the spending pie charts are presented and hidden by the inclusion of mandatory spending.

Can we work together to find a clearer and more effective way for the IRS to educate taxpayers on how their tax dollars are being invested for our future prosperity?

In his State of the Union Address, the President promised that this year, for the first time ever, American taxpayers would be able to go online and see exactly how their federal tax dollars are spent. The 2010 Federal Taxpayer Receipt, which provides a breakdown of how tax dollars are spent at a finer level of detail than the charts you reference, is now available on the White House website at http://www.whitehouse.gov/taxreceipt.

The IRS would be happy to receive suggestions on how the data could be presented differently in the IRS charts.

QUESTIONS ON MINORITY HIRING AND CONTRACTING

How can members of Congress work with the IRS to ensure that on the procurement and contracting side, we have the latest information regarding the amount and percent of contracts, if you have any, that IRS makes with small and disadvantaged business enterprises, particularly women and minority owned firms and to support your efforts to improve the IRS performance in reaching or exceeding Minority and Women Owned Businesses (MWOB) targets?

The Small Business Act (PL 85-536), section 8(a) set goals and targets for awarding contracts to Minority and Women Owned Businesses (MWOB). The IRS maintains data about the 8(a) program on the IRS.gov website, through the Procurement Small Business Program Office website (http://www.irs.gov/opportunities/procurement/article/0,,id=125164,00.html). Members and the public may view the list of approximately 500 8(a) firms who are actively marketing the IRS at any given time. "Marketing" means only that the company has contacted the IRS, representatives of the agency have met with them, and have obtained their capability statement. Some of these firms may have IRS contracts and some do not. This list is posted at the link:

http://www.irs.gov/opportunities/procurement/article/0,,id=125200,00.html.

The IRS periodically updates the list to add new 8(a) firms and to delete graduated 8(a) firms. Graduated firms are those that were certified as 8(a) firms, but have completed the 9 year development program. Graduated firms can no longer receive awards under this program.

The IRS has exceeded the 8(a) Small Business Goal of 2.5% for the past 3 years. In FY 2010, the Service awarded contracts for a total of $1,764,415,441.16 with $100,478,485.98 awarded to contractors under the 8(a) Program. This amount equates to a goal achievement of 5.6%. In FY 2009, the Service awarded contracts for a total of $1,590,277,169.77 with $77,607,753.78 awarded to 8(a) firms, achieving a goal of 4.8%; and in FY 2008, the Service awarded contracts for a total of $1,609,426,135.62 with $65,797,607.64 awarded to 8(a) firms, achieving a goal of 4%.

The IRS uses the 8(a) program to the maximum extent practicable and has various means of identifying 8(a) sources that can meet our needs. We have a history of cultivating relationships with 8(a) firms by way of conducting vendor outreach to locate sources and provide guidance on how to market to the IRS; hosting annual training and showcase events targeting 8(a)/HUBZone and SDVOSB firms; updating internal source lists that provide At-A-Glance listings of

HUBZone, SDVOSB and 8(a) firms; and having executive level commitments for reaching goals under the various socio-economic programs.

QUESTION REGARDING COMPANY OWNED LIFE INSURANCE

Many companies use life insurance policies taken out on their employees, often without their knowledge or consent, to pay out deferred compensation for some of their top executives.

Does this practice cause you any concern regarding how companies shelter income from equitable taxation?

We believe this practice has been curtailed in recent years. For employer-owned life insurance, the Pension Protection Act of 2006 limited the income tax benefits that otherwise would apply to amounts received by reason of the employee's death. As a result of these limitations, death benefits received under such a contract are not excluded from the employer's gross income unless the employee is notified in writing that the employer intends to purchase life insurance, and the employee consents in writing to being insured. In addition, the insurance must either (1) cover the life of someone who was an employee within 12 months of death or was a director or highly compensated employee or individual, or (2) be used to make a payment to the employee's beneficiaries or to purchase the employee's equity interest in the business.

The Administration's Fiscal Year 2012 Budget proposes an additional change in the treatment of employer-owned life insurance. Specifically, the proposal would further limit the ability of a business taxpayer to deduct interest expense allocable to tax-free inside buildup on life insurance contracts by repealing an existing exception from the pro rata interest expense disallowance rule for contracts that cover employees, officers, or directors, who are not also 20-percent owners of the business. (The current exception would be retained only for those individuals who are 20-percent owners.) Whereas the 2006 legislation addressed the conditions under which favorable treatment of death benefits is appropriate, the Fiscal Year 2012 Budget proposal would address the tax arbitrage that results when interest expense allocable to tax-preferred inside buildup on life insurance contracts is allowed to be deducted.

Do believe that the positive tax treatment of life insurance that Congress enacted was meant to allow corporations to shield executive pay from taxation and benefit from the deaths of their employees?

The taxation of an employee -- including an executive or other highly compensated individual -- depends on the application of the Internal Revenue Code to the terms of the compensation arrangement with the employee. The fact that the corporation owns life insurance contracts generally does not affect the taxation of the employee.

The tax benefits for an employer that owns life insurance contracts already are limited. For example, generally no deduction is allowed for premiums on life insurance policies, and deductions for interest expense with regard to life insurance contracts are subject to significant limitations. In addition, the Pension Protection Act of 2006 limited the circumstances under

which death benefits under a company owned life insurance contract are excluded from gross income.

Should that positive tax treatment be reserved for the families and loved ones of the deceased, which is what I believe Congress likely intended?

State insurable interest laws acknowledge that an employer has an economic stake in the lives of its employees. For example, death benefits under a life insurance contract may offset losses incurred as the result of the death of a key employee, or may be used to provide funds to redeem a deceased owner's interest in the business. Life insurance contracts also may be used to fund death benefits that are owed to a deceased employee's beneficiaries, or to fund other employee benefits. A number of limitations already apply to the tax benefits otherwise available with respect to company owned life insurance. Whether additional limitations are appropriate is a matter of tax policy.

VOLUNTARY DISCLOSURE PROGRAM AND TAX AVOIDANCE

Mr. Commissioner, let me congratulate you and your hard working staff on finally getting access to information related to the secret banks accounts of thousands of the wealthiest Americans.

It is unconscionable that there are those who refused to pay their fair share of taxes on wealth they were able to generate due to the hard work and trillions of dollars of investment and infrastructure building by hundreds millions of law abiding tax payers across the country.

Will you explain to this subcommittee the IRS's rationale behind allowing thousands of tax dodgers to volunteer to finally pay their taxes?

Persons who have undisclosed offshore accounts face potential criminal prosecution and potentially very large penalties. This sanction includes a penalty for not filing the Form 90-22.1 Report on Foreign Bank and Financial Accounts (FBAR). Although these persons could always take advantage of IRS's longstanding voluntary disclosure practice, in which qualifying taxpayers can minimize their chance of criminal prosecution, the unknown amount of the civil liability that would result kept many taxpayers from making a voluntary disclosure. In order to bring large numbers of taxpayers with offshore accounts into compliance with United States tax laws, in 2009 and now in 2011, the IRS announced initiatives that offered a resolution of civil penalties at less than their maximum amounts, thus providing an incentive and some certainty to taxpayers. Although the 2011 program is tougher than the 2009 program, both programs require all participants to pay all back taxes, interest, and significant penalties to participate. The Service has encouraged taxpayers to come in sooner rather than later because the stakes for late disclosure continue to increase. Should the Service receive information concerning a specific taxpayer's noncompliance prior to the taxpayer attempting to make a voluntary disclosure, the taxpayer will be ineligible for the initiative and for the voluntary disclosure practice.

These initiatives are producing increased revenue, as well as bringing taxpayers into compliance with fewer enforcement matters. An additional benefit for the IRS from the initiative is the information participants provide concerning offshore tax noncompliance—including information

about the financial institutions that are involved. Enforcement resources can then be applied to pursue other noncompliant taxpayers who do not self disclose, as well as those who promote and facilitate offshore tax noncompliance.

Did the IRS conclude that more revenue would be collected through this effort instead of pursuing existing enforcement actions against tax dodgers?

Yes. The IRS does not know the identities of all taxpayers with offshore accounts. Thus, the initiatives provide revenue from taxpayers the IRS had not yet discovered. In addition to the immediate revenue from participants in the initiative, a significant benefit is that large numbers of taxpayers are back in compliance with United States tax laws—which should result in additional future revenue. One more benefit for the IRS from the initiative is the information participants provide concerning offshore tax compliance – including information about the financial institutions that are involved. Enforcement resources can then be applied to pursue other noncompliant taxpayers who do not self-disclose, as well as those who promote and facilitate offshore tax noncompliance.

Will you also tell the subcommittee just how much was collected in taxes, fees and fines from these wealthy tax dodgers?

Through February 18, 2011, the IRS has collected over $574 million in tax, penalties and interest from these initiatives. This amount will continue to increase as additional cases are processed and closed.

While some of the bankers who allowed the perpetration of these illegal tax avoidance schemes are being prosecuted, and I understand that this may be sensitive information related to ongoing investigations by the IRS, but I would like to know if any persons who committed tax fraud and avoided paying their fair share, will be prosecuted and will their identities ever be made public?

The IRS's Criminal Investigation (CI) Division remains focused on international tax enforcement by investigating significant promoters and individuals participating in offshore abusive tax schemes. These investigations often involve the use of offshore bank accounts, trusts, corporations, partnerships and other entities to commit criminal violations of U.S. tax laws. CI pursues significant criminal investigations aimed at dismantling the network of promoters or bankers engaged in targeting U.S. taxpayers and those taxpayers who utilize offshore accounts with the intent to violate our U.S. tax laws. CI works closely with the Department of Justice Tax Division to recommend prosecution of those individuals or promoters involved in offshore abusive tax schemes. These prosecutions often involve persons who committed tax fraud and avoided paying his/her fair share. The prosecution of these persons holds them accountable for their actions and reveals their identities through publicity with the goal of deterring others from engaging in offshore abusive tax schemes.

Follow this link to Offshore Tax-Avoidance and IRS Compliance Efforts (http://www.irs.gov/newsroom/article/0,,id=110092,00.html) for a listing of legal actions against UBS clients and others who promoted or participated in offshore abusive schemes.

Of the secret bank accounts recently revealed to the IRS, what percentage of persons have participated in the voluntary programs and can we expect a wave of investigations, prosecutions and collection of federal revenue in the future?

Approximately 60% of UBS accounts received to date as a result of the August 19, 2009 agreement with the Swiss government were also disclosed by participants in the 2009 Offshore Voluntary Disclosure Program (OVDP).

The IRS is actively investigating accounts that were not disclosed under the 2009 OVDP. Examiners assigned to these cases will pursue both civil and criminal avenues. They will consider all available penalties including the maximum penalty for the willful failure to file the Form 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), as well as the fraud penalty.

What is the IRS doing so that these types of tax avoidance schemes will not happen in the future?

The IRS continues to have a vigorous criminal and civil offshore compliance program. Using information obtained from the offshore voluntary disclosures, the IRS expects to issue John Doe summonses to additional foreign banks to obtain information on unreported accountholders. The IRS also has an Offshore Compliance Initiatives unit charged with developing new projects, methodologies and techniques for proactively identifying taxpayers who are involved in abusive offshore transactions and financial arrangements for tax avoidance or tax evasion purposes.

Criminal Investigation (CI) also has a robust offshore enforcement program. They work closely with foreign governments and other domestic agencies to pursue some of the most significant cross border financial investigations targeting tax evasion. In FY 2010, CI opened international offices in three new locations: Beijing, Panama City, and Sydney. In addition, CI added Deputy Attachés to existing offices in Mexico City, Bogota, London, Canada, Frankfurt, Hong Kong, and Barbados. The new locations will put the IRS closer to key rapidly expanding economies as well as supporting our existing international tax administration mission. CI's overseas Special Agent attachés establish strong ties with foreign governments that ultimately promote U.S. and IRS interests.

In FY 2011 CI created the Office of International Operations to oversee and facilitate their offshore compliance efforts. The goal of International Operations is to enhance CI's overseas presence and compliance efforts through international case development involving tax and financial crimes. International Operations will leverage resources to enhance efficiency in providing international case support, international training and outreach to foreign entities as well as partner with IRS operating divisions, other federal agencies, domestic and foreign law enforcement entities, financial institutions, and other stakeholders to identify and address threats to our global financial system. With the creation of the Office of International Operations and the additional staffing gained in FY 2010, CI will continue to address complex international tax issues as well as partner with other IRS business units in identifying and combating compliance issues. CI will also enhance internal training to ensure agents are educated on emerging trends and techniques so that we are able to unravel the sophisticated and complex matters associated with international tax administration and financial crime.

In addition to these enforcement efforts, implementation of a new Chapter 4 of the Internal Revenue Code, the Foreign Account Tax Compliance Act (FATCA), enacted as part of the Hiring Incentives to Restore Employment (HIRE) Act of 2010 and signed into law on March 18, 2010 (PL 111-147), will aid in curbing offshore tax evasion. FATCA includes new reporting requirements for offshore financial institutions with respect to accounts they maintain for U.S. persons and certain foreign entities that are owned by U.S. persons. Financial institutions that fail to enter into an agreement with the IRS to report information regarding their U.S. accountholders will be subject to a 30 percent tax on payments made to that financial institution of income from sources within the United States, and on gross proceeds from the disposition of U.S. securities. Furthermore, accountholders that fail to provide a financial institution with sufficient information to allow that institution to fulfill its reporting obligations or refuse to consent to the reporting of the information will be subject to a 30 percent withholding tax on certain payments made to those accountholders and/or the closure of their accounts.

FATCA will be instrumental in curbing tax evasion through the use of offshore accounts as it will provide the Service with vital information regarding U.S. taxpayers who were previously able to hide their income by opening accounts in the name of foreign shell entities or in bank secrecy jurisdictions. FATCA's provisions are generally effective beginning in 2013, and the Treasury Department and the IRS are currently drafting regulations and other guidance that will describe the specific requirements for foreign financial institutions to comply with FATCA.

FRIDAY, APRIL 15, 2011.

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

WITNESS

HON. J. RUSSELL GEORGE, TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Mrs. EMERSON. Thank you so much, Inspector General, for being with us today. We really are grateful to you. Hopefully, my colleagues will come in and out. We have got these votes going on, so once an hour, we will have to race downstairs to do a vote and then come right back up. Since we are here in the Capitol, we will try our best to keep the hearing going. I am hoping that my other colleagues will get here sooner rather than later.

TIGTA was originally scheduled as our first hearing for the 112th Congress back in February, but with all the continuing resolutions that we were working on, we have had to delay until today. So thanks for your forbearance, we are very, very grateful. It seems rather fitting that not only would we be celebrating Jackie Robinson, but we would also be delaying this hearing until April 15th, tax day. It is not many people's favorite time of the year. Certainly, not for those of us who have to pay taxes.

Anyway, as we all know, we have a very difficult challenge in front of us with the debt at almost $14 trillion. It is really important that we build a foundation for living within our means. The Appropriations Committee, and certainly our subcommittee, has been tasked to make tough decisions ahead. And in so doing, I feel very strongly that you have to be very strategic in the reductions that you make. Therefore, we have to learn as much as we can about the agencies under jurisdiction in order to make these decisions.

Inspector General George, you have a daunting task of overseeing the IRS, which is an enormous organization that touches the lives of most Americans and with 100,000 employees and a budget of more than $12 billion, you have your hands full. If this subcommittee is going to reduce spending for the fiscal year and try to get back to 2008 levels, we are going to have to identify some savings in the IRS budget.

I want to do our best not to reduce service that the IRS provides taxpayers preparing their tax returns, nor do I want to jeopardize anything that would help us detect tax fraud so that we can get as much revenue in as possible. Hopefully, you will help us wade through some of these questions.

I welcome you back, Inspector General George, and so appreciate your being here, and look forward to your testimony. And now to my friend, Mr. Serrano.

Mr. SERRANO. Thank you, Madam Chair.

And I, too, join you in welcoming the Treasury Inspector General for Tax Administration on April 15th, which is a great day, J. Russell George, before the subcommittee today.

Inspector General George, you have an important job in helping ensure that the IRS is running our Nation's tax system in an effective and efficient manner. I am interested in learning more about your views of the current challenges that the IRS faces in both the fair administration of our tax laws and in the management challenges that the IRS itself faces with an aging workforce.

Additionally, I should have mentioned that we are in the process of finishing the fiscal year 2011 budget process. In fact, did the President sign it yet?

Mrs. EMERSON. I don't think so.

Mr. SERRANO. Soon.

The final bill, as you know, flat funds the IRS at the fiscal year 2010 level. I am interested to hear your views on the impact this will have on IRS efforts to close the tax gap and whether there are areas of vulnerability as a result of the funding level. We look forward to your testimony. And I am sorry you are a Mets fan, but that's not the right thing to say to me.

Mrs. EMERSON. At least he is from New York, gosh.

Mr. SERRANO. There is a big difference.

Mrs. EMERSON. I bet the tickets for the——

Mr. SERRANO. I am only kidding.

Mrs. EMERSON. The Mets have a new stadium, a newish stadium. How much does it cost for Mets tickets?

Mr. GEORGE. I have yet to visit it so I don't know the answer to that, Madam Chairwoman.

Mr. SERRANO. We cannot afford it, trust me.

Mrs. EMERSON. I know. Both my son and husband are West Point grads, and we went up to the West Point-Notre Dame football game at Yankee Stadium because it was kind of a fun thing to do, and those tickets were $175. I had actually gotten six because we were taking some friends, and I had no idea. I looked at the Visa charge, I mean, I figured they were probably $75, $80 which was still a lot for a football game, that we lost particularly. But nonetheless, Mr. Serrano tells me that the tickets are really about $475 for a decent seat.

Mr. SERRANO. $1,250 for a front row seat.

Mrs. EMERSON. Do they serve you food and drink or something for that $1,250?

Mr. SERRANO. They don't even guarantee you they are going to win. I don't know.

Mrs. EMERSON. We can have lots of fun at this hearing, but we really do need to try to get down to business and kind of going back to the whole issue of the country's debt. And I think all economists—I started getting carried away. We would like to hear from you.

Mr. GEORGE. If you would like to, I mean it is very brief.

Mrs. EMERSON. Absolutely, please go ahead and do that.

Mrs. EMERSON. We start getting carried away, and then I forget so I apologize. I apologize.

Mr. SERRANO. Baseball gets in the way.

Mr. GEORGE. Well, listen, hey, Tom Seaver.

Mr. SERRANO. The Franchise.

Mr. GEORGE. There you go, 1969 Mets and all that.

Chairwoman Emerson, Ranking Member Serrano, Members of the Subcommittee, thank you for the opportunity to appear today to testify on the issues confronting the Internal Revenue Service and helping hold it accountable as it administers the Nation's tax laws.

I represent the office of Treasury Inspector General for Tax Administration, commonly referred to as TIGTA. An organization consisting of approximately 800 men and women spread across the country, all of whom are dedicated to the mission of protecting the integrity of our Nation's system of tax administration. We do this by conducting independent audits, investigations, and reviews of IRS programs and operations.

We are a very unique Office of Inspector General in that our mission, which dates back over 50 years, includes the mandate to protect the Service from both external as well as internal threats to its personnel and operations. In the current threat environment in which the Nation finds itself, this responsibility takes on an even more important role.

Now as I indicated earlier to you, Madam Chairwoman, I am not a stranger to the longstanding challenges confronting the IRS. I served as staff director to Mr. Steve Horn, Government Management Subcommittee and then under—again, Steve Horn, who had a particular interest in the performance problems confronting the Internal Revenue Service, and it is unfortunate to say that some 16 years later, some of the very same problems persist.

As you indicated before, the IRS has a budget of over $12 billion with 100,000 employees, and it is one of the largest and most important components of the Federal Government. Each year, it collects over $2 trillion, and returns to the taxpayers approximately $400 billion in refunds. It is responsible for administering a very complex and lengthy tax code, which contains many new and sometimes temporary provisions. For the most part, the IRS administers these provisions in an effective manner. However, as I will note in a moment, it falls short in its administration of other areas.

Since 1999, my organization has identified cost savings and recommended efficiencies that, if adopted, would bring additional revenue into our Nation's treasury. As an aside, we estimate those savings and cost findings of additional revenue at over $223 billion.

I am statutorily required to identify the most serious management and performance challenges confronting the Internal Revenue Service pursuant to the Reports Consolidation Act of 2000. The issues identified in that report range from security of IRS employees and infrastructure, and the modernization of its information technology systems, to human capital, taxpayer rights, and erroneous and improper payments and credits. In the latter category, we released in February a report on the Earned Income Tax Credit. That report reveals, among a number of things, that the IRS failed to comply with the requirement that it provide quantifiable targets to reduce improper Earned Income Tax Credit payments. Out of a $50 billion appropriation for that program, the IRS itself estimates that 23 to 28 percent of these credits, the EITC, are wrongfully

paid each year totaling $11 billion to $13 billion. That amount equates to the entire operating budget of the IRS.

Another example of a refundable credit that is not being implemented effectively is the Additional Child Tax Credit. In 2009, we reported a significant increase in the Credit by filers who are unable to obtain Social Security numbers. However, they filed for the Credit and received it. For tax year 2000, these individuals received $62 million——

Mrs. EMERSON. Excuse me, will you just say that last sentence again?

Mr. GEORGE. Certainly. In 2009, we reported a significant increase in the number of Additional Child Tax Credit filers who were unable to obtain Social Security numbers.

Mrs. EMERSON. So the credits—excuse me for interrupting you, but I want to pursue this very quick. So they filed for the child tax credit but provided no Social Security number, and they still got it?

Mr. GEORGE. That is correct, this is correct.

Mrs. EMERSON. We will pursue that in a little bit. Thank you.

Mr. GEORGE. Now, for tax year 2000, these individuals received $62 million. For tax year 2007, the amount of the applicants for this Credit that was received increased to an astounding $1.8 billion. This is something, notwithstanding the fact that my auditors identified this as a problem and a possible approach to contain it, the IRS has failed to act.

Now as you both noted, and welcome Mr. Bonner, since today is traditionally the deadline to file taxes, and as you know, because of the holiday in the District of Columbia, it is extended until the 18th, I will close my oral comments with an assessment of the current filing season. We will be issuing our interim report on the filing season officially next week, but it will show that as of March 4th, the IRS received just over 60 million returns. Of those, 53.9 or 89 percent were electronically filed, and nearly 6 million to 7 million or 11 percent were filed on paper, a decrease of over 30 percent from this time last year. That is a good news story.

Mrs. EMERSON. A decrease in the paper?

Mr. GEORGE. Correct, that is correct. As you well know, electronically filed costs the IRS much less to process than those which are filed by paper.

In addition, nearly 52.6 million refunds totaling approximately $161 billion has been issued as of March 4th. Our report found that overall the IRS is doing a better job of intercepting and preventing fraud this year. I am sure you may want to delve into this later, we recently issued reports about prisoners receiving tax refunds they were not entitled amongst a host of other people. Since those reports were issued, the IRS has changed its procedures and is doing a much better job. We still have found that there are some improper credits still being paid, and they still have some issues as they relate to customer service that need to be addressed.

And I just want to close in my opening statement by saying Members of the Subcommittee, our Nation, notwithstanding the items that we will discuss today, which are we are here to focus on the problems that need to be addressed, we nonetheless have the best system of tax administration in the world. And it is my

challenge and my organization's challenge to help the IRS identify ways to ensure that that remains the case. We commit to do our level best to achieve that goal. That concludes my opening statement, Madam Chairwoman.

[The information follows:]

HEARING BEFORE THE
COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON
FINANCIAL SERVICES AND GENERAL GOVERNMENT
U.S. HOUSE OF REPRESENTATIVES

"Budget Hearing with the
Treasury Inspector General for Tax Administration"

April 15, 2011

Washington, D.C.

Testimony of
The Honorable J. Russell George
Treasury Inspector General for Tax Administration

TESTIMONY OF
THE HONORABLE J. RUSSELL GEORGE
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION
before the
COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON FINANCIAL SERVICES AND GENERAL GOVERNMENT
U.S. HOUSE OF REPRESENTATIVES

"Budget Hearing with the Treasury Inspector General for Tax Administration"

April 15, 2011

Chairwoman Emerson, Ranking Member Serrano, and Members of the Subcommittee, I thank you for the opportunity to testify on accountability over the Internal Revenue Service (IRS) in administering the Nation's tax laws. My comments will focus on how the Treasury Inspector General for Tax Administration (TIGTA) provides accountability for the IRS and oversight of its budget as well as the most significant challenges currently facing the IRS.

TIGTA plays a critical role in ensuring the accountability of the IRS. In accordance with the *Inspector General Act of 1978*, as amended, we conduct independent and objective audits, investigations, and reviews of IRS programs and operations.[1] TIGTA provides leadership and develops recommendations to promote economy, efficiency, and effectiveness and to detect and prevent fraud, waste, and abuse in IRS programs and operations. TIGTA reports the results of its investigations, audits, and reviews semiannually to the Congress, the Secretary of the Treasury, the IRS Commissioner, and the American people to maintain current awareness of the programmatic and operational challenges facing the IRS. We refer criminal matters to the United States (U.S.) Department of Justice and other law enforcement entities for prosecution and also investigate and refer allegations of misconduct by IRS employees and contractors to the IRS for administrative action. Appendix I provides a statistical summary of selected TIGTA accomplishments from Fiscal Year 1999 to Fiscal Year 2010.

Another important way TIGTA provides accountability is through the identification of the major challenges facing the IRS. The *Reports Consolidation Act of 2000*[2] requires TIGTA to summarize for inclusion in the *Department of the Treasury*

[1] 5 U.S.C. App. 3 §§ 2(1), 4(a)(1).
[2] 31 U.S.C. § 3516(d).

Accountability Report our perspective on the most serious management and performance challenges facing the IRS. This list of challenges forms the basis of our audit work concerning IRS programs and activities. The *Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2011* memorandum is included as Appendix II.

OVERVIEW OF THE IRS'S FISCAL YEAR 2012 BUDGET REQUEST

The IRS is the largest component of the Department of the Treasury and has primary responsibility for administering the Federal tax system. Since the Federal tax system is a system that relies upon voluntary compliance, almost everything the IRS does is in some way related to fostering compliance with tax laws. The IRS provides taxpayer service programs that help millions of taxpayers to understand and meet their tax obligations and administers enforcement programs aimed at deterring taxpayers who are inclined to evade their responsibilities. The IRS is charged with vigorously pursuing those who violate tax laws.

The IRS must strive to enforce the tax laws fairly and efficiently while balancing service and education to promote voluntary compliance and reduce taxpayer burden. To accomplish these efforts, the proposed Fiscal Year 2012 IRS budget requested appropriated resources of $13.3 billion.[3] The total appropriations amount is an increase of $1.138 billion, or approximately 9.4 percent, more than the Fiscal Year 2010 enacted level. The budget request includes a net increase in staffing for the IRS of over 5,100 employees, to total over 100,500 IRS employees.

The Administration seeks to increase funding over the Fiscal Year 2010 enacted operating levels for all five appropriation accounts, ranging from 3 to 26 percent increases (see following chart).

[3] The 2012 budget request also includes approximately $138 million from reimbursable programs and $204 million from user fees for a total program operating level of $13.6 billion.

IRS Fiscal Year 2012 Budget Request Increase Over Fiscal Year 2010 Enacted Budget (in Thousands)

Appropriation Account	Fiscal Year 2010 Enacted	Fiscal Year 2012 Request	$ Change	% Increase
Taxpayer Services	$2,278,830	$2,345,133	$66,303	2.91%
Enforcement	$5,504,000	$5,966,619	$462,619	8.41%
Operations Support	$4,083,884	$4,620,526	$536,642	13.14%
Business Systems Modernization	$263,897	$333,600	$69,703	26.41%
Health Coverage Tax Credit Administration	$15,512	$18,029	$2,517	16.23%
Total Budget Appropriated Resources	**$12,146,123**	**$13,283,907**	**$1,137,784**	**9.37%**

Generally, the five appropriation accounts fund the following IRS tax administration functions. The three primary appropriation accounts are Taxpayer Services, Enforcement, and Operations Support. The Taxpayer Services account provides funding for programs which focus on helping taxpayers understand and meet their tax obligations, while the Enforcement account supports the IRS's examination and collection efforts. The Operations Support account provides funding for functions that are essential to the overall operation of the IRS, such as infrastructure and information services. Finally, the Business Systems Modernization account provides funding for the development of a new taxpayer account database and investments in electronic filing, and the Health Insurance Tax Credit Administration account supports the administration of this credit.

ANALYSIS OF THE FISCAL YEAR 2012 BUDGET REQUEST

Changes to the Base

Adjustment to Reach Fiscal Year 2011 President's Budget Level[4] – $402 million increase (including a $123 million increase related to the Modernization appropriation).

[4] The initiatives included in the Fiscal Year 2011 budget submission are separate from the $839 million in program increases included in the Fiscal Year 2012 budget submission.

The Fiscal Year 2012 Budget Request does not specify which initiatives are included in the $402 million increase.

Maintaining Current Levels – $86 million increase to fund the non-labor inflation adjustments and an increase in Federal Employment Retirement System participation. Non-labor inflation adjustments include rent, postage, supplies, and equipment. No inflation adjustment is requested for pay in Fiscal Year 2012.

Program Reinvestment – $1.5 million increase (one-time cost) to fund one-time separation costs associated with the September 30, 2011, closure of the Atlanta submission processing site. Increased use of electronic filing has led to the consolidation of sites that process individual returns.

These increases are offset by a decrease of $190 million in Efficiencies and Savings (including a $1 million decrease related to the Modernization appropriation). The four largest areas of cost savings include reducing information technology infrastructure ($75 million decrease); reducing training, travel, and programs ($27.3 million decrease); increasing e-File savings ($22.4 million decrease); and non-recurring savings ($22 million decrease).

Program Increases

The Fiscal Year 2012 budget request includes program increases of $839 million. This includes an increase of $52 million in the Operations Support appropriation for costs related to maintenance of deployed modernization efforts. This increase is offset by a corresponding decrease of $52 million for the Business Systems Modernization (BSM) appropriation for Fiscal Year 2012.

The largest component of this $839 million increase is $606 million related to Enforcement Initiatives. The IRS remains committed to finding ways to increase compliance and reduce the Tax Gap,[5] while minimizing the burden on the vast majority of taxpayers who pay their taxes accurately and on time.

- IRS Enforcement Initiatives – Increase of $606 million focuses on activities targeted at improving compliance through nine multi-year initiatives. These increases form the backbone of the IRS's multi-year approach to make progress against the Tax Gap.

- Infrastructure Initiatives – Increase of $119 million focuses on enhancing employee security, developing disaster recovery system capability, and

[5] The Tax Gap is the difference between the estimated amount taxpayers owed and the amount they voluntarily and timely paid each year.

developing systems to implement various provisions of the *Patient Protection and Affordable Care Act of 2010*[6] (Affordable Care Act).

- Taxpayer Service Initiatives – Increase of $114 million focuses on improving taxpayer service and the IRS.gov website.
- Business Systems Modernization Initiatives – Net Increase of $0 The initiative to continue migration from the aging tax administration system includes a $52 million program increase for the Operations Support appropriation account for the operations and maintenance of deployed Modernization project releases. However, that increase is also subtracted from the BSM appropriation account, for a $0 net increase.

Business Systems Modernization

The IRS is required to submit an annual BSM expenditure plan that justifies the projects for which resources are requested. The Fiscal Year 2012 budget request indicates a total BSM budget of $333.6 million. This funding will improve taxpayer service and enforcement, and reduce the costs and risks of operating parallel tax processing systems.[7] The IRS plans to update and settle individual taxpayer accounts in 24 to 48 hours with current, complete, and authoritative data, and plans to facilitate expanded opportunities for compliance, increase analytical capabilities, and accelerate the identification of fraudulent trends.

TIGTA SERVES THE AMERICAN PEOPLE BY ASSISTING CONGRESS IN PROVIDING ACCOUNTABILITY FOR TAX ADMINISTRATION

TIGTA assists the Congress in ensuring accountability for the IRS through its audits, investigations, and reviews of IRS programs and operations. The IRS is a highly complex organization that collects more than $2 trillion in tax revenue each year and touches the lives of every American. As such, TIGTA's oversight of IRS programs and operations is multi-faceted, including audits, criminal and administrative investigations, and other reviews. These reviews are designed to promote the economy, efficiency, and effectiveness of tax administration and to protect the integrity of tax administration.

[6] Pub. L. No. 111-148, 124 Stat. 119 (2010).
[7] The IRS operates parallel tax processing systems that require updates to all systems when tax legislation is changed or updated. These parallel systems include Customer Account Data Engine (CADE), CADE 2, and the Individual Master File.

Audit Oversight

TIGTA audit reports provide IRS management with recommendations on ways to improve their operations. These recommendations include enhancing management practices and procedures, offering ways to better use agency funds, and questioning the actual spending of funds. The following table lists the amounts of potential cost savings[8] and inefficient use of resources[9] identified by TIGTA during Fiscal Year 2010. The table is followed by recent examples of audit oversight involving erroneous and improper payments.

Fiscal Year 2010 Potential Cost Savings and Inefficient Use of Resources	
Funds Put to Better Use	$2,818,631,262
Questioned Costs	$412,527
Inefficient Use of Resources	$36,227,181
Cost Savings and Inefficient Use of Resources Total	$2,855,270,970

The IRS administers appropriations which are much larger than its own budget. These are the appropriations for refundable credits. Refundable credits can result in refunds even if no income tax is withheld or paid; that is, the credits can exceed the liability for the tax. The two largest refundable tax credits are the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit (ACTC). For the 2011 Filing Season, the maximum EITC is $5,666; the ACTC is generally limited to 15 percent of earned income in excess of $3,000.[10] The appropriations for these credits in Fiscal Year 2010 were $54.7 billion for the EITC and $22.7 billion for the ACTC.

The IRS continues to report that 23 percent to 28 percent of EITC payments are issued improperly each year. In Fiscal Year 2009, this equated to $11 billion to $13 billion in improper EITC payments, which is approximately the size of the IRS's entire operating budget. The IRS has made little improvement in reducing EITC improper payments since it began reporting estimates of these improper payments to the Congress in 2002. The IRS's effort to balance its compliance/enforcement

[8] Potential cost savings includes both (1) funds put to better use defined as funds that could be used more efficiently if management took actions to implement and complete recommended actions and (2) questioned costs defined as those costs questioned because of an alleged violation of a provision of a law, regulation, contract, or other requirement; a finding that such cost is not supported by adequate documentation; or, an expenditure of funds for the intended purpose is unnecessary or unreasonable.
[9] Values of efficiencies gained from recommendations to reduce costs while maintaining or improving the effectiveness of specific programs.
[10] The ACTC is the refundable portion of the Child Tax Credit. This credit phases out for taxpayers depending upon their income level. Taxpayers with earned income of less than $3,000 may be eligible for a refundable credit if they have three or more qualifying children and have paid Social Security taxes that exceed their EITC.

resources among all income groups and its inability to implement alternative processes to address erroneous claims has hindered the IRS's ability to reduce the billions of dollars in erroneous claims for refundable credits.

As we reported in December 2008, the IRS has developed processes to identify successfully billions of dollars in erroneous EITC payments. However, the IRS did not have the resources to address many of these cases. The IRS needs to develop an alternative process that is less costly than an audit to protect revenue associated with erroneous EITC claims.[11]

In 2009, we reported a significant increase in ACTC claims by filers who were unable to obtain a Social Security Number or were not eligible to receive a Social Security Number. These individuals were not authorized to work in the U.S. They filed tax returns using an Individual Taxpayer Identification Number (ITIN).[12] The refundable credit claims made by these filers have grown substantially. For Tax Year[13] 2000, these individuals received $62 million in ACTCs. For Tax Year 2007, these individuals received almost $1.8 billion in ACTCs.

Prior to 1996, filers using an ITIN were entitled to claim the EITC. However, concerns were raised by the Government Accountability Office, the IRS, and the Congress regarding noncompliance with EITC requirements. The law was subsequently changed to deny the EITC to individuals who file a tax return without a Social Security Number that is valid for employment.[14] As such, filers using an ITIN are not eligible for the EITC. We believe the situation today with the ACTC is similar to the situation which preceded the prohibition of the EITC to ITIN filers. Billions of dollars in ACTCs were provided to ITIN filers without verification of eligibility, and IRS employees have raised concerns about the lack of an adequate process for identifying and addressing improper claims.[15]

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[11] *The Earned Income Tax Credit Program Has Made Advances; However, Alternatives to Traditional Compliance Methods Are Needed to Stop Billions of Dollars in Erroneous Payments* (Reference Number 2009-40-024, dated December 31, 2008).

[12] An Individual Taxpayer Identification Number (ITIN) is available to individuals who are required to have a taxpayer identification number for tax purposes, but do not have and are not eligible to obtain a Social Security Number because they are not authorized to work in the U.S.

[13] The 12-month period for which tax is calculated. For most individual taxpayers, the tax year is synonymous with the calendar year.

[14] The Social Security Administration will issue a Social Security Card that notes "NOT VALID FOR EMPLOYMENT" to individuals from other countries who: (1) are lawfully admitted to the U.S. without work authorization but with a valid nonwork reason for needing as Social Security Number, or (2) need a number because of a Federal law requiring a Social Security Number to get a benefit or service.

[15] *Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims* (Reference Number 2009-40-057, dated March 31, 2009).

The change in the law was made prior to the establishment of the ACTC. However, the language of the law is such that it could be interpreted to apply to the ACTC or any refundable credit. It prohibits individuals residing without authorization in the U.S. from receiving most Federal public benefits with the exception of certain emergency services and programs. Nonetheless, IRS management's view is that the law does not provide sufficient legal authority for the IRS to disallow the ACTC to ITIN filers. In addition, the Internal Revenue Code does not require a Social Security Number to claim the credit and does not provide the IRS math error authority to deny the credit without an examination.[16] As such, legislation would be needed to clarify whether or not refundable tax credits such as the ACTC may be paid to filers without a Social Security Number and, if these credits may not be paid, to provide the IRS math error authority to disallow associated claims for the credits. In our March 2009 report, we estimated that allowing the ACTC only to those filers who are eligible to live and work in the U.S. (*i.e.*, those with a Social Security Number that is valid for employment) would reduce Federal outlays by approximately $1.8 billion annually.[17] However, recent analysis shows that claims for this credit by ITIN filers have increased substantially. In Processing Year[18] 2010, ITIN filers received $4.2 billion in ACTCs.

The IRS's Taxpayer Assurance Program, formerly known as the Questionable Refund Program, is set up to identify and stop fraudulent refunds. As of April 17, 2010, the IRS identified 249,185 tax returns with $1.51 billion being claimed in fraudulent refunds and was able to prevent the issuance of $1.48 billion (98 percent) of the fraudulent refunds claimed. This represented a 50 percent increase in the number of fraudulent tax returns identified in the same period of the previous processing year. This increase is in part the result of the Accounts Management function effectively monitoring its case workload and adjusting thresholds during the filing season to increase the identification of potentially fraudulent tax returns for screening. For example, it lowered tolerances for some of its criteria to increase the number of potentially fraudulent tax returns for screening.

While the IRS has shown a significant increase in the number of fraudulent tax returns identified and refunds stopped, it needs expanded and expedited access to wage and withholding information during the filing season. This information would significantly increase the IRS's ability to efficiently and effectively verify wage and withholding information reported on a tax return at the time a tax return is processed.

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[16] Math error authority is a program in which the IRS contacts taxpayers through the mail or by telephone when it identifies mathematical errors or mismatches of taxpayer information that would result in a tax change.

[17] *Actions Are Needed to Ensure Proper Use of Individual Taxpayer Identification Numbers and to Verify or Limit Refundable Credit Claims* (Reference Number 2009-40-057, dated March 31, 2009).

[18] The year in which tax returns and other tax data are processed by the IRS.

Our analysis of the 151,776 Tax Year 2008 tax returns sent to an examiner for screening and then released for processing identified that 96,178 (63 percent) of these tax returns had valid wages reported. TIGTA estimates that the IRS needlessly expended 22,110 hours screening these tax returns. Currently, the law limits the IRS's access to the U.S. Department of Health and Human Services' wage information. In addition, processes have not been developed to expedite the use of wage and withholding data received from the Social Security Administration. We believe that legislation is needed to expand the IRS's access rights to the U.S. Department of Health and Human Services wage information. We also recommended that the IRS obtain wage information for paper tax returns with EITC claims and develop a process to expedite the availability of wage and withholding information received from the Social Security Administration. The IRS agreed with most of our recommendations, but only agreed to examine the benefits of obtaining wage information for paper tax returns with EITC claims.[19]

In our review of the IRS's processes to identify potentially fraudulent tax returns for screening, TIGTA found that the majority of tax returns the IRS identified as being filed by prisoners were not screened to assess fraud potential. Our review identified that 253,929 (88 percent) of the 287,918 tax returns filed by prisoners as of March 24, 2010, were not selected for screening. Of those tax returns not screened, 48,887 individuals had no wage information reported to the IRS by employers. These 48,887 prisoners claimed refunds totaling more than $130 million, including EITC claims of $78.5 million. Some of these refunds may have been stopped by other compliance activities. For example, we determined that the IRS prevented the issuance of nearly $18.1 million in EITC claims for 4,532 of the 48,887 prisoner tax returns.[20]

Further, our review of the IRS's compliance with the *Inmate Tax Fraud Prevention Act of 2008*[21] found that, as of October 2010, the IRS had not completed required agreements to allow the IRS to disclose prisoner tax return information to prison officials. As a result, no information has been disclosed to either the Federal Bureau of Prisons or State Departments of Corrections. We also found that the Calendar Year[22] 2009 Report to Congress on prisoner fraud is incomplete. The report stated that the IRS identified 44,944 fraudulent prisoner tax returns during Calendar Year 2009. However, the processes the IRS uses to identify prisoner tax returns cause the IRS to understate the amount of prisoner fraud. Our review of the process used by

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[19] *Expanded Access to Wage and Withholding Information Can Improve Identification of Fraudulent Tax Returns* (Reference Number 2010-40-129, dated September 30, 2010).
[20] *Ibid.*
[21] Pub. L. No. 110-428, 122 Stat. 4839, (codified as amended at 26 U.S.C. Section 6103 (k)(10)).
[22] Time period beginning of January 1 of a given year and ending on December 31 of the same year.

the Criminal Investigation Division to compile the 2009 prisoner data file identified a lack of managerial oversight to ensure the accuracy and reliability of this file.

TIGTA recommended that the IRS work with the Department of the Treasury to seek legislation to extend the period of time the IRS has to disclose prisoner tax return data to the Federal Bureau of Prisons and State Departments of Corrections. We have also made a number of other recommendations related to prisoner fraud, which include ensuring all tax returns filed by prisoners are processed through the Electronic Fraud Detection System and receive a prisoner indicator, revising prisoner filters to validate wages and withholding associated with prisoners incarcerated for the year in which the tax return is filed claiming a refund, and developing a process to assess the reliability of data received from Federal and State prisons. The IRS partially agreed to our recommendations, but work remains before the IRS is fully in control of this issue.[23]

Investigative Oversight

TIGTA protects Federal tax administration and holds the IRS accountable through investigative initiatives focused on three core components that expose the IRS to risk: employee integrity; employee and infrastructure security; and external attempts to corrupt tax administration. Our statutory mandate is substantially broader than that which applies to most Offices of Inspector General. While all Offices of Inspector General combat fraud, waste, and abuse, TIGTA is also statutorily charged with protecting the integrity of Federal tax administration. A key aspect of protecting Federal tax administration is the oversight and investigation of IRS employees and contractors.

Integrity lapses by IRS employees, real or perceived, erode public trust in the IRS's ability to enforce tax laws effectively, efficiently, and in the best interest of the Nation. TIGTA investigates the unauthorized access of tax information (UNAX) or disclosure of taxpayer information, bribery, extortion, theft of Government property and taxpayer remittances, taxpayer abuses, financial fraud, and misuse of IRS computer systems. One example of a UNAX investigation is an IRS employee in Kentucky who accessed the accounts of at least 202 taxpayers without authorization, all but five of whom were celebrities, spouses of the celebrities, sports figures, and well-known individuals.[24] Another example is a supervisory IRS employee who exceeded her authorized access to IRS computers approximately 250 times for private financial gain.[25]

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[23] *Significant Problems Still Exist With Internal Revenue Service Efforts to Identify Prisoner Tax Refund Fraud* (Reference Number 2011-40-009, dated December 29, 2010).
[24] TIGTA September 2008 Semiannual Report to Congress, page 3.
[25] TIGTA September 2006 Semiannual Report to Congress, page 32.

A key characteristic of UNAX cases is the opportunity for the investigation to lead to the discovery of other violations. For example, a UNAX investigation in New York was begun based on an internal lead of an IRS employee inappropriately accessing family members' IRS records. Ultimately, the IRS employee was charged with stealing Government funds totaling $160,863 and fraud in connection with computers.[26]

Bribery is also a serious risk for the IRS and a serious concern to TIGTA. If unchecked, bribery and extortion would substantially undermine the integrity of Federal tax administration and could lead to the growth of the Tax Gap. An example of a bribery investigation is a taxpayer who offered a $600,000 and a 2003 BMW 745LI to an IRS revenue officer to abate all outstanding tax liabilities.[27] A second example of bribery investigation is a taxpayer who paid $30,000 in bribe monies to a revenue agent to zero out the tax liability.[28] An example of an extortion investigation involved an IRS revenue agent attempted to extort $9,700 in cash from a taxpayer in order to make a tax liability go away.[29] Another example of an extortion investigation involved an IRS revenue agent who attempted to extort $5,000 from a taxpayer in exchange for a no change audit result.[30]

TIGTA promotes employee integrity by conducting proactive investigative initiatives to detect criminal and administrative misconduct in the administration of IRS programs. Additionally, TIGTA special agents conduct awareness presentations to remind IRS employees of our oversight responsibility. These presentations help employees identify ways in which they can prevent fraud, waste, and abuse.

Procurement Fraud Oversight

TIGTA is continuing to address the risk of financial loss due to procurement-related fraud and is increasing efforts to identify and prosecute offenders who would cheat the American taxpayer. TIGTA is dedicated to ensuring that contractors working for the IRS are scrutinized, and we will not tolerate any scheme that denies the American people the best value for their tax dollars. We are launching new strategic initiatives to detect and deter fraud, waste, and abuse in IRS procurements. As of February 11, 2011, the IRS had 891 active procurements worth approximately $31.5 billion. It is estimated that five percent of an organization's annual revenue is at risk of

[26] District Court of New York, Indictment filed on December 13, 2010.
[27] District Court of California, Indictment filed on October 2, 2008.
[28] District Court of California, Indictment filed on April 7, 2010.
[29] TIGTA September 2010 Semiannual Report to Congress, page 44.
[30] United States Attorney's Office, Southern District of New York press release.

fraud.[31] As part of our oversight responsibility, TIGTA has recently realigned its resources to enhance its investigation and audit efforts in the procurement fraud area.

The Office of Investigations Procurement Fraud Division has had ongoing efforts addressing multiple aspects of procurement fraud. For example, they have initiated investigations and expanded their outreach and education with IRS procurement personnel to educate them on potential fraud indicators. Their efforts have been increasingly successful, as court ordered settlements on procurement fraud cases have grown from approximately $18 million in Fiscal Year 2007 to almost $157 million in Fiscal Year 2010. These results have been achieved with a relatively small staff. Compared to all TIGTA Office of Investigations' financial recoveries, the two percent of TIGTA agents investigating procurement fraud brought in 59 percent of the recoveries. During Fiscal Year 2010, our Procurement Fraud Division participated in investigations that have resulted in settlements of more than $156 million to the Department of the Treasury. In one example, TIGTA worked with the Department of Justice, the General Services Administration, and other Federal agencies to investigate kickbacks and defective pricing schemes by the EMC Corporation and related Government contractors, which resulted in the corporation's repaying $87.5 million to the Department of the Treasury.[32]

The procurement fraud investigations have focused primarily on IRS procurements that originate at the national level. However, half of all IRS contracts originate in and are administered by the IRS's four regional procurement centers. To address this additional area of high risk, TIGTA's Procurement Fraud Division has developed a pilot program that will station agents at the four centers to develop investigations and audit referrals. The pilot program will initially place one agent at the IRS Dallas Procurement Center. If given additional resources, the other procurement center sites (Atlanta, New York, and San Francisco) will be staffed. Increased physical interaction and visibility of procurement fraud agents will increase investigations and audits, legal actions, recoveries, and will ultimately act as a deterrent to procurement fraud in the IRS.

The Office of Audit has focused its efforts regarding procurement fraud on three areas: invoice verification reviews; acquisition program reviews and non-contract acquisitions; and information technology procurements. Several referrals to the Office of Investigations have been made as a result of these reviews. The Office of Audit has

[31] The Association of Certified Fraud Examiners Report to the Nation in 2010 estimated that organizations lose 5 percent of their annual revenues to (employee) "occupational" fraud and abuse. The term "occupational fraud" may be defined as the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets.
[32] TIGTA September 2010 Semiannual Report to Congress, page 5.

recently increased its focus on procurement fraud by expanding ongoing reviews of systems development and other technology services (*e.g.*, maintenance contracts) to look for potential fraud indicators or fraud risks. The Office of Audit is also developing a cross-cutting procurement fraud audit strategy to support the conduct of audits and issuance of reports focusing on procurement fraud detection and deterrence.

During the course of these efforts, TIGTA has also identified systemic weaknesses in IRS procurement, which leave the IRS vulnerable to fraud. One example of a systemic weakness is the IRS's method for assigning a contracting officer's technical representative (COTR) to manage and oversee IRS contracts. COTRs are assigned contracts irrespective of their access to the deliverables or technical expertise. In one investigation, a COTR resubmitted invoices totaling approximately $600,000, which had already been paid the prior year. Another example of a systemic weakness is COTRs being directed by their supervisors to accept invoices for payment when those COTRs do not possess the technical knowledge and skills to determine whether the contractor actually delivered the product. In one investigation, the COTR accepted information technology-related invoices relying solely on the contractor's word that the work had been completed. TIGTA also conducted an audit of COTRs in 2009 and identified many of the same vulnerabilities and control weaknesses. We made several recommendations to the IRS to strengthen the COTR position.

SELECTED MAJOR CHALLENGES FACING THE IRS

As the IRS continues to deliver multiple programs and services to the American public, it faces a number of significant challenges:

Security

Concurrent with the IRS's monitoring of threats to its employees and facilities and from international criminals, the IRS must also remain vigilant with respect to computer security, particularly as it relates to safeguarding the privacy of confidential taxpayer information. The IRS is an attractive target for criminals who intend to commit identity theft by stealing Personally Identifiable Information[33] for their own financial gain or for hackers seeking to attack and disrupt the IRS's operations by exploiting security weaknesses within the IRS's computer architecture. According to the *IRS's Fiscal Year 2010 Data Book*, the IRS received more than 230 million tax returns, of which 141 million returns were from individual taxpayers. All of these taxpayers essentially entrust the IRS with their sensitive financial and Personally Identifiable Information that

[33] This is information that can be used to distinguish or trace an individual's identity, alone or when combined with other personal or identifying information.

are processed by and stored on IRS computer systems. To support and encourage voluntary compliance with tax filing requirements, the IRS has a fiduciary responsibility to ensure that sensitive data in its possession is protected from inadvertent or deliberate misuse, improper disclosure, destruction, and that computer operations supporting our Nation's tax administration system are secured against disruption or compromise.

To help protect taxpayers' Personally Identifiable Information, the IRS has implemented a plan to reduce its use of Social Security Numbers. However, as we reported in August 2010, it will not be eliminating or reducing the use of taxpayers' Social Security Numbers in the immediate future.[34] The IRS focused first on internal forms using Social Security Numbers and eliminating employees' Social Security Numbers from its systems. The IRS has many systems, notices, and forms that use Social Security Numbers that require significant analysis before Social Security Number use can be eliminated or reduced. As the IRS moves forward to reduce and eliminate the use of taxpayer Social Security Numbers, it needs to improve internal controls to ensure all planned actions are appropriately and timely accomplished. The IRS needs to maintain a complete list of systems, notices, and forms for monitoring purposes. It also needs to ensure milestones are established and updated when necessary. We are currently conducting an audit of the Disclosure Notification Process to determine if the IRS is making appropriate decisions to promptly and properly notify taxpayers of inadvertent disclosures of their Personally Identifiable Information, including tax return information.

The IRS has many processes and regulations that protect taxpayer information, but there are instances when taxpayer information is inadvertently disclosed. When this happens, if the IRS determines that there is a significant risk of identity theft or other harm, it must notify the taxpayer that his or her Personally Identifiable Information has been inadvertently disclosed. A recent report illustrates the importance of reducing the use of Personally Identifiable Information such as Social Security Numbers. We reported that during 2009, there was an increase in reports of potential disclosure of Personally Identifiable Information.[35] Inappropriate disclosure of Personally Identifiable Information can place individuals at a higher risk of identity theft and may erode public confidence in the Nation's tax system, which is built upon the principle of voluntary compliance with the provisions of the tax code. We have also reported that the IRS could improve the way it monitors security weaknesses identified at State government

[34] *Target Dates Have Not Been Established to Eliminate or Reduce Taxpayer Social Security Numbers From Outgoing Correspondence* (Reference Number 2010-40-098, dated August 13, 2010).
[35] *Revised Procedures Preceded Significant Increases in Reports of Potential Disclosure of Personally Identifiable Information* (Reference Number 2010-IE-R005, dated May 18, 2010).

agencies and ensure the timely and effective correction of these weaknesses.[36] In another review, we found that current IRS processes were not effective at identifying all contractors handling IRS taxpayer data who may have been subject to required security reviews. Further, we found that current processes were not followed to ensure weaknesses identified at contractor facilities were timely corrected.[37]

The IRS initially reported its computer security material weakness[38] in 1997. Their original declaration of the computer security material weakness consisted of five material weaknesses: computing center security; field office security; service center security; other IRS facility security; and system certification. In October 2002, the IRS combined these five security material weaknesses that were primarily based on facility types into one material weakness. Its goal was to address computer security from an enterprise-wide approach and to better align the weakness areas with the new organizational structure. The IRS further categorized the computer security material weakness into nine areas: 1) network access controls; 2) key computer applications and system access controls; 3) software configuration; 4) functional business, operating, and program units' security roles and responsibilities; 5) segregation of duties between system and security administrators; 6) contingency planning and disaster recovery; 7) monitoring of key networks and systems; 8) security training; and 9) certification and accreditation. The IRS has closed the segregation of duties between system and security administrators, security training, and certification and accreditation components. All other components remain open.

During Fiscal Year 2010, the IRS requested that TIGTA validate the IRS's closure of the functional business, operating, and program units' security roles and responsibilities component of the computer security material weakness. Our review of the IRS's completed actions on this component found that the IRS did not effectively complete four of its six corrective action objectives. Specifically, the IRS did not: 1) document all information technology (IT) security roles and responsibilities in the Internal Revenue Manual; 2) develop and document day-to-day IT security procedures and guidelines; 3) properly conduct compliance assessments to test IT procedures; and 4) establish effective metrics for measuring compliance.[39]

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[36] *While Effective Actions Have Been Taken to Address Previously Reported Weaknesses in the Protection of Federal Tax Information at State Government Agencies, Additional Improvements Are Needed* (Reference Number 2010-20-003, dated November 10, 2009).
[37] *Taxpayer Data Used at Contractor Facilities May Be at Risk for Unauthorized Access or Disclosure* (Reference Number 2010-20-051, dated May 18, 2010).
[38] The Department of the Treasury has defined a material weakness as "shortcomings in operations or systems which, among other things, severely impair or threaten the organization's ability to accomplish its mission or to prepare timely, accurate financial statements or reports."
[39] *More Actions Are Needed to Correct the Security Roles and Responsibilities Portion of the Computer Security Material Weakness* (Reference Number 2010-20-084, dated August 26, 2010).

Computer security weaknesses also affect the IRS's financial systems, which do not comply with the *Federal Financial Management Improvement Act of 1996.*[40] The IRS informed TIGTA in 2010 that it does not believe it will become compliant until approximately November 2014, pending the successful implementation of its strategy to modernize the processes used to account for the records of individual taxpayers.[41]

The IRS is, however, making steady progress over information security. For example, one of the major trends affecting the IRS is the "*explosion in electronic data, online interactions, and related security risks.*"[42] Another example of the IRS's commitment toward information security is the IRS's IT Security Program Plan, issued in September 2009. The Plan serves as a roadmap and a basis for benchmarking information security performance toward attaining security objectives. Senior IRS leaders will be able to use the IT Security Program Plan as input to their strategic business planning process.

All Federal Government agencies are required to establish and implement security controls on their computer systems. In addition, the *Federal Information Security Management Act* (FISMA)[43] requires agencies to report to the Office of Management and Budget (OMB) and the Congress on the effectiveness of their information security program and practices. During the 2010 reporting period, we determined that the IRS's information security program was generally compliant with the FISMA legislation, OMB information security requirements, and related information security standards. Specifically, the IRS met the level of performance for certification and accreditation, incident response and reporting, and remote access management. While the IRS information security program is generally compliant with the FISMA legislation, the program was not fully effective as a result of conditions identified in configuration management, security training, plans of action and milestones, identity and access management, continuous monitoring management, contingency planning, and contractor systems/financial audit.

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[40] Pub. L. No. 104-208, 110 Stat. 3009, (codified in a note to 31 U.S.C. § 3512).
[41] *Measurable Progress Has Been Made in Addressing Federal Financial Management Improvement Act Noncompliance; However, Significant Challenges Remain* (Reference Number 2010-10-065, dated June 4, 2010).
[42] IRS Pub. 3744, *IRS Strategic Plan 2009-2013* (April 2009) page 9.
[43] Pub. L. No. 107-347, 116 Stat. 2899 (2002), (codified as amended in 44 U.S.C. § 3541–3549).

The Implementation of Health Care Poses Multiple Challenges for the IRS

At least 42 of the 514 *Patient Protection and Affordable Care Act of 2010* (Affordable Care Act)[44] provisions add to or amend the Internal Revenue Code, and at least eight require the IRS to establish new operations. Taken together, these provisions represent the largest set of tax law changes in 20 years. The Affordable Care Act contains $438 billion worth of revenue provisions in the form of new taxes and fees. It also contains credits, which provide incentives for medical research and for businesses to offer employees health care insurance. Additionally, new reporting requirements have been established for certain business transactions. The Affordable Care Act further imposes penalties administered through the tax code for individuals and businesses that do not obtain health coverage for themselves or their employees. Other provisions raise revenue to help pay for the overall cost of health insurance reform.

Certain aspects of implementing health care reform are of concern for the security risks they may pose to IRS employees and infrastructure. Historically, implementation of a new Government program increases the risk of new avenues for fraud, waste, and abuse. The number and type of risks are typically proportional to the size and complexity of the program. Due to the size and nature of the program, the potential for new types of fraud is present with health care reform.

To address these risks, TIGTA has developed an oversight strategy to evaluate the IRS's planning and implementation of the Affordable Care Act provisions. Some provisions required immediate implementation. We have initiated reviews of the implementation of the Small Business Health Care Tax Credit as well as the Qualifying Therapeutic Discovery Project. Our reviews of the IRS's overall implementation plans will include new and expanded operations and information systems, as well as the IRS's development of the forms, publications, and outreach necessary to implement provisions as they become effective. While many of the provisions do not take effect for some time, the IRS's efforts to implement these provisions must start well in advance.

Risks Continue with Modernization Efforts

BSM is a complex and costly effort to modernize IRS technology and related business processes. It involves integrating thousands of hardware and software components while replacing outdated technology and maintaining the current tax system. The IRS originally estimated that the BSM effort would last up to 15 years and

[44] *Patient Protection and Affordable Care Act* (Pub. L. No. 111-148, 124 Stat. 119 (2010), (as amended by the *Health Care and Education Reconciliation Act of 2010* (Pub. L. No. 111-152, 124 Stat. 1029)).

incur contractor costs of approximately $8 billion. However, due to receiving less funding than initially anticipated and having difficulties in managing contractor work, the IRS has not completed as many modernization projects as planned.

In 1995, after encountering numerous problems, the IRS declared the modernization efforts as a material weakness under the *Federal Managers' Financial Integrity Act* (FMFIA)[45] and established a control system to manage the necessary improvement processes. In 1997, the IRS established BSM and began improving the controls and processes used to direct and manage current modernization activities. The current BSM has received $3.24 billion for contractor services, plus an additional $474 million for internal IRS costs. Since that time, BSM has established a comprehensive process to address management controls in 15 key areas. This includes identifying gaps and weaknesses, establishing corrective actions, monitoring progress, and identifying continuous improvement opportunities.

BSM is intended to address the Congress's interest in improving taxpayer service, including issuing faster refunds; offering expanded electronic filing capability; delivering web-based services for tax practitioners, taxpayers, and IRS employees; and providing IRS employees with faster and improved access to taxpayer account data.

However, the IRS is at a critical junction in its BSM efforts with respect to the demands for achieving success and has refocused BSM to deliver the modernized systems sooner. Based on our annual assessments, TIGTA has formulated four primary challenges the IRS must overcome to be successful:

- Implementing planned improvements in key management processes and committing necessary resources to enable success;
- Managing the increasing complexity and risks of BSM;
- Maintaining the continuity of strategic direction with experienced leadership; and
- Ensuring effective management of contractor performance and accountability.

While the IRS has made recent progress, we believe that these four challenges still need to be met to achieve program success. I am encouraged by the actions the IRS has planned and taken to refocus BSM; however, we believe the IRS should consider the overall BSM efforts a material weakness at this time.

[45] 31 U.S.C. §§ 1105, 1113, 3512 (2006).

Tax Gap Challenges Continue

Another serious challenge confronting the IRS is the Tax Gap, which, as I noted earlier, is defined as the difference between the estimated amount taxpayers owed and the amount they voluntarily and timely paid for a tax year. Despite an estimated voluntary compliance rate of 84 percent and IRS enforcement efforts, a significant amount of income remains unreported and unpaid. The IRS estimated the gross Tax Gap for Tax Year 2001 – the most current figures to date – to be approximately $345 billion. The IRS also faces significant challenges in obtaining complete and timely compliance data and in developing methods necessary to interpret the data. Even with improved data collection, the IRS needs broader strategies and more research to determine what actions are most effective in addressing taxpayer noncompliance. The IRS's strategy for reducing the Tax Gap is largely dependent on funding for additional compliance resources as well as legislative changes.

TIGTA continues to assess the IRS's efforts to address the Tax Gap. Underreporting of taxes, which is comprised of four major components (individual income tax, employment tax, corporate income tax, and estate and excise taxes), is estimated at $285 billion and accounts for the largest portion of the Tax Gap. Overall, the underreporting of individual income tax and employment tax constitutes more than 70 percent of the gross Tax Gap. The misclassification of millions of employees as independent contractors is a nationwide problem that continues to grow and contribute to the Tax Gap. In a report issued in Fiscal Year 2010,[46] we determined that the IRS has opportunities to enhance compliance in its Employment Tax Program by: 1) taking measures to ensure employment tax forms are not misused to avoid paying taxes, and 2) regularly sharing the results of worker classification examinations between IRS compliance functions to ensure the greatest possible use of the agency's resources when addressing the underreporting Tax Gap. Our audit identified more than 74,000 taxpayers who may have avoided paying approximately $26 million in Social Security and Medicare taxes in Processing Year 2008.

Individual Retirement Accounts (IRA) are a key tax-preferred way for individuals to save for retirement and are an important way for individuals to roll over savings from pension plans. TIGTA's review of Tax Years 2006 and 2007 IRA information showed that individual noncompliance with IRA contribution limits and minimum distribution requirements continued to grow since the previous review. TIGTA identified potential revenue losses associated with:

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[46] *Employment Tax Compliance Could Be Improved With Better Coordination and Information Sharing* (Reference Number 2010-30-025, dated March 23, 2010).

- 295,141 individuals improperly making excess contributions totaling $812 million for Tax Year 2006 and $757 million for Tax Year 2007. Estimated tax revenue losses are $94.2 million in excise tax[47] and $17.6 million in income tax[48] for these two tax years.
- 255,498 individuals not taking required minimum distributions totaling $348 million for Tax Years 2006 and 2007. The estimated tax revenue loss is $174 million in excise tax for these two tax years.[49]

TIGTA recommended that the IRS develop a service-wide strategy to address retirement provision noncompliance. IRS management agreed that a service-wide strategy is warranted. Senior IRS officials agreed to share responsibility for the development of this long-term strategy. This strategy will not only address compliance, but will also include plans for outreach and guidance for individual taxpayers and employee plan organizations.[50]

Estimates by the IRS show that the underreporting of income by sole proprietors constituted $68 billion of the $345 billion Tax Gap in 2001. TIGTA evaluated closed correspondence audits of individual returns reporting sole-proprietor operations and found that significant tax issues were not addressed during these audits.[51] Sole proprietors who underreport their income can create an unfair burden on honest taxpayers and diminish the public's respect for the tax system.

TIGTA recommended that the IRS require examiners to conduct and document verification in the audit case files for unfiled employment tax and information returns and the results of automated preliminary cash transactions analyses, including consideration given to transferring the audit to the field if issues are identified. In addition, TIGTA recommended that controls be expanded to ensure that examiners are properly performing checks for unfiled employment tax and information returns and are conducting preliminary cash transaction analyses so that corrective actions can be identified and taken, if needed. By taking these actions, the IRS could increase potential tax and interest assessments by $82.6 million over five years.

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[47] Generally, if the excess contribution for the year is not withdrawn by the due date of the tax return (including extensions), there is a 6 percent excise tax on the amount of excess contributions.
[48] This estimate is based on income from unreported interest on excess contributions to IRAs.
[49] Any portion of the required minimum distribution not taken by the individuals by the end of the year may be subject to a 50 percent excise tax.
[50] *A Service-wide Strategy Is Needed to Address Growing Noncompliance With Individual Retirement Account Contribution and Distribution Requirements* (Reference Number 2010-40-043, dated March 29, 2010).
[51] *Significant Tax Issues Are Often Not Addressed During Correspondence Audits of Sole Proprietors* (Reference Number 2010-30-024, dated February 24, 2010).

IRS management partially agreed with the recommendations by responding with alternate corrective actions. TIGTA agreed that the IRS's alternate corrective actions may help reduce the number of significant tax issues that are not addressed during correspondence audits of sole proprietors. However, the absence of a specific commitment from the IRS requiring that examiners conduct a preliminary cash transaction analysis during sole-proprietor audits is a concern. A preliminary cash transaction analysis can identify considerable differences between expenditures and income. These differences raise very serious questions about whether expenses may be overstated on the return and whether there may be additional sources of income that should have been reported.

Efforts to increase voluntary taxpayer compliance and reduce the Tax Gap continue to be the focus of many of the IRS's tax compliance initiatives. Those initiatives include the administration of tax regulations, the collection of the correct amount of tax from businesses and individuals, and the oversight of tax-exempt and government entities. One of the highest priorities, as identified by the IRS, is combating tax avoidance transactions.[52] There are tax returns with tax avoidance transaction issues that do not warrant examination before taxpayer contact, a process known as surveying. Surveying tax returns with a tax avoidance transaction issue without proper justification or approval could be counterproductive to the IRS's goal to combat abusive schemes. In addition, this approach can erode the public's confidence in the IRS's ability to enforce tax laws in an equitable and consistent manner. As a result, TIGTA recommended that the IRS:

- Develop internal controls and train employees to ensure that justification is in the case files to survey tax returns with a tax avoidance transaction issue;
- Have an independent function review the tax return for concurrence with the group manager's decision;
- Ensure that tax returns with tax avoidance transaction issues (surveyed as excess inventory) can be readily identified, and examinations are completed once taxpayers are contacted; and
- Develop procedures to ensure surveyed tax returns are included as part of the quality review process.

IRS management disagreed with the two recommendations related to strengthening existing controls and developing procedures to include surveyed tax returns as part of the quality review process. TIGTA continues to believe that the

[52] A tax avoidance transaction is generally a specific tax transaction or promotion that reduces tax liability by taking a tax position that is not supported by tax law. These strategies may be organized and marketed, often through the Internet. The definition is not merely limited to activities that improperly reduce tax, but may also include transactions that conceal assets and income.

breakdown in controls for the approval process indicates that tax returns surveyed without documentation may have yielded additional revenue for the Federal treasury..

The IRS also continues to face challenges in administering programs focused on ensuring that tax-exempt organizations comply with applicable laws and regulations to qualify for tax-exempt status. Because more than $15 trillion in assets are currently controlled by tax-exempt organizations or held in tax-exempt retirement programs and financial instruments, the IRS recognized in its most recent strategic plan that careful oversight of the non-profit and tax-exempt sector is more important than ever before.[53] The IRS also reemphasized the importance of maintaining a strong enforcement presence in the tax-exempt sector to ensure that charitable organizations are compliant with the Internal Revenue Code and not used for non-charitable or illegal purposes.

TIGTA also has a strong oversight presence in the tax-exempt area. For example, in a report issued in February 2010,[54] we determined that while the IRS has taken significant actions in response to our prior report to identify noncompliant Section 527 political organizations,[55] the IRS has not fully addressed noncompliance in this area. One out of every four Forms 8872 (*Political Organization Report of Contributions and Expenditures)* that we reviewed had incomplete or missing contributor or recipient information, although some of the filings may later be deemed acceptable. TIGTA recommended that the IRS: 1) conduct periodic reviews to determine whether political organizations are submitting complete filings; 2) develop procedures for reviewing responses and following up on nonresponses to notices, including assessing additional tax or penalties as appropriate; 3) correct untimely and missing notices; and 4) revise forms and instructions to improve compliance. The IRS agreed with our recommendations. In another example, we reported in Fiscal Years 2003 and 2005 that the Tax Exempt and Government Entities Division's approach to addressing fraud in the tax-exempt sector was disjointed and needed improvement. The IRS took corrective action to improve its fraud program and, in Fiscal Year 2009, we determined the number of fraud cases in the tax-exempt sector referred for criminal development had quadrupled. In addition, the IRS held individuals committing fraud through tax-exempt entities accountable by making approximately $10 million in tax, fraud penalty, and other assessments, with the potential to assess another $37 million.[56]

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[53] IRS Pub. 3744, *IRS Strategic Plan 2009-2013* (April 2009) page 23.
[54] *Improvements Have Been Made, but Additional Actions Could Ensure That Section 527 Political Organizations More Fully Disclose Financial Information* (Reference Number 2010-10-018, dated February 4, 2010).
[55] Political organizations include political parties; campaign committees for candidates for Federal, State, or local office; and political action committees. 26 U.S.C. § 527 (2006).
[56] *A Corporate Approach Is Needed to Provide for a More Effective Tax-Exempt Fraud Program* (Reference Number 2009-10-096, dated July 6, 2009).

The IRS Needs to Monitor Paid Tax Return Preparers to Improve Compliance

An increasing number of taxpayers are turning to tax return preparers for assistance. In Calendar Year 2009, the IRS processed approximately 83.1 million individual Federal income tax returns prepared by paid preparers. However, these preparers were not required to meet or comply with any national standards before selling tax preparation services to the public. A series of reports we issued strongly suggested the need to regulate those who prepare Federal tax returns. These reports led the IRS to launch its Return Preparer Review in June 2009. The following December, after its own six-month study of the problem, the IRS announced a slate of proposed reforms to improve oversight of the return preparer community. The reforms proposed by the IRS include the development of requirements for registration, competency testing, continuing professional education, ethical standards, and enforcement. The new preparer requirements will take several years to implement and will be phased in through Calendar Year 2014, at which time all preparers will be subjected to suitability and competency tests. In the meantime, the IRS plans to develop and implement a management information system to gather data on preparers and establish a database to assist taxpayers in identifying qualified preparers. Further, the IRS is planning to ensure that taxpayers understand the new requirements and the importance of using only registered preparers to prepare their tax returns.

Immediately after announcing the Return Preparer Review, the IRS established a Return Preparer Implementation Project Office. The Project Office will support the IRS in implementing key Return Preparer Program functions for the 2011 Filing Season and lay the foundation for long-term Program institutionalization. The IRS held public hearings, proposed rules around the new preparer requirements, and finalized regulations requiring all paid preparers to register for a Preparer Tax Identification Number (PTIN) in order to file tax returns after January 1, 2011.[57] Preparers began registering for the Program in September 2010.

In September 2010, TIGTA completed the first review of its Return Preparer Strategy.[58] We reported that when the decision was made to register paid preparers in September 2010, the IRS had only begun to implement the Return Preparer Program and had not established all Program requirements. The IRS also had not established the organizational structure of the Return Preparer Program or determined how it would test to ensure all preparers met the requirements. The IRS also has not determined how it will enforce Program requirements and has not developed the system(s) and

[57] The Return Preparer Program requirements apply only to paid return preparers.
[58] *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (Reference Number 2010-40-127, dated September 30, 2010).

processes necessary to administer and oversee the Program. Because the IRS does not have the resources, systems, or processes in place to appropriately screen applicants and conduct suitability checks on preparers applying for PTINs in Calendar Year 2010, there will not be any assurance until Calendar Year 2014 that all paid preparers meet Program requirements.

TIGTA is monitoring preparers in the 2011 Filing Season to evaluate whether they are compliant with the new PTIN requirements, as well as the new e-File mandate that requires preparers who anticipate preparing 100 or more Federal individual or trust tax returns during the year to start using IRS e-File.

Globalization Provides Challenges for the IRS

A major shift in the tax administration environment has occurred since TIGTA stood up in 1999. Global business is rapidly expanding, and the IRS Commissioner has stated that combating offshore tax evasion is a priority. The Congress, the Department of the Treasury, and the IRS are concerned about the International Tax Gap – that is, whether U.S. and nonresident persons conducting cross-border transactions comply with U.S. tax laws. The IRS has not estimated the size of the International Tax Gap, but non-IRS estimates range from $40 billion to $123 billion[59] annually. While there might be overlap between the IRS Tax Gap estimate and the International Tax Gap estimate, it is doubtful that the $345 billion Tax Gap estimate includes the entire International Tax Gap. Recent legislative changes and Department of Justice and IRS activities are increasing awareness about international tax compliance.

Several recent actions illustrate the increased emphasis on international tax administration. First, the IRS developed a plan called the "Servicewide Approach to International Tax Administration." The plan is designed to improve voluntary compliance with international tax provisions and to reduce the Tax Gap attributable to cross-border transactions. Second, the IRS conducted a voluntary disclosure program to allow noncompliant taxpayers to self-report offshore accounts. The program resulted in about 14,700 voluntary disclosures. Third, the Fiscal Year 2011 IRS budget requested an additional $121 million for international tax compliance enhancements. Fourth, the Fiscal Year 2012 IRS budget requested an additional $73 million for international tax compliance enhancements. The IRS also has reorganized and increased the size of the Deputy Commissioner (International) within the Large Business & International Division. Successful strategic implementation requires aligning

[59] *A Combination of Legislative Actions and Increased IRS Capability and Capacity Are Required to Reduce the Multi-Billion Dollar U.S. International Tax Gap* (Reference Number 2009-IE-R001, dated January 27, 2009).

the strategy, structure, operational processes, performance measures, and human capital components.

Another factor that holds potential in addressing the International Tax Gap is recent legislation on foreign-tax reporting and disclosure of financial assets, which may require some taxpayers to file the *Report of Foreign Bank and Financial Accounts* (FBAR) form and the new foreign-financial-assets disclosure statement with their income tax return. These reporting requirements will potentially add to both taxpayer burden and the complexity of tax law changes. Specifically, U.S. citizens, residents, and domestic entities that have a financial interest in or signature or other authority over a foreign-financial account that exceeds $10,000 in the aggregate at any time during the calendar year are required to file the FBAR. New legislation will require individual taxpayers with an aggregate balance of more than $50,000 in foreign financial assets to file a disclosure statement with their income tax return. The IRS is working to address the impact that these legislative requirements have on U.S. citizens and residents.[60]

Like the IRS, TIGTA is also making a commitment to provide comprehensive oversight of IRS international programs and operations through the creation of a new international programs office. The oversight of international tax administration requires nimble, flexible, and proficient work teams that can provide both rapid responses and comprehensive oversight of all aspects of the IRS's international programs and operations. A final strategy and implementation plan are being developed, but our goal is to provide enhanced oversight of these programs.

TIGTA recently reported that taxpayers excluded $19.2 billion in foreign earned income on Tax Year 2008 tax returns.[61] Our review identified 23,334 tax returns with erroneous foreign earned income tax exclusions totaling $675 million, with an estimated revenue loss of $90 million. Over five years, TIGTA estimated erroneous claims could result in a total revenue loss of $450 million. Some of the recommendations that TIGTA provided were that the IRS:

- Review the tax returns of those individuals that TIGTA identified as incorrectly claiming the foreign earned income exclusion;
- Establish a unit to address taxpayers identified as erroneously claiming the foreign earned income exclusion;

[60] *New Legislation Could Affect Filers of the Report of Foreign Bank and Financial Accounts, but Potential Issues Are Being Addressed* (Reference No. 2010-30-125, dated September 29, 2010).
[61] *Improvements Are Needed to Reduce Erroneous Foreign Earned Income Exclusion Claims* (Reference Number 2010-40-091, dated August 16, 2010).

- Assess whether compliance project criteria can be used to identify erroneous claims during tax return processing; and
- Include programming to forward tax returns (both electronically filed and paper) for correction when individuals incorrectly compute their foreign earned income exclusion.

IRS management agreed with most of the recommendations, but they stated that substantial barriers prevented the implementation of certain recommendations at the time of the review. TIGTA is concerned that the lack of corrective actions will allow continued revenue loss.

Increasing International Threats Also Pose a Challenge

In addition to risks to the system associated with employee integrity and physical security, TIGTA has identified a risk to the IRS from crimes that are international in scope. The migration of Federal tax administration operations into the electronic environment increases internal and external vulnerabilities that can be exploited by criminals. The relative anonymity of the Internet has provided a virtual breeding ground for modern-day scams and schemes, which capitalize on IRS name recognition. In recent years, our Office of Investigations' Electronic Crimes and Intelligence Division has observed a steady increase in cybercentric fraud schemes which either target Federal tax administration directly, resulting in losses to the Department of the Treasury, or indirectly through schemes involving the impersonation of IRS employees to intimidate or entice victims into providing sensitive personal data, financial data, or in some cases, payments directly to the scammers.

Some of the most common countries of origin of these scams include Russia, China, Romania, Nigeria, and Jamaica. Although the specifics of these fraudulent schemes vary depending on the individuals or group behind them, broad categories include IRS phishing, fraudulent IRS e-File websites, stock scams, lottery scams, and *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding*, Form W-8BEN scams. The common thread in these scams, which makes them effective, is the repeated impersonation of the IRS. For instance, in IRS phishing scams, victims receive an e-mail indicating that the IRS has identified them for a refund or similar purpose. Victims are then asked to follow an included link which, if clicked, will take the victim to a fraudulent website that is often an electronic copy of the actual IRS.gov website frequently hosted on a compromised (hacked) web server. The victims will be prompted to provide a great deal of personal information, including items such as their Social Security Numbers, as well as financial data such as a credit card number or bank account information and associated security features such as passwords. This information is often bundled with similar information and then sold on the digital

underground in a method analogous to how a stolen vehicle is processed in a "chop shop." Since 2008, more than 10,400 IRS phishing sites have been identified. TIGTA and the IRS Office of Online Fraud Detection and Prevention (OFDP) work around the clock to contact Internet hosting providers and request the shutdown of illegal sites, which impersonate the IRS. These sites are normally taken off line within hours, however, may remain online for a period of days, depending upon the cooperation of the hosting provider, which in some cases, reside in countries with governments unwilling to assist. OFDP provides data to TIGTA regarding this criminal activity which, in concert with the U.S. Department of Justice, is evaluated for investigative potential and pursued accordingly. All 10,400 sites identified have been shut down.

Impersonations in lottery and stock scams involve demands for payments from the "IRS" for capital gains and often target elderly victims who have been identified by the scammers through commercial "sales lead" services. There have also been documented instances involving fraudulent websites that impersonate IRS authorized e-File services that are utilized by scammers to intercept and steal tax refunds.

Physical Security of Employees and Facilities Poses Major Challenges to the IRS

Physical violence, harassment, and intimidation of IRS employees pose some of the most significant challenges to the implementation of a fair and effective system of tax administration. Threats of violence directed at the IRS have increased at the same time that many individuals face financial challenges. The IRS is frequently a target for citizens' issues with taxation, authority, and government. From Fiscal Years 2008 to 2010, TIGTA's Office of Investigations has experienced a 37 percent increase in the number of threat and assault cases it has initiated – a total of 1,631 such cases in Fiscal Year 2010 alone. From October 1, 2010 through March 31, 2011, the number of initiated threat and assault investigations is 723. The number of investigations initiated in Fiscal Year 2011, compared to the previous fiscal years of 2008 and 2009, indicates that our threat and assault investigations are trending up.

The growing threat to the safety of the IRS workforce was demonstrated in February 2010 in Austin, Texas, when a pilot flew his plane into a building partially occupied by the IRS, resulting in the death of an IRS employee.[62] This attack illustrates the environment in which the IRS is operating. Subsequent to the Austin attack, TIGTA reviewed 251 complaints of threatening behavior wherein taxpayers made statements referencing or supporting the Austin incident. Threat-related work trended upwards for the remainder of the fiscal year. We are monitoring security measures that the IRS initiated after the Austin incident at the majority of its buildings nationwide. TIGTA will

[62] TIGTA March 2010 Semiannual Report to Congress, page 31.

continue to place a priority on our oversight of IRS employee safety and physical security.

The IRS Needs to Continuously Deliver Quality Taxpayer Service to Increase Tax Compliance

The Department of the Treasury and the IRS recognize that the delivery of effective taxpayer service has a significant impact on voluntary tax compliance. Answering taxpayers' questions to assist them to correctly prepare their returns reduces the need to send notices and correspondence when taxpayers make errors. Taxpayer service also reduces unintentional noncompliance and shrinks the need for future collection activity. The IRS continues to focus on the importance of improving service by emphasizing it as a main goal in its strategic plan. It is also seeking innovative ways to simplify or eliminate processes that unnecessarily burden taxpayers or Government resources.

Despite other options available to taxpayers, the telephone remains the number one choice for taxpayers to make contact with the IRS. One of the IRS's goals for Fiscal Year 2011 is to increase taxpayers' access to its toll-free telephone assistors, which the IRS calls its Level of Service.[63] Access to telephone assistors in the 2010 Filing Season was 75.3 percent. While the 2010 Level of Service was better than that for the 2009 Filing Season (which was 64 percent), it was lower than the 2007 and 2008 Filing Seasons.

The IRS has determined that the Fiscal Year 2011 $20.9 million budget initiative will increase the toll-free base program budget to the level needed to achieve a 75 percent Level of Service.

However, there has been no program increase since the IRS is currently operating under a continuing resolution. Thus, the 2011 Filing Season goal is 71 percent. The last time the IRS achieved a Level of Service of more than 80 percent was during the 2007 Filing Season, when the Level of Service was 83 percent.

As of March 5, 2011, approximately 39 million taxpayers contacted the IRS by calling the various Customer Account Services function toll-free telephone assistance lines.[64] IRS assistors have answered 8.4 million calls. The Level of Service is 71.7 percent, with taxpayers waiting approximately 11 minutes to speak to an assistor.

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[63] Level of Service is the IRS's primary measure of providing taxpayers with access to an assistor. It is the percentage of callers who wish to speak to an assistor and who are able to speak with one.
[64] The IRS refers to the suite of 26 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."

More taxpayers are abandoning calls, and the IRS is also blocking more calls than last year's filing season. A blocked call occurs either because 1) no line is available at the time the call arrives (*i.e.,* the taxpayer receives a busy signal), or 2) the system is programmed to block calls because the queue is beyond a pre-defined threshold (*i.e.*, the taxpayer receives a recorded announcement to call back at a later time).

Many taxpayers seeking assistance with their taxes choose to visit one of the IRS's 401 walk-in offices, called Taxpayer Assistance Centers. The IRS plans to assist more than 6.5 million taxpayers in Fiscal Year 2011. Between October 1, 2010, and February 26, 2011, the Taxpayer Assistance Centers served 2.3 million walk-in taxpayers, which includes 1.2 million walk-in taxpayers for the 2011 Filing Season.

As part of a 2011 Filing Season audit to assess the quality of customer service the IRS provides to taxpayers who seek assistance when filing their tax returns, TIGTA auditors posed as taxpayers and visited 26 Taxpayer Assistance Centers to ask tax law questions. During the visits, assistors answered 35 of 35 (100 percent) tax law questions accurately. However, auditors waited an average of 62 minutes before they received assistance. The wait times ranged from none to four hours. On five occasions, auditors who visited three different Taxpayer Assistance Centers were turned away or denied services and asked to return another day.

The Volunteer Program also plays an important role in achieving the IRS's goal of improving taxpayer service and facilitating participation in the tax system. TIGTA has been conducting audits of this Program since the 2004 Filing Season when auditors, posing as taxpayers, had 35 tax returns prepared with a zero percent accuracy rate. Subsequently, the IRS has taken numerous actions to increase the accuracy of tax returns prepared by volunteers, including the implementation of a quality assurance program that is producing positive results. In the 2010 Filing Season, of the 39 tax returns prepared for TIGTA auditors, 35 (90 percent) were prepared correctly. However, during the 2011 Filing Season, as of March 5, 2011, auditors have had 9 (60 percent) of 15 tax returns prepared correctly.[65] We will report our final results in August 2011.

As part of its Volunteer Program, the IRS awarded matching grants to 111 organizations for the 2009 Filing Season and 147 organizations for the 2010 Filing Season. However, the number of tax returns prepared by volunteers increased by only 1 percent (from 2.98 to 3.02 million) from the 2009 to the 2010 Filing Season. The number of tax returns prepared is only one measure with which the IRS plans to gauge

[65] *Improvements to the Volunteer Program Are Producing Positive Results, but Further Improvements Are Needed to the Quality Assurance Process* (Reference Number 2010-40-109, dated September 3, 2010).

the Volunteer Program. The second measure is whether the Program also meets its geographic and target populations. TIGTA conducted an audit of the Volunteer Program in 2009 and reported that the IRS established the 2009 Filing Season as the baseline for the Volunteer Program's performance goals.[66] We are conducting a follow-up audit this year to evaluate the IRS's success with the Volunteer Program.

Tax Law Changes Present Challenges to Filing Season Activities

Changes to the tax law have a major impact on how the IRS conducts its activities, how many resources are required, and how quickly the IRS can meet strategic goals. Problems with tax return processing can delay refunds, affect the accuracy of accounts, and generate incorrect notices. Along with the usual required updates, the *Housing and Economic Recovery Act of 2008*,[67] the *Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010*,[68] and the Affordable Care Act created additional challenges for the 2011 Filing Season.

During the 2011 Filing Season, the IRS expects to receive 141 million individual tax returns including 106 million (75 percent) electronically filed (e-Filed) tax returns. Due to legislation enacted in late 2010, individuals filing Forms 1040, *U.S. Individual Income Tax Return*, with Schedule A, *Itemized Deductions,* and those claiming certain deductions had to wait until February 14, 2011, to file their individual tax returns. The delay impacted both individuals who file via paper and e-File. The IRS reported that it held approximately 6.5 million e-File tax returns that were transmitted prior to February 14th (not including e-Filed tax returns that tax preparers were holding). In addition, as of February 11, 2011, the IRS had received and held for processing approximately 100,000 paper tax returns. The IRS has been able to efficiently process the paper and e-Filed tax returns that were held.

The IRS also has developed processes and procedures to assist individuals with the First-Time Homebuyer Credit (Homebuyer Credit) repayment requirements. Individuals who purchased a home between April 9 and December 31, 2008, and claimed the Homebuyer Credit are required to begin repaying their credit on their 2010 tax return. To assist these individuals, the IRS issued notices to 1.5 million individuals who must repay the credit over 15 years beginning in 2010. This notice will be sent to individuals each year until the Homebuyer Credit is fully repaid. The notice lists the amount of the credit the individuals received and the amount the individuals have to repay as additional tax.

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[66] *Internal Controls for the Volunteer Income Tax Assistance Grant Program Are in Place but Could Be Strengthened* (Reference Number 2009-40-125, dated August 19, 2009).
[67] Pub. L. No. 110-289, 122 Stat. 2654 (2008).
[68] Pub. L. No. 111-312, 124 Stat. 3296 (2010).

However, implementing some provisions included in new tax legislation is presenting challenges for the IRS. These challenges are resulting in payments of erroneous claims, and the inability to identify and prevent erroneous claims at the time tax returns are processed. Specifically, as of March 4, 2011, we identified:

- 54 individuals were allowed $331,557 in erroneous Homebuyer Credits based on an ineligible purchase date. These resulted from tax examiner errors;
- 51,185 individuals were allowed in excess of $34.4 million in erroneous Non-Business Energy Property Credits; and
- 166 (88 percent) of the 189 individuals who claimed the Qualified Plug-in Electric Drive Motor Vehicle Credit reported non-qualifying makes of vehicles. The amount erroneously claimed totals $498,688.

In addition, the IRS recognized that the changes to the Adoption Credit (which increased from $12,150 to $13,170 and is now refundable) could increase the risk for erroneous claims and developed a strategy in an attempt to address these risks. However, our analysis of the IRS's Adoption Credit processing controls identified that while the IRS requires individuals to attach documentation to their tax return in support of an adoption, it does not have math error authority to deny the Adoption Credit if the documentation is not provided. Without this authority, the IRS cannot deny the credit during processing of the tax return, but must instead deny the credit post-processing through the examination process, which is a much more costly and resource-intensive process.

On October 29, 2010, we alerted the IRS management and recommended that they work with the Department of the Treasury to make a request for such authority from the Congress. However, the IRS did not agree with this recommendation. As of March 4, 2011, the IRS had received returns from 9,859 individuals claiming over $124 million in Adoption Credits. Of the 9,859 Adoption Credit claims, 6,974 (71 percent) of the claims either had no required documentation attached to their tax return or the documentation was invalid or insufficient. According to IRS procedures, each of these claims will be sent to the Examination function for further review.

Finally, as of March 4, 2011, the IRS had identified 335,341 tax returns with $1.88 billion being claimed in fraudulent refunds and prevented the issuance of $1.82 billion (97 percent) of the fraudulent refunds being claimed. This represents a 181 percent increase in the number of tax returns identified for this same period during the

2010 Filing Season. Furthermore, in a prior TIGTA review[69] assessing the IRS fraudulent tax return screening process we reported that the majority of tax returns identified as being filed by prisoners are not sent to a tax examiner for screening to assess the potential that the tax return is fraudulent. As of March 4, 2011, the IRS had selected 63,501 tax returns filed by prisoners for screening. This represents an 88 percent increase in the number of prisoner tax returns identified for this same time period during the 2010 Filing Season that were sent to a tax examiner to assess fraud potential.[70]

OTHER RECENT TIGTA ACCOUNTABILITY OVERSIGHT

Recovery Act Oversight

The Recovery Act was enacted on February 17, 2009, and presents significant challenges to Federal agencies as they move to implement provisions quickly while attempting to minimize risk and meet higher standards for transparency and accountability. With its 56 tax provisions (20 related to individual taxpayers and 36 related to business taxpayers), the Recovery Act poses specific challenges to the IRS as the Nation's tax collector and administrator. These provisions will continue to challenge the IRS over multiple filing seasons. Since September 2009, TIGTA has issued 21 reports addressing various Recovery Act provisions. These reports have identified 41 recommendations to address identified fraud, waste, and abuse involving more than $189 million and affecting approximately 13.5 million taxpayers.

As part of our Recovery Act oversight, we addressed the IRS's administration of the Homebuyer Credit. The *Worker, Homeownership, and Business Assistance Act of 2009*[71] revised, extended, and expanded the Homebuyer Credit to a broader range of home purchases and added new documentation requirements. For example, long-time residents of the same main home may claim the Homebuyer Credit if they purchase new principal residences. New documentation requirements mean that taxpayers claiming the Homebuyer Credit may not file their tax returns electronically and must file paper tax returns. In Processing Years 2009 and 2010, the IRS reported issuing Homebuyer Credits of more than $12.3 billion and $13.7 billion, respectively.

We reported that three key controls were not in place before claims for the Homebuyer Credit were processed. Specifically:

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[69] *Expanded Access to Wage and Withholding Information Can Improve Identification of Fraudulent Tax Returns* (Reference Number 2010-40-129, dated September 30, 2010).
[70] *Interim Results of the 2011 Filing Season* (Reference Number 2011-40-032, dated March 31, 2011).
[71] Pub. L. No. 111-92, 123 Stat. 2984 (2009).

- Documentation was not required to substantiate claims for the Homebuyer Credit;
- Filters to identify erroneous claims for the Homebuyer Credit were not implemented until late into the filing season, and the filters were missing some components; and
- Information provided on Form 5405, *First-Time Homebuyer Credit and Repayment of the Credit*, was not entered into IRS computers from paper returns and date of purchase information from paper and electronic returns was not immediately utilized to verify eligibility for the Homebuyer Credit.[72]

IRS management initially stated that a requirement to supply documentation during the processing of returns would be burdensome for the taxpayers and the IRS. In addition, the IRS stated that it did not have math error authority to disallow the Homebuyer Credit during processing even if it did ask for documentation but none was provided. The IRS initially took no steps to obtain this math error authority. After the issuance of TIGTA's first interim report, the Congress passed legislation requiring documentation for the Homebuyer Credit and providing the IRS with math error authority to disallow the Credit if the documentation was not provided. In response to TIGTA's report, the IRS required taxpayers claiming the Credit after November 6, 2009, to attach a copy of their Form HUD-1, *U.S. Department of Housing and Urban Development Settlement Statement*, to support their claim. Because of the extensive requirements for programming and the late passage of the first bill containing the Homebuyer Credit, IRS management did not request or implement the transcription of the Form 5405.

Today we are releasing the results of the last phase of our review of the IRS's controls to identify erroneous claims for the Homebuyer Credit.[73] The report discusses additional erroneous claims for the Homebuyer Credit that were paid by the IRS. Overall, we estimate that more than $513 million in potentially erroneous claims were issued with no IRS scrutiny. Based on this and other TIGTA work, we believe the IRS should require taxpayers to provide documentation to support eligibility for all refundable tax credits. If such documentation is required, the IRS will also need math error authority to deny other refundable credits when supporting documentation is not provided.

The Recovery Act also includes provisions that encourage the purchase of motor vehicles that operate on clean renewable sources of energy. Individuals claimed more

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[72] *The Internal Revenue Service Faces Significant Challenges in Verifying Eligibility for the First-Time Homebuyer Credit* (Reference Number 2009-41-144, dated September 29, 2009).
[73] *Administration of the First-Time Homebuyer Credit Indicates a Need for Improved Controls Over Refundable Credits* (Reference Number 2011-41-035, dated March 31, 2011).

than $163.9 million in plug-in electric and alternative motor vehicle credits from January 1 through July 24, 2010. As of July 24, 2010, TIGTA identified 12,920 individuals who electronically filed their tax returns and erroneously claimed $33 million in plug-in electric and alternative motor vehicle credits. Further, 1,719 of the 12,920 individuals also erroneously reduced the amount of Alternative Minimum Tax owed by almost $5.3 million. The IRS took corrective actions to reduce erroneous claims when we brought process weaknesses to its attention. These actions have resulted in an estimated $3.1 million in revenue protected.[74]

Another significant provision of the Recovery Act is the Making Work Pay Credit, which applied to most taxpayers with earned income. The Making Work Pay Credit was advanced to taxpayers through their wages by a decrease in Federal income tax withholding. The Making Work Pay Credit was in effect for Tax Years 2009 and 2010 and was implemented through new income tax withholding tables issued by the IRS. We advised the IRS in a report issued in November 2009 that the reduced withholding associated with the Making Work Pay Credit would make some taxpayers vulnerable to under-withholding of taxes for Tax Years 2009 and 2010.[75] Taxpayers who were advanced more of the Making Work Pay Credit than they were entitled to owed taxes when filing their Tax Year 2009 returns and may again owe when filing their Tax Year 2010 tax returns.

The IRS initiated significant outreach to inform taxpayers about the Making Work Pay Credit and its potential effects. Despite these actions, TIGTA estimates that approximately 13.4 million taxpayers were or will be negatively affected by the Making Work Pay Credit when filing their returns for Tax Years 2009 and 2010. The changes to the withholding tables did not take the following situations into consideration: 1) dependents who receive wages; 2) single taxpayers with more than one job; 3) joint filers when both spouses work or either spouse has more than one job; 4) individuals who file a return with an ITIN; 5) taxpayers who receive pension payments; and 6) Social Security recipients who receive wages.

A survey of the taxpayers who may have been negatively affected by the reduced withholding associated with the Making Work Pay Credit indicated that most were not aware of the Credit or its effect on their taxes. Further, TIGTA estimates that approximately 108,000 taxpayers may have been assessed the Estimated Tax Penalty as a result of the Making Work Pay Credit and that an additional 1.02 million taxpayers may have had their Estimated Tax Penalty amount increased. TIGTA recommended

[74] Revenue protected results from proper denial of claims for refunds, including the prevention of erroneous refunds or efforts to defraud the tax system.
[75] *Millions of Taxpayers May Be Negatively Affected by the Reduced Withholding Associated With the Making Work Pay Credit* (Reference Number 2010-41-002, dated November 4, 2009).

that in the case of future credits implemented through changes in the withholding tables, the IRS consider including simplified withholding adjustment instructions on the IRS website for specific scenarios that could result in under-withholding. We also recommended the IRS identify those taxpayers who owed any Estimated Tax Penalty as a result of the Making Work Pay Credit and notify them of their right to have the portion of the Penalty related to the Credit abated. The IRS responded that it plans to continue outreach efforts but declined to contact taxpayers that owed any Penalty based on the Making Work Pay Credit. We are concerned about the IRS's response because we believe any portion of the Penalty associated with the Making Work Pay Credit should be identified and abated.

Troubled Asset Relief Program Oversight

As part of our broad-reaching oversight responsibilities, TIGTA reviewed the tax compliance of participants in the Troubled Asset Relief Program (TARP).[76] The TARP is a large expenditure of public funds that required participants to indicate in agreements with the Department of the Treasury that all material Federal taxes were paid. IRS records showed 130 of the 558 institutions included in this audit had unpaid taxes totaling $530.8 million when agreements were signed between the Department of the Treasury's Assistant Secretary for Financial Stability and the institutions' representatives. However, IRS records also showed that 97 percent of the unpaid taxes were resolved by December 2009.

It is important to recognize that when the agreements were signed, the Department of the Treasury was in the beginning stages of establishing the TARP. As a result, the focus on stabilizing the financial system may have taken priority over establishing the controls needed to identify unpaid taxes. At the time of our review, IRS officials were collaborating across functional areas and adapting traditional collection processes to accelerate the identification and resolution of unpaid taxes. It is equally important to add perspective on the amount of unpaid taxes. According to IRS records, the five publicly traded institutions that received the most TARP funds (of the institutions included in this audit) voluntarily paid $16 billion of corporate income and employment tax liabilities during the time their accounts contained $227 million of unpaid taxes. Records also showed that, as of their respective agreement execution dates, the accounts of those institutions contained nearly $17 billion of credits.

[76] *Most Unpaid Taxes of Participants in the Troubled Asset Relief Program Have Been Resolved* (Reference Number 2010-30-050, dated April 28, 2010).

TIGTA's Budget Request and Justification

The President's Fiscal Year 2012 budget request for TIGTA strikes a balance in addressing the critical needs of the Nation. Included in the request is an additional 29 Full-time Equivalents (FTE)[77] provided for the oversight of the IRS's implementation of the Affordable Care Act. This budget authority totals $5,600,000 that will see that the IRS implements the law effectively. It is important to note that no portion of this request will be used to support traditional "overhead" positions such as human capital, finance, or information and technology support. However, TIGTA's budget reduces existing programs by $3,474,000 below the President's Fiscal Year 2011 request. These cuts reflect the tough choices that the Nation's current economic situation demands. TIGTA is reviewing all of its functions and pledges to reduce only those programs that will have the smallest impact on its critical mission. The President's Fiscal Year 2012 budget request for TIGTA of $157,831,000 meets both the challenges of implementing robust oversight of the Affordable Care Act as well as the expectation that the Government do more with fewer resources.

Given the unique responsibilities TIGTA has among the Inspectors General, specifically protecting the integrity of tax administration, TIGTA's Fiscal Year 2012 budget request represents an increase of 1.5 percent above the Fiscal Year 2011 requested level. These requested resources will finance critical audit, investigative, and inspection and evaluation services, protecting the integrity of tax administration on behalf of the Nation's taxpayers. TIGTA's audit, investigative, and inspection and evaluation priorities include:

- Adapting to the IRS's continuously evolving operations and mitigating intensified risks associated with security, modernization, addressing the Tax Gap, and human capital challenges facing the IRS in domestic and international operations;
- Responding to domestic and foreign threats and attacks against IRS employees, property, and sensitive information;
- Improving the integrity of IRS operations by detecting and deterring fraud, waste, abuse, or misconduct by IRS employees;
- Conducting comprehensive audits, inspections, and evaluations that include recommendations for monetary benefits and enhancing the IRS's service to taxpayers;
- Informing the American people, the Congress, and the Secretary of the Treasury of problems and progress made to resolve them; and

[77] A measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.

- Overseeing the IRS's efforts to administer tax provisions of the Recovery Act and Affordable Care Act.

In Fiscal Year 2012, TIGTA faces the challenge of adapting its oversight activities to address increasingly complex and high-risk issues associated with IRS operations. This is particularly true in adapting to the renewed focus of the IRS to close the International Tax Gap. This effort will be in addition to TIGTA's continuing work, including assessing IRS tax compliance initiatives, evaluating the IRS's efforts to administer tax provisions in the Recovery Act and Affordable Care Act, detecting and investigating fraud and electronic crime, reviewing procurement activities, safeguarding taxpayer privacy, evaluating IRS human capital activities, and providing IRS program reviews requested by the Congress and other IRS stakeholders.

Since Fiscal Year 2001, TIGTA has achieved its performance and quality expectations by implementing several efficiency-enhancing and cost-saving measures. In addition, through incremental FTE losses and implementation of cost-cutting initiatives in non-labor expense categories, TIGTA has been able to finance annual pay and labor-related benefit increases (health care, pensions, and retirement) while also maintaining the FTE level necessary to meet performance and quality expectations. However, TIGTA's efficiency-enhancing and cost-cutting initiatives are largely exhausted. The impact of any budget reductions will fall almost exclusively on labor and would affect TIGTA's capability to provide comprehensive oversight of IRS operations.

Over the past 12 years, TIGTA's employee population has declined 14 percent. Authorized FTEs have declined from 1,000 in 1999 to a current level of 835. Compounding the steady loss of authorized FTEs is the ongoing retirement wave. Approximately 34 percent of all TIGTA employees will be eligible to retire by September 30, 2013. This is especially troubling since the responsibilities of TIGTA's auditors, investigators, information technology specialists, and systems specialists require unique skill sets.

The Department of the Treasury included a total Fiscal Year 2012 budget request for TIGTA in the amount of $157,831,000. This request includes $2,692,000 for training and $380,000 needed to support the Council of the Inspectors General on Integrity and Efficiency.

TIGTA also faces the challenge of meeting additional requests from the Congress and other IRS stakeholders in a timely and efficient manner. In recent years, TIGTA has reallocated resources to perform congressionally requested audits and to comply with new statutory provisions.

TIGTA's FY 2012 request proposes eliminating certain reviews conducted to comply with reporting requirements in the IRS Restructuring and Reform Act of 1998 (RRA 98). These statutory reviews yield little in the way of improving performance measures and are of relatively low value. TIGTA would prefer to redirect resources

applied to these reviews to conducting high-risk audits. TIGTA recommends legislative changes, supported by the Department of the Treasury, eliminating reporting requirements in the following areas:

- The requirement to report information regarding any administrative or civil actions related to Fair Tax Collection Practices violations in one of TIGTA's Semiannual Reports. This pertains to Internal Revenue Code § 7803 (d)(1)(G). In TIGTA's 2009 and 2010 audits,[78] we did not identify any Fair Tax Collection Practices that were substantiated. The IRS has taken action based on a prior TIGTA recommendation to more accurately code cases on the system it uses to track employee behavior that might warrant IRS management administrative actions.
- The requirement to review and certify annually that the IRS is complying with the requirements of 26 U.S.C. § 6103(e)(8) regarding information on joint filers. In TIGTA's 2009 and 2010 audits,[79] we found that IRS procedures provide employees with sufficient guidance for handling joint filer collection activity information requests. However, we cannot determine if the IRS is fully compliant because its management information systems do not separately record or monitor joint filer requests, and there is no legal requirement for the IRS to do so.
- The requirement to annually report on the IRS's compliance with Internal Revenue Code §§ 7521(b)(2) and (c) requiring IRS employees to stop a taxpayer interview whenever a taxpayer requests to consult with a representative and to obtain their immediate supervisor's approval to contact the taxpayer instead of the representative if the representative has unreasonably delayed the completion of an examination or investigation. In TIGTA's 2009 and 2010 audits,[80] we found that IRS procedures provide employees with sufficient guidance to follow in their day-to-day contacts with taxpayers and their representatives. We, however, continue to report on our inability to give an opinion on how well the IRS is complying with the legal restrictions on direct contract because of limitations in IRS's management information systems.
- The annual reporting requirement for the remaining RRA 98 provisions should be revised to a biennial reporting requirement.

A continued decline in personnel strength threatens TIGTA's overall ability to effectively fulfill its core mission. An inability to fill vacated positions with skilled

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[78] *Collection Employees Adhered to Fair Tax Collection Practices in Calendar Year 2008* (Reference Number 2009-10-101, dated July 23, 2009) and *Collection Employees Adhered to Fair Tax Collection Practices From January 2009 Through September 2009* (Reference Number 2010-10-037, dated March 17, 2010).

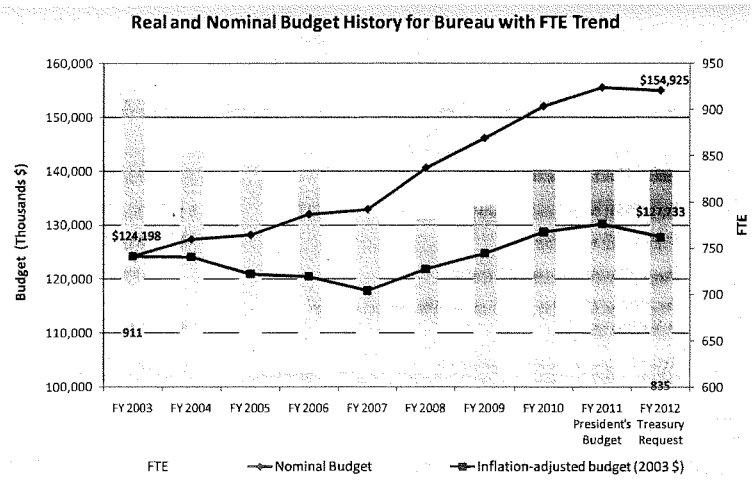
[79] *Fiscal Year 2009 Statutory Review of Disclosure of Collection Activity With Respect to Joint Filers* (Reference Number 2009-30-046, dated March 12, 2009) and *Fiscal Year 2010 Statutory Review of Disclosure of Collection Activity With Respect to Joint Filers* (Reference Number 2010-30-026, dated February 19, 2010).

[80] *Fiscal Year 2009 Statutory Review of Restrictions on Directly Contacting Taxpayers* (Reference Number 2009-30-054, dated March 24, 2009) and *Fiscal Year 2010 Statutory Review of Restrictions on Directly Contacting Taxpayers* (Reference Number 2010-30-060, dated June 3, 2010).

investigators will reduce TIGTA's enforcement capacity and limit its efforts to combat IRS employee misconduct as well as to investigate external threats to the security and integrity of IRS personnel and infrastructure. Anticipated increased attrition rates will further reduce opportunities to devote resources to high-risk areas and thereby may shrink financial benefits derived from audit recommendations and lessen TIGTA's ability to identify cost savings and protect the integrity of the Federal revenue stream.

TIGTA's Fiscal Year 2011 budget request of $155,452,000 represented an increase of 2.3 percent above the Fiscal Year 2010 enacted level. The Department of the Treasury included in TIGTA's Fiscal Year 2011 budget request $2,572,000 for training and $332,000 needed to support the Council of the Inspectors General on Integrity and Efficiency.

Overall, TIGTA has been very successful in generating financial benefits and making critical recommendations to the IRS that greatly improve its revenue collection efforts. For example, during Fiscal Year 2010, TIGTA achieved financial accomplishments of more than $11.69 billion, representing a return on investment of $74 for each dollar invested in TIGTA. Our financial accomplishments include cost savings, increased revenue, revenue protection, taxpayer rights and entitlements, inefficient use of resources, protection of dollars, and financial recoveries. Through these accomplishments, TIGTA has consistently provided a return on investment. In Fiscal Year 2008 and Fiscal Year 2009, our accomplishments yielded $14.68 billion, respectively. As our accomplishments show, the need for TIGTA's oversight has never been greater. The following chart shows that TIGTA has provided these successful results with funding that has remained relatively flat when adjusted for inflation.



We at TIGTA take seriously our mandate to provide independent oversight of the IRS, including efficient and effective operation of our Nation's tax system. I hope my discussion of some of the major challenges facing the IRS and how TIGTA assists the Congress in ensuring accountability over the IRS and its budget assists you with your oversight duties.

Chairwoman Emerson, Ranking Member Serrano, and Members of the Subcommittee, thank you for the opportunity to share my views.

Appendix I

Select TIGTA Accomplishments
Fiscal Year 1999 through Fiscal Year 2010

Accomplishment	Cumulative Totals
Investigative Recoveries (embezzlement/theft funds recovered, court ordered fines, penalties/restitution, out of court settlements)	$493,896,089
Increased Revenue/Revenue Protection	$137,130,618,734
Funds Put to Better Use	$31,941,695,000
Reports with Questioned Costs	$189,787,000
Reports with Additional Quantifiable Impact on Tax Administration	$53,151,217,000
Total Financial Accomplishments	$222,907,213,823

Number of Reports Issued	2,002
Number of Recommendations Made	2,724
Number of Recommendations Open as of 9/30/2010	142
Number of Corrective Actions Open as of 9/30/2010	151
Closed Investigations	46,792
Referrals to Department of Justice Accepted for Prosecution	3,192
Number of Convictions	3,071

Appendix II

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20005

INSPECTOR GENERAL
FOR TAX
ADMINISTRATION

October 15, 2010

MEMORANDUM FOR SECRETARY GEITHNER

FROM: J. Russell George
Inspector General

SUBJECT: Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2011

The *Reports Consolidation Act of 2000*[1] requires that the Treasury Inspector General for Tax Administration (TIGTA) summarize, for inclusion in the *Department of the Treasury Accountability Report for Fiscal Year 2010,* its perspective on the most serious management and performance challenges confronting the Internal Revenue Service (IRS). The issues described in this document are derived from a variety of activities conducted and reviewed by TIGTA. In addition to external factors, such as those that will be discussed that relate to recent attacks and threats to the IRS, each year TIGTA strategically evaluates IRS programs, activities, and functions to identify the areas of highest vulnerability to the Nation's tax system. For Fiscal Year 2011, the top 10 challenges in order of priority are:

1. Security;
2. Modernization;
3. Tax Compliance Initiatives;
4. Implementing Health Care and Other Tax Law Changes;
5. Providing Quality Taxpayer Service Operations;
6. Human Capital;
7. Erroneous and Improper Payments and Credits;
8. Globalization;
9. Taxpayer Protection and Rights; and
10. Leveraging Data to Improve Program Effectiveness and Reduce Costs.

While TIGTA's assessment of the major IRS management challenge areas for Fiscal Year 2011 has remained relatively unchanged from the prior fiscal year, one significant change did occur. Due to recent events at IRS facilities and the potentially expanding role of the IRS, Security has replaced Modernization as the top challenge facing the IRS. Notwithstanding this change, Modernization remains a major challenge for the IRS. For Fiscal Year 2011, we have also expanded the Implementing Tax Law

[1] 31 U.S.C. Section 3516(d).

Changes challenge to include the tax-related health care provisions of the *Patient Protection and Affordable Care Act*.[2]

Although not listed, complexity of the tax law remains a serious, underlying issue that has wide-ranging implications for both the IRS and taxpayers. This complexity, including frequent revisions to the Internal Revenue Code, makes it increasingly difficult for the IRS to explain and enforce the tax laws and more costly and time consuming for taxpayers who want to comply. As elected officials continue to effect broad policy changes using the Internal Revenue Code, the IRS will continue to face the challenge of responding quickly by shifting resources and altering established plans.

The following is a discussion of each of the most serious management and performance challenges facing the IRS during Fiscal Year 2011.

SECURITY

In addition to safeguarding a vast amount of sensitive financial and personal data, the IRS must also protect approximately 100,000 employees and more than 700 facilities throughout the country. Attacks and threats against IRS employees and facilities have risen steadily in recent years. The February 2010 attack on an IRS facility in Austin, Texas, is a stark reminder of the dangers that IRS employees face every day in trying to perform their jobs. Animosity towards the tax collection process is nothing new, but the Austin incident and other recent events point to a surge of hostility towards the Federal Government. According to the Anti-Defamation League, the militia movement has almost quadrupled in size in the past two years, growing to more than 200 groups across the country.[3] The Southern Poverty Law Center has reported that anti-government and hate groups have grown from 149 groups in 2008 to 512 groups in 2009, a 244 percent increase.[4] The ongoing public debate regarding the recently enacted health care legislation may also lead to increased threats against IRS employees and facilities, underscoring the need for continuing vigilance in the area of physical security.

As a result of these and other threats, the IRS is developing the Threat Information and Critical Incident Response Center (TIRC), which will be supported by TIGTA and other law enforcement agencies. The TIRC will encourage effective review and dissemination of threat information to IRS stakeholders in support of the critical employee-safety mission, an unprecedented effort to marshal resources and potentially lifesaving information in real time. The TIRC will also serve as a focal point for the timely and efficient sharing of threat information, including cyber- and Internet-based threats, to maximize the IRS's ability to engage in appropriate threat mitigation.

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[2] Pub. L. 111-148, 124 Stat. 119 (2010), as amended by the Health Care and Education Reconciliation Act of 2010 (Pub. L. 111-152, 124 Stat. 1029).
[3] Anti-Defamation League, *The Militia Movement in 2010: A Snapshot*, http://www.adl.org/main_Extremism/Hutaree_Militia_Facts.htm?Multi_page_sections=sHeading_2 (posted March 29, 2010).
[4] Mark Potok, *Rage on the Right: The Year in Hate and Extremism*, Southern Poverty Law Center Intelligence Report, Spring 2010.

Concurrent with the IRS's monitoring of threats against its employees and facilities, the IRS must also remain vigilant with regard to computer security, particularly as it relates to safeguarding the privacy of confidential taxpayer information. As computer usage continues to be inextricably integrated into core business processes, the need for effective information system security becomes essential to ensure the confidentiality, integrity, and availability of data. The IRS relies extensively on its computer systems to carry out the demanding responsibilities of administering the Nation's tax laws, including processing Federal tax returns and collecting Federal taxes. IRS computer systems process hundreds of millions of tax returns and contain confidential tax information for over 100 million taxpayers. From a security standpoint, the IRS is responsible for maintaining effective information security controls to protect confidential taxpayer information from inadvertent or deliberate misuse, improper disclosure, or destruction.

The IRS is specifically required by Federal law to keep taxpayer data confidential and prevent unauthorized disclosure or browsing of taxpayer records.[5] Each tax return contains Personally Identifiable Information, such as the filer's name, address, Social Security Number, and other personal information. Because of the volume and type of data it maintains, the IRS is an attractive target for criminals with the intent to commit identity theft by stealing and using someone's personal information for their own financial gain. In February 2010, the Federal Trade Commission reported that, for the 10th year in a row, identity theft was the number one consumer complaint nationwide.[6]

From a law enforcement perspective, the migration of Federal tax administration operations into the Internet and electronic environment increases internal and external vulnerabilities that can be exploited by criminals. For example, we have seen attacks on the integrity of the system launched from around the world, and we have also seen the amount of exposure and damage that can be done by a single individual employee whether intentional or accidental.[7] Hackers and foreign governments increasingly attempt sophisticated intrusions into computer networks. If an intrusion is successful, it could result in substantial economic disruption.

The *Federal Information Security Management Act* (FISMA)[8] requires each Federal Government agency to report annually to the Office of Management and Budget and to the Congress on the effectiveness of its security programs and to perform an annual independent evaluation of its information security program and practices. The IRS has made steady progress in complying with FISMA requirements since the law's enactment in 2002 and continues to place a high priority on efforts to improve its security program. However, the IRS still needs to take additional actions in the areas of certification and accreditation and configuration management to better secure its systems and data.

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[5] 26 U.S.C. Sections 6103, 7213, 7213A, 7431 (2006).

[6] *Consumer Sentinel Network Data Book for January – December 2009*, Federal Trade Commission, dated February 2010.

[7] Recently, in a case worked jointly with the IRS Criminal Investigation Division, individuals were arrested for their participation in an online international phishing scheme to steal income tax refunds intended for U.S. taxpayers. After taxpayers uploaded their tax information seeking refunds for Federal and State taxes, co-conspirators in Belarus collected the data and altered the returns so that legitimate tax refund payments would be redirected to U.S. bank accounts under their control.

[8] 107 Pub. L. 347, 116 Stat. 2899 (2002), codified as amended in 44 U.S.C. Sections 3541 – 3549.

Additionally, we have reported that the IRS prematurely closed the security roles and responsibilities component of its computer-security material weakness.[9] As a result, the IRS cannot ensure all IRS and contract employees will carry out their responsibilities to protect the confidentiality, integrity and availability of taxpayer data

MODERNIZATION

The Business Systems Modernization Program (Modernization Program or Program) is a complex effort to modernize IRS technology and related business processes. It involves integrating thousands of hardware and software components while replacing outdated technology and maintaining the current tax system. The IRS originally estimated that the Modernization Program would last up to 15 years and incur contractor costs of approximately $8 billion. The Program is now in its 12th year and has received approximately $3.24 billion for contractor services, plus an additional $474 million for internal IRS costs.[10] These amounts represent increases of approximately $540 million (20 percent) in contractor services and approximately $121 million (34 percent) in internal IRS costs from Fiscal Year 2009. The total amount for contractor services and for internal IRS costs increased by approximately $661 million (22 percent) from Fiscal Year 2009.

Factors that characterize the IRS's complex information technology environment include widely varying inputs from taxpayers (from simple concise records to complex voluminous documents), seasonal processing with extreme variations in processing loads, transaction rates on the order of billions per year, and data storage measured in trillions of bytes. The Modernization Program is working toward providing improved benefits to taxpayers that include:

- Issuing refunds, on average, five days faster than existing legacy systems;
- Offering electronic filing capability for large corporations and small businesses, tax-exempt organizations, and partnerships, with dramatically reduced processing error rates;
- Delivering web-based services for tax practitioners, taxpayers, and IRS employees; and
- Providing IRS customer service representatives with faster and improved access to taxpayer account data with real-time data entry, validation, and updates of taxpayer addresses.

The Modernization Program has continued to help improve IRS operations and is refocusing its efforts to improve business practices with new information technology solutions. However, project development activities have not always effectively implemented planned processes or delivered all planned system capabilities to achieve the Program's expectations. Management of the Program's cost and schedule has

[9] Treasury Inspector General for Tax Administration, Ref. No. 2010-20-084, *More Actions Are Needed to Correct the Security Roles and Responsibilities Portion of the Computer Security Material Weakness* (2010).
[10] Treasury Inspector General for Tax Administration, Ref. No. 2010-20-094, *Annual Assessment of the Business Systems Modernization Program* (2010).

improved since the previous year, but more attention must be paid to the development and management of Program requirements.

Further, resolution has not yet been completely achieved for security vulnerabilities affecting two significant systems. The IRS revised its Modernization Program and is currently testing a prototype[11] database concept for all taxpayer data. The new approach will require the IRS to increase its employees' information technology-related skills, tools, and operations to effectively deliver the revised program.

Since November 2001, TIGTA has reported nine assessments on annual accomplishments and activities of the Modernization Program. In developing the assessments, TIGTA formulated four primary challenges the IRS must overcome to be successful:

1. Implement planned improvements in key management processes and commit necessary resources to enable success;
2. Manage the increasing complexity and risks of the Program;
3. Maintain the continuity of strategic direction with experienced leadership; and
4. Ensure effective management of contractor performance and accountability.

Notwithstanding recent progress made by the IRS, TIGTA continues to take the position that these four challenges still need to be met to achieve program success. We are encouraged by the actions the IRS has planned and taken to refocus the Program; however, we believe the IRS should consider the overall Modernization Program a material weakness at this time.

TAX COMPLIANCE INITIATIVES

Another serious challenge confronting the IRS is tax compliance. Despite an estimated voluntary compliance rate of 84 percent and IRS enforcement efforts, a significant amount of income remains unreported and unpaid. Tax compliance initiatives include the administration of tax regulations, collection of the correct amount of tax from businesses and individuals, and the oversight of tax-exempt and government entities. Increasing voluntary taxpayer compliance and reducing the Tax Gap[12] continue to be the focus of many IRS initiatives. The IRS continues to face significant challenges in obtaining complete and timely compliance data, and in developing methods necessary to interpret the data. Even with improved data collection, however, the IRS needs broader strategies and more research to determine what actions are most effective in addressing taxpayer noncompliance. The IRS's strategy for reducing the Tax Gap is largely dependent on funding for additional compliance resources and legislative changes. In its Fiscal Year 2011 budget submission, the IRS has requested a 5.3 percent increase in enforcement funds over its Fiscal Year 2010 request.

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[11] This prototype is an approach to system development using an iterative process of discovering requirements, designing, and building a trial model, examining the results, and repeating the process until the desired solution is attained.

[12] The IRS defines the Tax Gap as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely paid for a tax year.

Businesses and Individuals

The IRS estimated the gross Tax Gap for Tax Year 2001 – the most current figures to date – to be approximately $345 billion. Underreporting of taxes, which is comprised of four major components (individual income tax, employment tax, corporate income tax and estate and excise taxes), is estimated at $285 billion and accounts for the largest portion of the Tax Gap. Overall, the underreporting of individual income tax and employment tax constitute over 70 percent of the gross Tax Gap. The misclassification of millions of employees as independent contractors is a nationwide problem that continues to grow and contribute to the Tax Gap. In a report issued in Fiscal Year 2010,[13] we determined that the IRS has opportunities to enhance compliance in its Employment Tax Program by 1) taking measures to ensure employment tax forms are not misused to avoid paying taxes, and 2) regularly sharing the results of worker classification examinations to ensure the greatest possible use of the agency's resources when addressing the underreporting Tax Gap. Our audit identified over 74,000 taxpayers who may have avoided paying approximately $26 million in Social Security and Medicare taxes.

Tax-Exempt Entities

The IRS continues to face challenges in administering programs focused on ensuring that tax-exempt organizations comply with applicable laws and regulations to qualify for tax-exempt status. Legislative changes and judicial decisions contribute to a constantly changing environment affecting today's non-profit or tax-exempt organizations. For example, the January 2010 Supreme Court decision *Citizens United v. Federal Election Commission*,[14] could lead to additional expenditures by those tax-exempt organizations that advocate the election or defeat of Federal candidates.

Since more than $15 trillion in United States assets are currently controlled by tax-exempt organizations or held in tax-exempt retirement programs and financial instruments, the IRS recognized in its most recent strategic plan that careful oversight over the non-profit and tax-exempt sector is more important than ever before. In its Fiscal Year 2011 budget submission, the IRS reemphasized the importance of maintaining a strong enforcement presence in the tax-exempt sector to ensure that charitable organizations are compliant with the Internal Revenue Code and not used for non-charitable or illegal purposes.

In a report issued in Fiscal Year 2010,[15] we determined that the IRS has taken significant actions to identify Section 527 political organizations[16] that do not timely notify the IRS of their existence or timely submit reports of their contributions and

[13] Treasury Inspector General for Tax Administration, Ref. No. 2010-30-025, *Employment Tax Compliance Could Be Improved With Better Coordination and Information Sharing* (2010).
[14] 130 S.Ct. 876 (2010).
[15] Treasury Inspector General for Tax Administration, Ref. No. 2010-10-018, *Improvements Have Been Made, but Additional Actions Could Ensure That Section 527 Political Organizations More Fully Disclose Financial Information* (2010).
[16] Political organizations include political parties; campaign committees for candidates for Federal, State, or local office; and political action committees. 26 U.S.C. Section 527 (2006).

expenditures. However, the IRS has not fully addressed noncompliance among political organizations. For example, one out of every four Political Organization Report of Contributions and Expenditures (IRS Form 8872) that we reviewed had incomplete or missing contributor or recipient information. While some of these filings may later be deemed acceptable, we determined the IRS is not reviewing these filings to determine if they are complete or if penalties should be assessed.

Also, the IRS is not always timely issuing notices that include all information needed by political organizations to become compliant. Lastly, the IRS is not following up on information it has requested from political organizations to verify compliance.

Tax Return Preparers

An increasing number of taxpayers are turning to tax return preparers for assistance. In Calendar Year 2009, the IRS processed approximately 83.1 million individual Federal income tax returns prepared by paid preparers. However, these preparers were not required to meet or comply with any national standards before selling tax preparation services to the public.

A series of reports strongly suggesting a need to regulate those who prepare Federal tax returns, including reviews conducted by TIGTA, the Government Accountability Office and other agencies, led the IRS to launch its Return Preparer Review in June 2009. The following December, after its own six-month study of the problem, the IRS announced a suite of proposed reforms to improve oversight of the return preparer community. The reforms proposed by the IRS include the development of requirements for registration, competency testing, continuing professional education, ethical standards, and enforcement. The new preparer requirements will take several years to implement, and will be phased in through Calendar Year 2014, at which time all preparers will be subjected to suitability and competency tests. In the meantime, the IRS plans to develop and implement a management information system to gather data on preparers and establish a database to assist taxpayers in identifying qualified preparers. Further, the IRS is planning to ensure that taxpayers understand the new requirements and the importance of using only registered preparers to prepare their tax returns.[17]

IMPLEMENTING HEALTH CARE AND OTHER TAX LAW CHANGES

Each filing season tests the IRS's ability to implement tax law changes made by the Congress. Most individual taxpayers file their income tax returns during this annual January through April period and contact the IRS with questions about specific tax laws or filing procedures. Correctly implementing late tax law changes remains a significant challenge because the IRS must often act quickly to assess the changes and determine the necessary actions to ensure all legislated requirements are satisfied. In addition, the IRS must often create new or revise existing tax forms, instructions and publications; revise internal operating procedures; and reprogram major computer systems used for processing tax returns. For example, on November 6, 2009, the

[17] Treasury Inspector General for Tax Administration, Ref. No. 2010-40-127, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (2010).

Worker, Homeownership, and Business Assistance Act of 2009 (WHBAA)[18] was enacted. The WHBAA, among other things, extended the First-Time Homebuyer Credit to May 1, 2010. In order to implement this legislation for the 2010 Filing Season, the IRS organized an executive task group to oversee revisions to the Form 5405 (First-Time Homebuyer Credit), its related instructions, and the extensive computer programming changes necessary to process the tax returns claiming the credit. The IRS completed revisions and released the Form 5405 and Instructions on January 15, 2010. However, due to the extensive programming changes required to process tax returns claiming the credit, the IRS had to postpone processing these returns until February 15, 2010. Refunds for these returns were subsequently delayed until mid-March 2010.

The Congress frequently changes the tax laws, so some level of change has become a normal part of the IRS's operating environment. Although the IRS has generally been able to adapt and react to tax law changes, the new laws do have a major effect on how the IRS conducts its activities, determines resource requirements, and progresses toward meeting its strategic goals. While the IRS has recognized the increasing complexity of tax administration in formulating its strategic plan, it has also acknowledged the impossibility of predicting with 100 percent accuracy the timing and extent of the impact of changes in the tax laws. As such, the IRS will continue to face significant challenges in its efforts to respond quickly, accurately, and effectively to tax law changes.

Health Care

The recently enacted health care reform legislation[19] contains an extensive array of tax law changes that will be a continuing source of challenge for the IRS in the coming years. While the Department of Health and Human Services will have the lead role in the policy provisions of the *Patient Protection and Affordable Care Act*, the IRS will administer the law's numerous tax provisions. The IRS estimates that at least 42 provisions will either add to or amend the tax code and at least eight will require the IRS to build new processes that do not exist within the current tax administration system. Examples of new IRS responsibilities resulting from this law include:

- Providing tax credits to businesses and individuals to assist in covering the cost of health coverage;
- Administering the mandate for individuals to purchase health coverage or be subject to a penalty on their individual Federal tax returns; and
- Administering multiple tax provisions designed to raise revenues to offset the cost of health care reform.

[18] *Worker, Homeownership, and Business Assistance Act of 2009*, Pub. L. No. 111-92, 123 Stat. 2984.
[19] *Patient Protection and Affordable Care Act*, Pub. L. 111-148, 124 Stat. 119 (2010), as amended by the *Health Care and Education Reconciliation Act of 2010*, Pub. L. 111-152, 124 Stat. 1029.

American Recovery and Reinvestment Act

The *American Recovery and Reinvestment Act of 2009* (Recovery Act)[20] was enacted on February 17, 2009. The Recovery Act presents significant challenges to all Federal agencies as they move to implement provisions quickly while attempting to minimize risk and meet increased standards for transparency and accountability. With its 56 tax provisions (20 related to individual taxpayers and 36 related to business taxpayers), the Recovery Act poses significant challenges to the IRS as the Nation's tax collection agency and administrator of the tax laws. These provisions will continue to challenge the IRS as it implements the required changes over multiple filing seasons.

TIGTA has issued numerous reports related to the IRS's efforts to implement Recovery Act tax provisions. Some examples include:

- In a review of the IRS's implementation of mandated Health Coverage Tax Credit provisions, we determined that the IRS executed the provisions appropriately, but some project management practices need improvement.[21]
- In a review of the IRS's controls surrounding the First-Time Homebuyer Credit, we determined that although the IRS had taken positive steps to strengthen controls, 1) weaknesses allowed fraudulent claims filed by prison inmates to be processed, 2) multiple claims for the same home were allowed, and 3) claims were allowed for homes purchased prior to the dates allowed by law.[22]
- In a review of the IRS's 2010 Filing Season, we identified inadequate controls and incomplete and inaccurate programming related to certain Recovery Act tax benefits. Although the IRS executed an aggressive outreach campaign to alleviate confusion and prevent errors with the First-Time Homebuyer and the Making Work Pay Credits, we identified over 120,000 taxpayers claiming nearly $100 million in erroneous credits.[23]
- In a review of the IRS's readiness to implement the planning, awarding and reporting of Recovery Act-funded procurements, we determined that although the IRS took proactive steps prior to the enactment of the Recovery Act, it still does not have the necessary controls in place to ensure future procurements will comply with Recovery Act requirements.[24]
- In a review of the IRS's controls to ensure that direct subsidies for Build America Bonds were accurate and timely and whether controls prevented disbursement of erroneous payments, we determined that, generally, all complete requests for

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[20] *American Recovery and Reinvestment Act of 2009* (Pub. L. No. 111-5, 123 Stat. 115).
[21] Treasury Inspector General for Tax Administration, Ref. No. 2010-21-057, *Recovery Act Provisions for the Health Coverage Tax Credit Were Implemented, but Development Processes Could Be Improved* (2010).
[22] Treasury Inspector General for Tax Administration, Ref. No. 2010-41-069, *Additional Steps Are Needed to Prevent and Recover Erroneous Claims for the First-Time Homebuyer Credit* (2010).
[23] Treasury Inspector General for Tax Administration, Ref. No. 2010-41-128, *Verifying Eligibility for Certain New Tax Benefits Was a Challenge for the 2010 Filing Season* (2010).
[24] Treasury Inspector General for Tax Administration, Ref. No. 2010-11-071, *Additional Actions Are Needed to Ensure Readiness to Comply With the American Recovery and Reinvestment Act of 2009 Procurement Requirements* (2010).

payment of the Build America Bond Federal subsidies were processed accurately, timely and without indications of fraudulent or erroneous disbursement.[25]

TIGTA continues to support the Recovery Accountability and Transparency Board (Recovery Board) in fulfilling its responsibilities for providing transparency for Recovery Act-related funds and for preventing and detecting fraud, waste and mismanagement. We also continue to evaluate the IRS's compliance with Recovery Act and Office of Management and Budget guidance. Additionally, we have evaluated multiple Recovery Board leads that contain allegations of misuse of Recovery Act funds.

Other Tax Law Changes

Implementing legislation for the 2010 Filing Season required the IRS to update many tax products and perform extensive programming in an effort to ensure that tax returns would be processed accurately. We identified 71 tax products (33 tax forms, 12 instructions, and 26 publications) requiring updates due to new legislation. Although tax law changes challenged the IRS during the 2010 Filing Season, the IRS still completed the processing of tax returns on schedule and issued taxpayer refunds within 45 calendar days of the April 15, 2010, due date. However, implementation of some new tax law provisions did cause problems resulting in increases in error inventories from taxpayer errors, payment of erroneous claims, and the inability to identify and prevent erroneous claims at the time tax returns were processed.[26]

PROVIDING QUALITY TAXPAYER SERVICE OPERATIONS

In July 2005, the Congress requested that the IRS develop a five-year plan, including an outline of how the IRS will improve the service it provides to taxpayers and a detailed list of which services the IRS should provide. The IRS developed the plan – the Taxpayer Assistance Blueprint – which focuses primarily on services that support the needs of taxpayers who file or should file the Form 1040 series tax returns.[27] The Blueprint includes performance measures, service improvement initiatives and an implementation strategy for improving future service investment decisions. The IRS has begun implementing the Blueprint, but much of its implementation depends on the availability of future funding.

The Department of the Treasury and the IRS recognize that the delivery of effective taxpayer service has a significant impact on voluntary tax compliance. Answering taxpayers' questions to assist them to correctly prepare their returns reduces the need to send notices and correspondence when taxpayers make errors. Taxpayer service

[25] Treasury Inspector General for Tax Administration, Ref. No. 2010-11-083, *Initial Build America Bond Subsidy Payments Were Processed Accurately and Timely* (2010).
[26] Treasury Inspector General for Tax Administration, Ref. No. 2010-41-128, *Verifying Eligibility for Certain New Tax Benefits Was a Challenge for the 2010 Filing Season* (2010).
[27] The Form 1040 series tax returns include any IRS tax forms that begin with "1040" such as the U.S. Individual Income Tax Return (Form 1040), U.S. Individual Income Tax Return (Form 1040-A), and Income Tax Return for Single and Joint Filers With No Dependents (Form 1040EZ).

also reduces unintentional noncompliance and shrinks the need for future collection activity. The IRS continues to focus on the importance of improving service by emphasizing it as a main goal in its strategic plan, including seeking innovative ways to simplify or eliminate processes that unnecessarily burden taxpayers or government resources.

HUMAN CAPITAL

Human capital is the Federal Government's most critical asset. At a time when the Federal Government is preparing for increased retirements and taking on such challenges as health care reform, the recruitment of new employees and retention of existing employees plays a key role in ensuring the maintenance of a quality workforce capable of meeting the needs of the American public. Like many Federal agencies, the IRS is faced with the major challenge of replacing existing talent because of a large number of retirements expected over the next several years. Of the approximately 100,000 employees, including 9,100 managers that the IRS employs, more than half have reached age 50 and can retire within 10 years. In addition, 39 percent of IRS executives are already eligible for retirement. Replacing these employees represents a significant challenge since many possess unique skills and institutional knowledge that will be difficult to replace.

The IRS has taken significant actions to improve its ability to recruit qualified candidates. These improvements have enabled the IRS to report that it is on target to meet its mission-critical occupational,[28] geographic and diversity hiring goals. However, improving recruiting activities will require long-term commitment and focus, as some improvements are still in process.

The IRS's challenge of having the right people in the right place at the right time is made more difficult by many complex internal and external factors. The work performed by IRS employees continually requires greater expertise as tax laws become more complex, manual systems used to support tax administration become computer-based, and attempts by taxpayers and tax practitioners to evade compliance with the tax laws become more sophisticated. The IRS must also compete with other government agencies and private industry for the same human resources, which becomes more complicated as younger generations of employees move between jobs more frequently than employees in the past. Furthermore, budget constraints, legislative changes and economic shifts can create unforeseen challenges for the IRS in addressing its long-term human capital issues.

ERRONEOUS AND IMPROPER PAYMENTS AND CREDITS

As defined by the *Improper Payments Information Act of 2002*,[29] an improper payment is any payment that should not have been made or that was made in an incorrect amount (including overpayments and underpayments) under statutory, contractual, administrative or other legally applicable requirements. Improper payments include any payment to an ineligible recipient, any payment for an ineligible service, any duplicate

[28] Mission-critical occupations are those positions critical to front-line enforcement and direct support to front-line operations needed to meet the stated IRS goals.
[29] Pub. L. No. 107-300, 116 Stat. 2350.

payment, payments for services not received and any payment that does not account for credit for applicable discounts. The Administration has emphasized the importance of reducing improper payments. In November 2009, the President issued Executive Order 13520, which included a strategy to reduce improper payments by increasing transparency, holding agencies accountable and creating strong incentives for compliance.[30] Recently, the *Improper Payments Elimination and Recovery Act of 2010*[31] placed additional requirements on Federal agencies to reduce improper payments. Erroneous and improper payments involving the IRS generally involve improperly paid refunds, tax return filing fraud, or overpayments to vendors or contractors.

Refundable Credits

The IRS administers numerous refundable tax credits. These refundable credits allow individual taxpayers to reduce their tax liability below zero and, thus, receive a tax refund even if no income tax was withheld or paid. Two significant refundable credits are the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit. The Recovery Act also authorized several new refundable credits, examples of which include the First-Time Homebuyer Credit and the Making Work Pay Credit.

The EITC remains the main refundable credit and continues to be vulnerable to a high rate of noncompliance, including incorrect or erroneous claims caused by taxpayer error and resulting from fraud. Each year a substantial number of taxpayers claim the EITC. For example, in a population of 154 million Tax Year 2007 individual income tax returns, 24.5 million returns claimed $48.5 billion in Earned Income Tax Credits. Although numerous changes have been made to the EITC qualifications to reduce the amount of fraud associated with the claims, recent estimates indicate an EITC improper payment rate between 23 percent and 28 percent, or roughly $11 billion to $13 billion each year.[32]

In a recent review of the IRS's EITC Paid Preparer Strategy,[33] we determined that the IRS has made strides in its effort to increase EITC tax return preparer compliance. However, the IRS could further improve the effectiveness of identifying high-risk EITC tax return preparers by expanding risk factors and using the computed probability score. Although the IRS developed a process that appropriately weighs the significance of risk factors used to compute a probability

[30] Executive Order 13520, 74 Fed. Reg. 62201 (Nov. 25, 2009). TIGTA has an ongoing audit related to assessing the IRS's efforts to implement this Executive Order. We initiated this audit to comply with the requirement under the Executive Order to evaluate the IRS's methodology for quantifying, preventing and recovering Earned Income Tax Credit improper payments. This audit is included in our Fiscal Year 2011 Annual Audit Plan.
[31] Pub. L. No. 111-204, 124 Stat. 2224.
[32] http://www.paymentaccuracy.usaspending.gov/content/programs-not-reported (last visited October 14, 2010).
[33] Treasury Inspector General for Tax Administration, Ref. No. 2010-40-116, *Actions Can Be Taken to Improve the Identification of Tax Return Preparers Who Submit Improper Earned Income Tax Credit Claims* (2010).

score to identify potentially noncompliant tax return preparers, the score was not used exclusively when identifying and selecting preparers for a due diligence visit.[34]

Contract and Other Payments

Federal contract spending has more than doubled since 2002. In Fiscal Year 2008, the Federal Government spent approximately $540 billion to acquire goods and services. Similarly, contract spending by the IRS represents a significant outlay of funds. As of March 2010, the IRS administered more than 839 contracts with a value of approximately $48 billion over the life of the contracts. Numerous past TIGTA audits have identified millions of dollars in questioned costs and several instances of contractor fraud.

We recently analyzed TIGTA audit findings related to the IRS's acquisition process from audit reports that were issued from January 1999 through June 2009. We identified several findings that continued to exist throughout the 10-year period, and which, if not corrected, could affect the IRS's ability to effectively prevent erroneous and improper payments and credits. Among TIGTA's findings: 1) the IRS did not have sufficient monitoring controls or processes to ensure contractors were meeting the contract terms and conditions; 2) contractors did not provide adequate documentation to support invoice charges; and, 3) invoices included unallowable labor and travel charges.[35]

GLOBALIZATION

The scope, complexity, and magnitude of the international financial system present significant enforcement challenges for the IRS. International business holdings and investment in the United States have grown from nearly $188 billion in 1976 to over $14.5 trillion in 2007, while U.S. business and investment grew from nearly $368 billion to nearly $15 trillion over the same period. As technology continues to advance and cross-border transactions rise, the IRS is increasingly challenged by economic globalization. Technological advances have provided opportunities for offshore investments that were once only possible for large corporations and wealthy individuals.

The number of taxpayers who conduct international business transactions – individuals, businesses and tax-exempt organizations – continues to grow. The IRS is challenged by a lack of information reporting on many cross-border transactions. In addition, the varying legal requirements imposed by different jurisdictions result in complex business structures that make it difficult to determine the full scope and effect of cross-border transactions.

Over the past few years, the Federal Government has taken actions to better coordinate international tax compliance issues. The IRS has developed a strategic plan specifically for international tax issues with two major goals: 1) enforce the law to ensure all taxpayers meet their obligation to pay taxes and 2) improve service to make voluntary compliance less burdensome. The IRS has also worked with the U.S. Department of

[34] A due diligence visit is an examination to determine whether a paid preparer is in compliance with all four due diligence requirements. 26 U.S.C. Section 6695.
[35] Treasury Inspector General for Tax Administration, Ref. No. 2010-10-088, *Procurement Audit Results Indicate Problems Continue to Exist After Corrective Actions Were Implemented* (2010).

Justice on tax evasion cases that involve foreign countries with bank secrecy laws that prevent the U.S. from obtaining information on taxpayer transactions. Additionally, the President's Fiscal Year 2010 budget contained several proposals to change offshore tax strategies.[36] The proposals targeted both businesses and individuals with a particular emphasis on increasing transparency. This year, the IRS announced that it would realign and rename its Large and Mid-Size Business division to create a more centralized organization dedicated to improving international tax compliance. The IRS expects that the realigned division, now referred to as the Large Business and International division, will improve international tax compliance by allowing the IRS to focus on high-risk issues and cases with greater consistency and efficiency.

As capital markets become increasingly global, U.S. investors may be able to benefit from a corresponding increase in international investment opportunities. In this environment, the Securities and Exchange Commission (SEC) believes that U.S. investors would benefit from an enhanced ability to compare financial information of U.S. companies with that of non-U.S. companies. The SEC believes the International Financial Reporting Standards (IFRS)[37] have the potential to best provide the common platform on which companies can report and investors can compare financial information. In November 2008, the SEC proposed a "Roadmap" that would potentially require U.S. domestic issuers of annual reports to the SEC to use the IFRS. The "Roadmap" sets forth several milestones that, if reached, could lead to the mandatory use of the IFRS by U.S. issuers in their filings with the SEC in Calendar Year 2015 at the earliest. In Fiscal Year 2010, we assessed the IRS's progress in preparing for the tax issues and implications of potentially converting from United States Generally Accepted Accounting Principles to the IFRS. Our report noted the IRS's progress in this area.[38]

In another recent audit related to globalization, we reviewed the processing of U.S. Nonresident Alien Income Tax Returns (Form 1040NR) to determine whether controls were in place to ensure that taxpayers receiving refunds are entitled to those refunds. Our audit revealed significant control weaknesses in the processing of refunds claimed on Forms 1040NR. If the IRS does not take immediate steps to address these control weaknesses, the problem could increase significantly. We also found a lack of consistency by the IRS when applying tax treaty provisions regarding the taxability of gambling income and a need for clarification regarding the designation of certain income earned through U.S.-based, multi-level marketing companies as "U.S. Source Income."[39]

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[36] *General Explanations of the Administration's 2010 Budget Proposal.* Department of the Treasury (Issued May 2009).

[37] The IFRS, issued by the International Accounting Standards Board, are a set of accounting standards that serve as a framework for financial reporting. The IFRS are rapidly gaining worldwide acceptance and are now used for public reporting purposes in more than 100 countries.

[38] Treasury Inspector General for Tax Administration, Ref. No. 2010-30-112, *Actions Are Being Taken to Address the Impact That International Financial Reporting Standards Will Have on Tax Administration* (2010).

[39] Treasury Inspector General for Tax Administration, Ref. No. 2010-40-121, *Improvements Are Needed to Verify Refunds to Nonresident Aliens Before the Refunds Are Sent Out of the United States* (2010).

TAXPAYER PROTECTION AND RIGHTS

The IRS must ensure that tax compliance activities are balanced against the rights of taxpayers to receive fair and equitable treatment. The IRS continues to dedicate significant resources and attention to implementing the taxpayer rights provisions of the *IRS Restructuring and Reform Act of 1998* (RRA 98).[40] Annual audit reports are mandated for the following taxpayer rights provisions:

- Notice of Levy;
- Restrictions on the Use of Enforcement Statistics to Evaluate Employees;
- Fair Debt Collection Practices Act Violations;
- Notice of Lien;
- Seizures;
- Illegal Protestor Designations;
- Assessment Statute of Limitations;
- Restrictions on Directly Contacting Taxpayers Instead of Authorized Representatives; and
- Separated or Divorced Joint Filer Requests.

In general, the IRS has improved its compliance with these statutory taxpayer rights provisions. The IRS has shown improvement over prior years when documenting that taxpayers were informed of their rights. However, the IRS did not fully comply with requirements concerning the use of records of tax enforcement results to evaluate employees,[41] and did not always follow procedures for mailing notices to taxpayers or their representatives in Federal tax lien cases.[42]

Some IRS management information systems do not track cases that require mandatory annual audit coverage.[43] Thus, neither TIGTA nor the IRS could evaluate the IRS's compliance with certain RRA 98 provisions.

LEVERAGING DATA TO IMPROVE PROGRAM EFFECTIVENESS AND REDUCE COSTS

While the IRS has made progress in using its data to improve program effectiveness and reduce costs, this area continues to be a major challenge. The IRS lacks a comprehensive, integrated system that provides accurate, relevant and timely financial and operating data that can be used to evaluate performance measures, productivity and the associated costs of IRS programs. In addition, the IRS cannot produce timely,

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[40] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).
[41] Treasury Inspector General for Tax Administration, Ref. No. 2010-30-076, *Fiscal Year 2010 Statutory Audit of Compliance With Legal Guidelines Restricting the Use of Records of Tax Enforcement Results* (2010).
[42] Treasury Inspector General for Tax Administration, Ref. No. 2010-30-072, *Actions Are Needed to Protect Taxpayers' Rights During the Lien Due Process* (2010).
[43] Treasury Inspector General for Tax Administration, Ref. No. 2010-30-026, *Fiscal Year 2010 Statutory Review of Disclosure of Collection Activity With Respect to Joint Returns* (2010) and Treasury Inspector General for Tax Administration, Ref. No. 2010-30-060, *Fiscal Year 2010 Statutory Review of Restrictions on Directly Contacting Taxpayers* (2010).

accurate and useful information needed for day-to-day decisions, hindering its ability to address financial management and operational issues to fulfill its responsibilities.

TIGTA and GAO have continued to report that various IRS management information systems are insufficient to enable IRS management to measure costs, determine if performance goals have been achieved, or monitor progress in achieving program goals. In its most recent financial statement audit,[44] GAO reported that the IRS's financial management systems do not comply with *Federal Financial Management Improvement Act of 1996* (FFMIA)[45] requirements. In addition, GAO noted that the IRS continues to have material weaknesses in internal controls over information security and unpaid assessments.

While the IRS has made measurable progress in addressing the issues causing its noncompliance with the FFMIA, our review of the IRS's September 30, 2009, FFMIA remediation plan identified that the IRS continues to experience difficulties in developing resource estimates for remediation actions related to information security. In addition, the IRS informed us that it does not expect to become compliant with the FFMIA and address the material weakness relating to unpaid assessments until approximately November 2014.[46]

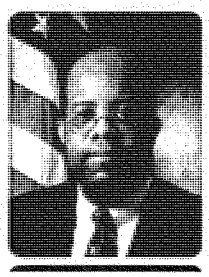
CONCLUSION

These are the 10 major management and performance challenges for the IRS in Fiscal Year 2011. TIGTA's *Fiscal Year 2011 Annual Audit Plan* and *Inspections and Evaluations Plan* contain our proposed reviews and are organized by these challenges. If you have questions or wish to discuss TIGTA's views on the challenges in greater detail, please contact me at (202) 622-6500.

cc: Deputy Secretary
Assistant Secretary for Management and Chief Financial Officer
Commissioner of Internal Revenue

[44] U.S. Government Accountability Office, GAO-10-176, *Financial Audit: IRS's Fiscal Years 2009 and 2008 Financial Statements* (2009).
[45] Pub. L. No. 104-208, 110 Stat. 3009.
[46] Treasury Inspector General for Tax Administration, Ref. No. 2010-10-065, *Measurable Progress Has Been Made in Addressing Federal Financial Management Improvement Act Noncompliance; However, Significant Challenges Remain* (2010).

J. Russell George
U.S. Department of the Treasury
Inspector General for Tax Administration



Meet the IG: J. Russell George

Following his nomination by President George W. Bush, the United States Senate confirmed J.Russell George in November 2004, as the Treasury Inspector General for Tax Administration. Prior to assuming this role, Mr. George served as the Inspector General of the Corporation for National and Community Service, having been nominated to that position by President Bush and confirmed by the Senate in 2002.

A native of New York City, where he attended public schools, including Brooklyn Technical High School, Mr. George received his Bachelor of Arts degree from Howard University in Washington, DC, and his Doctorate of Jurisprudence from Harvard University's School of Law in Cambridge, MA. After receiving his law degree, he returned to New York and served as a prosecutor in the Queens County District Attorney's Office.

Following his work as a prosecutor, Mr. George joined the Counsel's Office in the White House Office of Management and Budget where he was Assistant General Counsel. In that capacity, he provided legal guidance on issues concerning presidential and executive branch authority. He was next invited to join the White House Staff as the Associate Director for Policy in the Office of National Service. It was there that he implemented the legislation establishing the Commission for National and Community Service, the precursor to the Corporation for National and Community Service. He then returned to New York and practiced law at Kramer, Levin, Naftalis, Nessen, Kamin & Frankel.

In 1995, Mr. George returned to Washington and joined the staff of the Committee on Government Reform and Oversight and served as the Staff Director and Chief Counsel of the Government Management, Information and Technology subcommittee (later renamed the Subcommittee on Government Efficiency, Financial Management and Intergovernmental Relations), chaired by Representative Stephen Horn. There he directed a staff that conducted over 200 hearings on legislative and oversight issues pertaining to Federal Government management practices, including procurement policies, the disposition of government-controlled information, the performance of chief financial officers and inspectors general, and the Government's use of technology. He continued in that position until his appointment by President Bush in 2002.

Mrs. EMERSON. Thank you so much, Mr. George.

And thanks for being here, Jo.

I am going to go out of order now because I want to pursue this child tax credit and ask, how is it possible that you can file for a tax credit and not provide a Social Security number? I mean, I am just curious. It sounds like not having to have any income and getting $200,000 mortgage when you make $35,000 a year. How is that possible?

Mr. GEORGE. By a multitude of actions and/or inactions. One, Congress was silent on this issue. Unlike the EITC, when years ago we identified similar problems, Congress passed legislation that mandated that anyone who applied for EITC had to supply a Social Security number. Then the IRS's contention is that for the Additional Child Tax Credit, the law is silent on that issue and that it does not necessarily need to deny these credits.

As you know, with a refundable credit, it is very difficult for the IRS to anticipate problems. In effect, they have to wait until people apply for it, receive the credit, the refund, and then in a very inefficient way, doing a cost-benefit analysis, go after money that has already gone out of the door.

We recommended that the IRS receive what is known as math error authority, which would give them the ability when they identify problems before the money has gone out the door, that they can in effect change the taxpayer's tax form and prevent it from going outside, from being submitted. Because once it is submitted or returned to the taxpayer, it becomes, in their argument, cost prohibitive to go after it; it is cost-benefit analysis. Do you go after a $500 tax refund when it would cost $1,000 in manpower and what have you?

Mrs. EMERSON. So we would have to probably fix that legislatively?

Mr. GEORGE. Yes, that would require legislative action. And we have made recommendations to that effect.

Mrs. EMERSON. When you submit the report to the commissioner, is the traditional process that the commissioner then gets together with you to discuss all of these items and ways to work on them, or how does the process work when you submit your findings?

Mr. GEORGE. That is a great question. First of all, what we do is, in advance of any final report, we give the IRS an opportunity to comment on it, to make sure, in all candor, we are not misstating things and, if we have, to have a discussion with them regarding that. The Department—and this has been the case since I have been the Treasury Inspector General, and I served under three Secretaries now—the Secretaries have delegated substantive tax policies to the Office of the Assistant Secretary for Tax Policy. And so I am truly, both by the directive as well as by the Inspector General Act, I am prohibited from engaging in substantive tax policy. I can comment on it, but I really can't create it. That is for Congress and that is for the Administration.

Mrs. EMERSON. Right.

Mr. GEORGE. So that Commissioner and my staff, we will discuss issues, findings, especially ones they disagree with, but we don't in advance decide this is the best way you should recommend to Con-

gress or to the Administration, unless that is a formal part of the recommendation in the report.

Mrs. EMERSON. If some of the recommendations that you all made are not agreed to, then do you re-pursue those?

Mr. GEORGE. Yes, that is a great question. The Department actually has a process in place where every recommendation that we make and every audit report is put into a data bank. And that data bank is something that is available to the department heads, to the Commissioner and to ourselves. And so, periodically, we issue over 120 audit reports a year, if not more, and hundreds of recommendations. So we have a certain process for doing so in terms of revisiting them. So we do revisit them, but we can't do it every month or every 6 months, just because of resources and other priorities.

But the bottom line is something along the lines as important as this, we certainly would bring to the attention, and I have to both the Secretary and to the Deputy Secretary.

Mrs. EMERSON. Let me talk about the EITC, because I have many, many people in my congressional district who are fortunate enough to take advantage of this, and it is their safety net, if you will, in many cases.

But can you go over just a little bit in further detail the issue of the erroneous payments and the fact that the IRS doesn't seem to have a quantifiable means by which to make corrections?

Mr. GEORGE. Yes, if you have a very detailed response to that. Just speaking off the cuff, Madam Chairwoman, as you know, the Earned Income Tax Credit is a refundable Federal income credit for low- to moderate-income working families and individuals. To qualify, taxpayers must have earned income from employment, self employment or another source and meet certain rules. In addition, they must either meet the additional rules for workers without a qualifying child or have a child that meets all the qualifying child rules.

The IRS reported 24 million taxpayers received $55 billion in Earned Income Tax Credits for tax year 2009. GAO has listed the EITC programs having the second highest dollar amount of improper payments of all Federal programs.

Now there was an Executive order issued by President Obama in November 2009, which said reducing improper payments was supposed to increase the pressure on Federal agencies to hold departments more accountable for reducing improper payments. And as it relates to the IRS, the IRS is required to provide TIGTA with a report on four action items: the methodology for computing the error rate, and they have done that; the reduction target and plans for meeting improper payment reduction targets, and they have not done that; plans to ensure program access and participation by eligible beneficiaries, and they have not done that; and a quarterly reporting requirement. Now the problem as it relates to that, and this is something that is not within the jurisdiction of this committee, it is Title 26 Section 6103 of the Internal Revenue Code or the tax code prohibits the IRS, myself, the Secretary from revealing taxpayer information under penalty of both jail time as well as a fine. So there are just certain privacy restrictions on what type of

information they can report. So that may be the reason why that quarterly report has not yet been submitted to us.

We have observed that the IRS has made little progress in reducing EITC improper payments since being required to report these estimates to Congress. The IRS continues to report, again, the figure of 23 to 28 percent of improperly paid each year, and we believe that the IRS is not in all honesty responding to the President's Executive order in an effective manner.

The IRS has contended, and rightfully so, that the some of the changes that they are initiating as it relates to paid preparers will be helpful in helping to reduce the number of erroneous EITC payments.

Part of the problem, Madam Chairwoman, is the tax code, tax forms are difficult. I am an attorney, and there are times when I have to call an accountant and/or the IRS to figure out how do I respond to a particular question on the tax form, let alone somebody who has not yet had that type of training. So we agree to pay tax preparers, especially once the IRS initiates this program, to register them, to test them, and to ensure that they have the credibility and the training as the first line of defense in the IRS and our efforts to help administer an effective and fair tax system.

Mrs. EMERSON. But realistically, how many folks who are qualified for the EITC can afford a paid tax preparer?

Mr. GEORGE. Great question, I don't know the direct answer to that. But I can tell you and I am sure you are aware of, there is the free file program. There are a number of new ways that the IRS and others have worked together to help people comply with their tax obligation.

This is a point, and I am glad you opened up this area of discussion, I believe, Madam Chairwoman, that it is the obligation of the Internal Revenue Service to make it as simple as possible for people to comply with their tax obligations. And it is my contention, although I don't have any empirical evidence to follow it up, but it is my gut that says, you make it easy for people to comply, they will. Obviously, there are bad apples out there and people who just will do the wrong thing one way or the other. But if it is simple to comply, believe me—and I don't advocate this, because, one, it is a policy issue—but if the government, like some countries, were to—and actually some States—were to fill out the forms for you and in effect you just confirm their numbers and sign and send a check or just validate the refund, you would have a much higher compliance rate.

Mrs. EMERSON. I know that is somewhat controversial in some areas, but the Free File is a program that I embrace wholeheartedly, as a matter of fact I actually did a seminar, Webinar if you will, with some of my community organizations throughout my district so that they could get more people to use the Free File and/or help some of their customers and/or clients do that. I know that makes a big difference.

About the online services, it is one thing to pay $29.95 or whatever it is these days, but to hire an accountant is, you know, rather expensive. But the Free File does work, and obviously for those folks within this income range, that is available. And those are all good programs. So I appreciate that. In the interest of time, so we

all have an opportunity to ask questions, I am going to go to Mr. Serrano.

I called on you to ask questions.

Mr. SERRANO. I was trying to figure something out here.

Just to follow up on this issue of folks without Social Security numbers. Now my understanding is that you can have a business in this country and pay taxes without being here with proper documentation. I would suggest the IRS doesn't care who it gets money from is the bad joke. Now is that also related to the possibility of people applying for the tax credit without a Social Security number? Because as you know, the flip side of that is that America's worst kept secret is the number of undocumented, or some would call them illegals, who are working with shall we say an improper Social Security card, paying into Social Security, but will never ask for a penny from the fund because they can't come out in public to do that. And so in a very bizarre and strange way, they are paying for the rest of us in so many ways. So how can that be related?

Mr. GEORGE. That is a very important point that you raise, sir.

I would only quibble with the word improper number for organizations the way you pose it in your question. Because the Internal Revenue Service has established what they call an individual taxpayer identification number, which is not a Social Security number; it is a number literally made up by the IRS to give individuals in that particular—individuals and entities—it could also be an individual who has a tax obligation because they have business transactions in the United States and yet who don't qualify for a Social Security number and so nonetheless would like to comply and should comply with their tax obligation. But that number, the ITIN——

Mr. SERRANO. When I was referring to improper—and then there is another group that does have a Social Security card, but it has been said for years, I have no proof of this, that those cards were gotten improperly—initially.

Mr. GEORGE. Well, if I may, because I think it is a slightly different issue, there are very limited number of circumstances in which a Social Security number can be issued for the purpose of paying taxes but not for the purpose—not to say, though, that you are a U.S. citizen and not to say that you are entitled to any benefits under Social Security. One of my colleagues here can really delve into that more deeply if necessary.

You are exactly right, there are a number of undocumented aliens or I am not sure what term you prefer nowadays, but the bottom line is, who do believe if they comply with their tax obligation, it may in the long run help them if they decide to apply for legal status in the country.

But the bottom line is the law, especially as it relates to the Additional Child Tax Credit, does not allow these people to benefit from that credit.

Mr. SERRANO. From the credit.

Mr. GEORGE. But it is nonetheless accepting the ITIN in that way, and they shouldn't be doing so.

Mr. SERRANO. Okay. The other thing was, just again, it is another aside, that on the EITC, some years ago, we discovered that 17 percent of all tax filers claimed the EITC, but 37 percent of au-

dits were on this particular group at one point. I was making the point at that time that, okay, I understand that IRS has to audit who it has to audit, but auditing EITC at 37 percent and not auditing some higher income folks at the same percentage may not be getting a good bang for the buck.

Mr. GEORGE. Sir, again, that predated me. But you were right in terms of my understanding as to how it was done historically, but that has definitely changed under the current Commissioner Shulman and under Everson, I believe, it started, and that now the focus is more so on high-end earners. And in all honesty, to get the biggest bang for the buck is to go after those people who earn the most money. And they have changed processes, both of in terms of domestic taxpayers but even much more important, international, foreign tax—corporations and individuals, in terms of dollars that they are hiding or keeping overseas and not declaring on their U.S. tax forms.

Mr. SERRANO. Let me ask you a question about your budget. You have a unique perspective in your role as Inspector General For Tax Administration. In addition to receiving a fine education in New York City public schools, the Chancellor will love this, you served on the Committee on Government Reform and Oversight and on the Government Management, Information Technology Subcommittee. You have conducted exactly the type of hearing that we are holding this morning, including oversight of Inspector Generals across the government. In addition, you have been in your current position for almost 7 years.

What can you tell us about the responsibilities of your office? You have a staff of roughly 827 FTEs and you make important decisions about how to deploy that staff to conduct oversight of the IRS. How do you make those decisions?

Mr. GEORGE. A wonderful question. And thank you for the plug on the New York City public school system, because it gave me great opportunities. The bottom line is we have to be, unfortunately, a very reactive organization, Congressman. It depends on the day of the week. The largest component of TIGTA, and we are approximately the fourth largest Inspector General in the Federal Government, is again to protect the administration of our Nation's tax system. And this is, as I indicated in my opening statement, something of longstanding responsibility. We were initially called the Inspection Service set up over 50 years ago. We were the Internal Affairs Division of the Internal Revenue Service, and it was with the Restructuring and Reform Act of 1998 that we stood up officially as an Inspector General.

The role of an Inspector General—to root out waste, fraud, and abuse—is very different than the role of the protector of the system of tax administration. So more than half of my staff literally consists of Special Agents spread all over the country, who when threats are made against the system of tax administration writ large, namely tax, IRS employees or other people who are engaged in the system of tax administration, they literally rush out to the scene in any part of the country and world and either effect arrests or conduct investigations.

The irony is that we have the responsibility if a threat is made against a criminal investigation employee of the Internal Revenue

Service, it is my agents who, at 2 o'clock in the morning, rush to the scene and provide whatever assistance is needed. Case in point, when that person flew an airplane into a building in Austin, Texas, and murdered Vernon Hunter, an innocent IRS employee who was just doing his job, and just by the grace of God, his plane hit a support beam as opposed to going just 3 feet lower and would have gone into the atrium, and there would have been massive casualties had that happened. So that is just one example of where my Special Agents go after that type of matter. I could go on and on, sir.

But as it relates to audits, in every aspect of the system of tax administration, if someone makes an allegation that a tax employee of the IRS is soliciting a bribe, we will send out people and we will use whatever means necessary, legally of course, but to find, root out, identify that person, to prove or disprove the allegation and to then refer it to the appropriate prosecutorial entity. And vice versa, if a taxpayer solicits a bribe from an IRS employee, and believe me, that happens a lot, fortunately—and again, I can't say completely that every IRS employee will report that, but I am extraordinarily proud of the number of IRS employees who do come to us and say, this taxpayer offered me $10,000 to reduce their $100,000 tax obligation. And so we literally, whether it is using some of the investigative technologies that we have, hopefully investigate those and again pass them along to prosecutors.

Mr. SERRANO. Thank you.

Madam Chair, I will stop here so our colleagues may ask questions.

Mrs. EMERSON. Thank you.

Mr. Bonner.

Mr. BONNER. Mr. George, welcome.

Mr. GEORGE. Thank you, sir.

Mr. BONNER. I was conflicted about whether I would be able to make this meeting until my wife told me last night how much more we owe in taxes. So I thought I would take advantage of this opportunity. I don't blame you.

Mr. GEORGE. I don't set the rates.

Mr. BONNER. I came with three questions, and I am going to try to get to them, but your response to the chair and to the ranking member has actually now raised a few additional questions.

You said, I don't think you would get any disagreement from anyone here, certainly not from this member, that our tax forms are too difficult and that even with that great education from New York City public schools and Howard University and Harvard Law School, that you, too, have had to seek professional help to fill out your forms.

Has the IRS ever done a survey of their employees—how many employees are there, 110,000?

Mr. GEORGE. Roughly, roughly. Depends, during the filing season, it goes up slightly more than during nonfiling season.

Mr. BONNER. Have they ever done a survey to find out how many of the employees of the Internal Revenue Service have to seek help either from a professional accountant, Turbo Tax, H&R Block, someone like that?

Mr. GEORGE. Not to my knowledge.

Mr. BONNER. That would be really interesting. I don't know if that would fall in your jurisdiction or if we need to bring that to the commissioner. But I think it would be fascinating to know.

Mrs. EMERSON. If you will yield for a minute, perhaps that would be something that we could just encourage in report language in our bill. It wouldn't cost any money because you can do it on e-mail with the fancy new computer system there that exists now.

Mr. BONNER. Well, it is just a suggestion, and I would certainly welcome the chair's help in making that happen.

The other comment you make, which I certainly agree with, is that it is your opinion that the IRS should have an obligation to make filing and paying your taxes as simple as possible. In your position, what grade would you give service in terms of doing just that?

Mr. GEORGE. That is a very, very—and you put me on the spot because Mr. Steve Horn, as you may recall, used to issue report cards on the status of Federal agencies as it related to Y2K and financial management issues.

Mr. BONNER. I will give you a chance to think about it because I didn't mean to put you on the spot, but I want to tell you why I ask that question. We all have the privilege of serving on this committee, and as such, we serve on different subcommittees. And earlier this week, we had an opportunity in the Defense Subcommittee to meet with Dr. Ashton Carter, who is the head of procurement for the Department of Defense, a very smart man like yourself, someone who could be doing so much more in the private sector, but you dedicated your life and certainly this chapter of your life to serving your country in this role. And so we thank you and we thank people like Dr. Carter as well.

When asked by one of our colleagues how many people worked in procurement at the Department of Defense, he said approximately about 140,000. So actually more people work in that than work at the Internal Revenue Service. So one of our colleagues said, well—and the example was when we were talking about Defense is that sometimes it takes 7 or 10 or 12 years just to get what should be a pretty simple system underway and funded and then into service. How many of those 140,000 people are really good at what they do? And his answer was not enough.

So I don't say this to put a black mark on any of the 110,000-plus men and women who are dedicated and who are doing their work. But to your point that I agree with, it should be the obligation of the Service to make it as simple as possible to comply with the laws that this Congress passes and previous Congresses. I would just like to know if you would care to give a letter grade?

Mr. GEORGE. I would, I would. And again, it is risky to do this, but in all fairness to the IRS, they get a B in terms of giving decent and accurate information to taxpayers. And that wasn't always the case. It really did take the hearings in the late 1990s to help bring some sanity in some areas. A lot of—I know many of my colleagues who were around back then—and Mrs. Emerson and Mr. Serrano, you may have been two of them—some of the claims made against the IRS were exaggerated, as proven later on. But nonetheless, certain changes were implemented, including the standing up of TIGTA, that have assisted the Commissioners of the IRS, the Sec-

retaries of the Treasury and the American people have a more efficient and effective system of tax administration.

Former Commissioner Mark Everson used to say that compliance equals enforcement plus customer service. And so there was that balance between making sure that people got telephone calls answered in a prompt fashion, who went to taxpayer assistance centers and got accurate information and then——

Mr. BONNER. Accurate and consistent.

Mr. GEORGE. And consistent, that is exactly right, because as you are suggesting, when we first started doing examinations, we found we would send people undercover to taxpayer assistance centers, and literally, the accuracy rate of the tax return was zero percent. Not a single tax return was correctly filled out by people who were IRS employees paid to do this. And our most recent examination, again, it was a very limited sample, a much smaller number, because there are hundreds of taxpayer assistance centers, the accuracy rate was 100 percent.

Mr. BONNER. That is great.

Mr. GEORGE. They made very good progress in that regard. Is there perfection? No, you are right. They call one number one time and get a different answer than they may get the next time. That is still a possibility. Human nature; people make mistakes. But I would give them a B.

Mr. BONNER. Well, I am going to submit two of the questions for the record. But I want to get the last question in that really is something that has been a pet peeve of mine for years. I was a staffer up here for 18 years. I have only been elected in the House for 9 years. I don't know that I will ever be a good Congressman; I was a great staffer, if I say so myself.

Mr. SERRANO. You are a great Congressman.

Mr. BONNER. You are very nice. Thank you.

Mrs. EMERSON. Yes, you are.

Mr. SERRANO. Is it shrimp time——

Mr. BONNER. Two, weeks, 2 weeks.

Liberal groups, conservative groups, this crosses the spectrum: Senior citizens throughout our country get letters just like this, dear senior citizen, send us your money, so we can go to Washington and keep Congress from destroying Social Security, destroying Medicare, destroying whatever it is. And it struck a raw nerve for me when a 92-year-old lady in my district who is suffering from dementia and who actually has relatives in a colleague's district who notified me about this, that she drained every penny of her savings.

And Mr. George, I don't know about Mr. Womack or Mr. Serrano or Mrs. Emerson, I have never seen any of these people in the 18 years I was on staff and the 9 years I have been in Congress who have actually come in to my office and say we are here to keep you from destroying Social Security or Medicare.

Now I ask this because the Internal Revenue Service, as I understand it, has oversight responsibilities for these 501(c)(4) groups. If that is true, how well is the Service performing in their oversight? I know we have the First Amendment. We celebrate the First Amendment. We are a better Nation because of the First Amendment.

But it is just unconscionable to have companies, groups that are able to use the current deduction system to fund themselves to go out and become a plague on the senior citizens of our great country. And with that, I will yield to your answer and thank the chair for the opportunity to ask some questions.

Mr. GEORGE. A very important question, Congressman. Initially, I thought where you were going with this are these tax schemes being perpetrated by many people from foreign lands and even people domestically, who say you have won a lottery, all you have do is pay the tax and we will send you a check for a million dollars, and you would be surprised how many people fall prey to that.

Mr. BONNER. We have a number in our district as well. That was a different question.

Mr. GEORGE. But as it relates to this, when you say oversight of 501(c)(4)s, we actually did conduct, at the request of Congress, two reviews, and because of privacy and tax restrictions, I can't say which groups we looked at, but they were prominent, and you can probably guess which ones they were. What we were only able to do, sir, is to look at the processes within the Internal Revenue Service for overseeing complaints against these types of people, groups, rather, and how the IRS handled those things. Because again, the 6103 would put me in jail if I were to reveal particular tax groups, individuals and/or organizations, and at this stage, I don't want to lose my job.

But what I can do is, one, commit that we will share the report with the committee as well as with you in response. I don't know—it won't answer your question spot on, but it will give you a better sense of what the IRS has and has not done. Actually, they are getting two reports, and they are both issued within the last year, year and a half.

Mr. BONNER. Thank you.

Mrs. EMERSON. Thank you. And I will tell you one of the things I do, because this just annoys me to death and scares me because I have so many seniors who do, in fact, do that, but every time that we do any kind of mailing, any time we answer any kind of letter, most every time, to seniors, I put a little thing in if somebody is asking you to pay $10 to help save your Medicare and Social Security, do not send, do not, throw it away and don't send any money in. In many cases, especially with high gas prices, that $10 can make it, give you enough gas to go back and forth at least to the grocery store.

With that, Mr. Womack.

Mr. WOMACK. Thank you, Madam Chairwoman and Mr. Inspector General. There is not an ad on television that upsets me any more than an ad that comes on and says, if you want to have some help in gaming this country by saving on your debt obligation to the United States of America, it is that ad. We have all seen them. I think you touched on this a little earlier. Help me out; how does that work?

Mr. GEORGE. The IRS has a formal program which is entitled Offers and Compromise, which any citizen, with or without the help of a third party, has a right to go and petition the IRS for, in effect, an agreement if they are having problems paying their tax obligations.

Congressman, you hit the nail on the head. Over 2 years ago, and one of my colleagues directly behind me will attest that I requested that we take a look at some of these things and find out, Tax Masters and Roni Deutch and all these others, when they were making these claims, we will reduce $50,000 obligation to $5,000, were they telling the truth or not? And once again, we have a report, happy to share with you, I don't recall all the conclusions, but at the same time, I do know that under the State Attorney Brown, before becoming Governor of California, he filed suit against Roni Deutch making allegations of criminal wrongdoing and these types of solicitations. I believe it is ongoing, so I don't know what the final result is of that, but that is something that is still on our radar.

In some instances, there have been proven allegations that people are getting ripped off, for lack of a better word, but that is something that I am also very concerned about. But again, the bottom line is the IRS does have a legitimate program which does, in effect, allow that. And I think, my understanding is and I may ask him to come up and address this, that in the limited cases that we looked at, the allegations that were actually made in the TV ad were accurate.

Is that the case? So, yes. I was just told by staff that it was valid what this particular business was claiming in terms of how they handled a particular case. But that may be just one out of thousands as opposed to every single client receiving that type of benefit.

Mr. WOMACK. I understand the need to have some negotiated process on potentially doubtful and uncollectible accounts. But depicted in these ads, and I know a lot of it is just style and verbiage, but depicted in these ads are people who obviously have lifestyle levels that are suggested to be through the ad greater than the average American. And there is no more of an outrage—and I think I speak on behalf of most Americans when I say for those who, like me, pay my taxes and probably could do a little better for ourselves if we looked here and there for better deductions and this sort of thing, it is just, to me, not really worth the effort all that much. But on behalf of taxpayers across America who pay their taxes and pay them on time, there is no more outrage that I feel, perhaps except for those who are willingly selling their homes because they are under water—or letting their houses go into foreclosure because they are under water, even though they never missed a payment and still could make those mortgage payments, but we will save that for another discussion.

I want to go back to the EITC for just a moment, because I come from an area in northwest Arkansas that has been impacted by illegal immigration, and I would like to know if there are accurate numbers out there that have impacted our Federal Treasury of people who are not entitled to the EITC but nonetheless are collecting that credit.

Mr. GEORGE. The short answer is, yes, there are. I am going to turn to my staff. Do we have numbers? Number of illegal aliens receiving the EITC?

Mr. MCKENNEY. Yes, our primary concern is the EITC—the EITC is about 2 million.

Mr. WOMACK. Two million.

Mrs. EMERSON. Excuse me, can you just identify yourself please for the court reporter?

Mr. MCKENNEY. Michael McKenney, Assistant Inspector General for Audit.

Mrs. EMERSON. Thank you so much.

Mr. WOMACK. We will submit for the record, I would like a little bit more detail on what we know and what we don't know, so that I can intelligently answer those questions with constituents of mine who pay attention to these sorts of things, and I think we all should pay attention.

We have got people gaming the system across the spectrum of the Tax Code, but in particular with EITC, we have a lot of gamers out there?

Mr. GEORGE. We do. Again, Mr. Womack, I don't know if you were here when I was introducing myself. I, too, served on the Hill as a staffer over 16 years ago. When we first looked at this issue, it was then estimated that the annual improper payment rate was in the $20 billion a year range. And so subsequently, through, again, oversight hearings that Congress held and later action by the administrations——

Mr. WOMACK. That was about what year?

Mr. GEORGE. That was 1995, 1996 timeframe. So it is now roughly $11 billion to $13 billion a year. Still an outrageous amount of money, but obviously, the trend seems to be in the right direction. Again, that is just EITC.

As my colleague alluded to a moment ago, there is an additional tax credit on the Additional Child Tax Credit, which has similarly been very large numbers of improper payments and that literally the Congress, because of inaction of Treasury, IRS, state that they are not in a position to address it. That is something that could be fixed by Congress, and that is something we discuss in detail in my written testimony.

Again, I have to again, sir, I don't think you were here, I have limitations on the substance of tax policy that I can advocate in my role as the Inspector General, and it is the Assistant Secretary for Tax Policy that the Secretary has delegated that responsibility to. But he, too, Michael Mundaca, is aware of that issue.

Mr. WOMACK. Thank you. We would like to see some more detail on the reporting.

Madam Chairwoman, our country is a great country with a terrific system in place, albeit with its flaws and its complicated tax codes, but there is, I will say again, no more outrage that I could have than to have people who game our system and take advantage of things to which they are not entitled that over time adds up to billions and billions and billions of dollars at a time when our country is faced with the financial distress that we face.

With that, I yield back.

Mrs. EMERSON. Well, thanks.

And I totally agree with you, particularly when we can actually touch and feel where this fraud is being perpetrated, and that is very, very frustrating. Because what it does is hurt the people who actually need to take advantage of these types of tax credits, where it helps them be able to put food on the table or even maybe even

save a little bit for school supplies and stuff. It is very, very frustrating. There are some things that we might have the opportunity to do, and we will engage you on those.

Mr. SERRANO. I would like to comment on this because every so often, we are going to find issues where both sides, Democrats and Republicans, can agree on.

There is another side to this that has to be looked at. In my district, in the Bronx for instance, around tax time, a lot of places we know by name open up storefront operations to do taxes. They have the whole issue of basically we think—can I prove it? I guess I am within the bar of the House, but we suspect in some cases, they are telling folks to fill out this and fill out this and go for this and you can get that. And the person is either a person with less education about these matters and goes along with it, or in some cases, it might be undocumented folks, who are afraid of their shadow, who want to pay taxes, because you are right, they know, one, it is the right thing to do; two, it could help years from now. Whenever we talk about any kind of immigration reform, the first thing we say is pay your taxes, learn English and so on. So a lot of that is going on.

Then you have the other addition, which is these folks will advertise that on the day they fill out your form, they will give you a check—a loan, not a check, a loan for the return. These folks think they are getting a check from the IRS. They are not. They are getting a discounted amount because this person is making a loan. It may be one of the few issues you will find, actually many, but one of the glaring ones we will find where conservatives have a reason to be angry and liberals also have a reason to be angry, and we can work on it.

Mrs. EMERSON. We found some new opportunities to hopefully save money.

Mr. George, did you have something you wanted to say while everybody else was making small talk?

Mr. GEORGE. As it relates to Mr. Serrano's comment, it is, again, the commissioner's thinking that by registering and in some way validating these paid tax preparers, we may be able to root out the less scrupulous ones and to bring in people who will help avoid that situation.

Mr. SERRANO. I don't know if this happens in your district, but in my district, it is amazing, they dress up like mascots. They hire local folks who dress up in these outfits to stand and give out and say, down the block, we will get your taxes done.

Mrs. EMERSON. I live in a rural area. It is not done quite the same, but we do have——

Mr. SERRANO. They stand by the highway and wave?

Mrs. EMERSON. With the signs "free taxes" or "discounted taxes."

One of the things that the IRS has helped us do that I find positive is that we have all these volunteers that go to our senior centers and nutrition centers to help seniors, free, fill out the forms. And they have got the computers there. That is a terrific system that has helped multiple numbers of people. However, then you get the ones who have no more business than I do in trying to fill out people's taxes.

Mr. GEORGE. If I may, Madam Chairwoman, as I indicated, we went to these private organizations—the tax centers—and had 100 percent accuracy rate. Some of the VITA programs, they have had some problems in terms of accuracy in terms of filling out taxpayer forms. That is something I would suggest this committee—as we are going to be a little more aggressive have on.

Mrs. EMERSON. Well, I appreciate that because I visited two of those centers in my district, and I guess—and I had IRS folks there with them. I am not sure how many hours of training each of these individuals has had to have.

Mr. GEORGE. The groups are the ones that support that.

Mrs. EMERSON. Just keep our eye on this one, too, okay.

Mr. GEORGE. Lastly, to Mr. Serrano's point, with the First-Time Home Buyer Credit, it was the same situation. You had people literally telling people hey, come into my office, pay me X amount of money, I will fill out the tax forms for you and help you with a refundable credit. Until our audits identified many of the problems associated with that, namely 4-year-old, people who hadn't actually purchased homes or people who had purchased homes prior to the implementation of the legislation, these unscrupulous tax preparers and taxpayers were getting away with it.

Mrs. EMERSON. This is a very good discussion. I think it is really helpful. I want to move to a different subject, if that would be all right, just because apparently we are going to have soon three votes, and if we could try to get finished with the real questions that we want to ask so you don't have to wait around. I hate to have you do that, Mr. George, because a 10-minute sequence of votes ends up taking an hour because people chitchat and don't vote.

On Monday, I was down at IRS headquarters with the Commissioner and his staff discussing the new IRS taxpayer account database. There is no doubt that this really has—there is an opportunity to immeasurably improve the IRS customer service and tax return processing. I know my children, who file their tax returns want those tax refunds back immediately. It is certainly much better since they do it electronically.

But I want to know how much confidence you have in the IRS to meet its goal of launching the database by next January so it can support the 2012 filing season. And then, after 50 years of working with a database that gets updated on a weekly basis, IRS employees are going to have to use a database that is updated on a daily basis. Are employees prepared to have their schedules totally disrupted in order to maintain this huge investment that we all have made?

Mr. GEORGE. The short answer is, I have been told by my staff who have actually conducted the audits on the ground that the IRS is making very good progress in anticipating the implementation of the customer account data engine version 2, CADE 2. CADE 1, as you know, is still a work in progress. But it is still the master file, what the IRS has been relying upon for over 50 years, that is what the IRS employees have to rely upon. I have to admit my view and my response is somewhat clouded, I think is the word, by their experience with the tax system modernization effort that you may recall started in the mid 1990s. They spent $2.5 billion on a system

that was behind schedule, didn't produce what was promised, and ultimately just completely thrown away. And so $2.5 billion were wasted. As my former boss, Mr. Horn said back then to Commissioner Rosatti, after $100 million, couldn't you realize this wasn't working? Why do you have to wait until it gets—I am told it is actually closer to $3 billion that was completely wasted.

So I am from the Show-me State on this one. So I really have to see it to believe it. But I have been told that they have learned from the past mistakes. And I am reasonably optimistic that they will be able to achieve a lot of what they promised. Now will it be done on time? I have no idea. I can't predict the future. But I do know that they have made changes that are somewhat disappointing because at one point their goal was to have a system similar to what you do when you encounter your credit card companies, you call in and you can just input your credit card number, or, in this case, your Social Security number or whatever it would be, and then how much money have I paid into the system, how much money do I owe, when do I owe it, so on and so forth.

I think it was being called MyIRS. And it was supposed to be this really high tech or avant garde type of situation. And they have abandoned that. Not necessarily their fault. The resources that they received were cut back and so they have to make choices between what to provide and what not to provide, given the limited resources that they have. And then added obligations that I am sure you will talk about in a moment.

Mrs. EMERSON. I am certainly hopeful that it does work. One of the questions I asked them was: well, if you aren't here in 2 years or 3 years when it is completed, how can you ensure that this gigantic investment we have made will actually be carried forward, to which, of course, nobody can answer that question because you can't see into the future. But this does worry me, given the fact that I think the entire government has done a horrible job across the board on IT modernization and we just haven't kept up. Unfortunately, it does require an investment. It needs to be done much quicker than—and we dole out moneys a little bit at a time. By the time you have finished it, it is already obsolete.

Anyway, hopefully we can get it underway. So I guess the original estimate was that this whole modernization was going to take about 15 years and it was going to cost about $8 billion. So we are in the 12th year and how much money have we spent on this altogether?

Mr. GEORGE. They are below the budget. So $3.25 instead of $8.

Mrs. EMERSON. I know the Commissioner suggested that if we were able to give them about $111, $112 million over the next 2 years, they thought that would do the trick to get it completed. Do you all have any sense of whether or not that is a real number? Am I putting you—will you identify yourself.

Mr. DUNCAN. Alan Duncan, Assistant Inspector General for Security and Information Technology. We have been looking at this project for quite some time. Every year, we issue a business system modernization assessment. And in looking at that, CADE 2 is really in a three-phase installation plan. The first phase of CADE 2 will be implemented, as they have planned, in January of 2012. There are two additional phases for that project. So that may be

the money that you are talking about to finish the existing database to get us an authoritative database that will have all individual taxpayers accounts.

Mrs. EMERSON. Rather than using the tapes that they currently use, like the old-fashioned way. Everything would be on one database.

Mr. DUNCAN. That is correct. That is on schedule. We have been reviewing this very extensively. We have four audits currently in process, including your reference there to the daily processing, which is not just a technology issue, it is also an individual employee issue because they have to be ready to go from a very extensive process that they have to do before they know what your account looks like to every day it will updated, which is with what we should be expecting as a taxpayer. I think they are on track to do that and to have that first phase in place for the filing season next year.

Mrs. EMERSON. So, if, in fact, you have phase 1 completed—and I didn't really go into all of the details about phases 2 and 3, only hoping they could get phase 1 finished on time.

Mr. GEORGE. Yes.

Mrs. EMERSON. And somewhat close to budget. How long are the additional phases to take?

Mr. DUNCAN. We are looking at 2014 for the full implementation and the elimination of the redundant systems that are currently processing. This would then give us the opportunity—and the 2012 is important because it sets the baseline upon which then we will be able to go forward. They must meet that.

Mrs. EMERSON. So it is much easier to do once you get phase 1.

Mr. DUNCAN. If they can get 2012, I believe they will have a very good opportunity to then complete the other two phases in the budget that they have set forward.

Mrs. EMERSON. As an IT expert, which I assume you are since you are in charge of this, do you—well, we all know that some people get promoted into positions because somebody at the lower doesn't want them. Been there, done that in the private sector.

Is this a good system?

Mr. DUNCAN. We believe the change that they made 2 years ago to redesign for the Commissioner to endorse this particular approach, which is a major change in the way they have been doing business system modernization, is a correct approach. And I did do a lot of work on the commercial sector before coming here. This type of an approach is the type of approach, as we move into the Web environment and the portal environment, which will allow all of our taxpayers to really be able to get the type of information, the processing that they require. We believe that they are on the right track at the moment. They need to follow through. And you already touched on it—the executives to stay in place. We have had a serious concern. If you continue to change executives at the top level and they bring in their own ideas and their own approach, then we may have a problem as we go forward.

Mrs. EMERSON. Would you design a system like this yourself?

Mr. DUNCAN. Yes, I would. This would be the approach that I would take.

Mrs. EMERSON. I know that you—and then I am going to turn it over to Mr. Serrano. Mr. Alexander just came in—you and GAO both have found a little bit of security weaknesses.

Mr. DUNCAN. Yes, ma'am.

Mrs. EMERSON. Have those been addressed?

Mr. DUNCAN. They have a material weakness that has been reported in the security arena. We believe, again, that this project that they are called CADE 2 will help to address—not saying it will resolve it—but help to address some of the major issues that have been reported in the past on security.

Mrs. EMERSON. I think perhaps we will have that discussion in a private session.

Mr. Serrano.

Mr. GEORGE. Madam Chairwoman, as you indicated at the outset of this questioning, with the rapid transition in technology, again, something that looks good now, 2 years ago may be antiquated. I just want to make sure I made that point.

Mrs. EMERSON. I know. It scares me to death.

Mr. GEORGE. I just wanted to make sure I made that point.

Mr. SERRANO. Yesterday, we voted on the budget that keeps the IRS at fiscal year 2010 levels. Given the cuts in the IRS budget, where do you feel the budget is most vulnerable? What accounts worry you the most as far as these cuts go?

Mr. GEORGE. Great question. It hasn't come up yet, but of course with the Affordable Care Act having passed, and is law, and the key role that the Internal Revenue Service is going to play in this implementation, unless additional resources are provided to the IRS, they are going to have to take away from either the enforcement side of the house or the customer service side of the house in order to meet some of the obligations they have under the ACA.

It is almost a zero sum game, Congressman, because, again, unless the IRS gets much more resources, they have such a massive responsibility, that is namely the tax revenue entity of the most powerful Nation in the world, they are just going to have to make some tough choices, and most likely the sacrifices will be on the customer side of the house.

Mr. SERRANO. So you may be on your way to answering the second question, which is how does the IRS even begin to close a tax gap with fewer resources than it has currently? I am just saying that they have to make a decision since health reform is the law.

Mr. GEORGE. It is not only health reform, it is really any new requirement change to the Tax Code, which, unfortunately, many times comes so late in the year, too, that it requires the IRS—it is almost like the Army. They will get it done. It may not be pretty, but they can get the job done. And that is the case—that is been the case for the AMT and a few of the other tax provisions.

I carry around a card with me everywhere I go. And this is very telling. And it is just a few seconds. Let me read this, if I may. Third party reporting. And this is really IRS information-based information. There is such a high correlation between tax compliance and third-party information reporting and withholding. The IRS estimates individuals whose wages are subject to withholding report 99 percent of their wages for tax purposes. Self-employed individuals who operate nonfarm businesses are estimated to report only

68 percent of their income for tax purposes. But the most telling figure, self-employed individuals operating businesses on a cash-only basis are estimated to report only 19 percent of their income.

And what I am suggesting is I know Congress recently took action as it related to the 1099 and the $650 business transaction figure. But these numbers are telling. When you have someone else reporting how much money you earn, you are most likely going to be honest with the IRS as relates to money you earn. Obviously, the reverse being the case.

A way to address that tax gap is more third-party information reporting. That is a way. And so how to make it as least burdensome on taxpayers, that is the challenge that Members of Congress have before them.

Mr. SERRANO. It is interesting you say what you just said because part of what we hear a lot these days, and I say this with all due respect, is we have got to reduce the size of government, we have got to have less government, and let American small business take care of the economy. I guess what you are saying is yes, and then make sure they pay taxes. That would help the economy.

Ms. EMERSON. And I will just give you a perfect example. My husband is an attorney. He is a partner in a small law firm in Missouri. He is very good about paying his quarterly taxes, but they don't have withholding. For the clerical help, yes. But for the partners, they just get a big old check and it is up to you to go ahead and be responsible and pay your taxes. But I can see how easily it would be for some people who chose not to pay their fair share, even in spite of the fact that those schedule K–1's that the businesses have to file anyway as a business tax return basically indicates how much the firm has made. But you would have to have somebody rat on you, almost, to necessarily put that at the top of your list for investigations.

Mr. GEORGE. Again, it makes common sense why people will say, If you pay me cash, I will give you a lower figure for the item that you are buying.

Mrs. EMERSON. Although, when you go to the hospital and you work a deal with them that you don't pay it through the insurance company, they will, in fact, give you a big discount.

Mr. SERRANO. Am I supposed to be hearing all this?

Mrs. EMERSON. No, no, no. Any hospital administrator will tell that of.

Mr. SERRANO. I am looking at Mr. Womack. And I have got great respect for him and his background both as a mayor and a colonel. A mayor and a colonel. Not a major. How do we treat our men and women in uniform? I remember when I was in the Army 1,000 years ago for a very underwhelming small career, I used to get these letters from New York State when I was stationed somewhere, saying, "You didn't pay." I said, "No one told me." It was ahead of time and so on. And no one seemed to know where men and women in uniform were supposed to be paying taxes or not. No one told us.

What happens with that now?

Mr. GEORGE. When I first became the Inspector General, we had a review of that very situation where the servicemen and women were not being informed of their right not to have to submit tax

returns on a particular date. And I don't recall the exact, because the laws have changed and that was literally 7 years ago, 6 years ago. But we issued a report and the IRS did take action in that regard.

Mr. MCKENNEY. They are better on following up on that. They have an indicator on servicemembers' accounts so that they know that they are military. They have obviously their combat zone pay is exempt and they have extensions of time to file. So we think they are doing better at putting the indicator and making sure their——

Mr. SERRANO. The worst thing in the world—and now I am going to sound not like a liberal—liberals don't get credit for saying anything nice about the military. The worst thing in the world is to be serving your country and then to have a tax issue because somebody didn't tell you what you are supposed to do or not to do.

If you are in a combat zone, that pay is exempt.

Mr. GEORGE. Correct.

Mr. SERRANO. Is it up to every State to determine whether they will——

Mr. MCKENNEY. I couldn't tell you. I assume most States follow the Federal. But I am not certain of that.

Mr. SERRANO. Do you know, Mr. Womack?

Mr. WOMACK. Not specific to that question, although I think—correct me if I am wrong; these guys will know more than I do—I think the amount of pay is exempt up to and including the pay equal to a Sergeant Major in the Army. I think there is a difference for higher-ranking personnel. It has been a while since I have looked at the income levels of the various servicemembers, but I think somewhere at the senior captain level, captain level, and above, not all of that pay——

Mrs. EMERSON. I would agree, with a son who is a captain in the Army, that when he was in Iraq—he made captain in Iraq, so he started—it started costing him a little bit more.

Mr. SERRANO. I don't think anyone who is in a battle zone should pay a penny of tax. How is that? That is my statement for the day.

One last question, given these cuts, how will your office respond? Are there vulnerable areas of IRS that will receive more attention from your investigators?

Mr. GEORGE. As I indicated in response to an earlier question, Mr. Serrano, it really will depend on circumstances. If there are threats that are issued because of anti-tax protestors that would require us to have people in, whether it is New Hampshire or——

Mr. SERRANO. Anti-tax protestors?

Mr. GEORGE. Believe it or not. But there is no question that some hot-button issues as is relates to business systems modernization as it relates to a lot of the refundable tax credits, and then, again, the American—the Health Care Act, those are things that we would want to bring—highlight our focus on to make sure that they are implemented effectively.

We have found, again, that it is much more beneficial for the IRS and for the American taxpayer for us to identify problems before they really manifest themselves or before the money goes out the door, because it then becomes so much more difficult and costly for

the IRS to try to recover that, and in many instances, they just give up.

Mr. SERRANO. Well, I thank you.

Madam Chair, I have a few questions I will submit for the record. I thank you for your service. I think that we all, whether inspector generals or direct IRS employees, should make it easier for the taxpayer to file and pay their taxes. It should not be something where people feel threatened or intimidated. And so anything we can do in that direction helps.

Lastly, I don't think even a major tax break will help the Mets this year. I don't think there is anything you can do for them.

Mr. GEORGE. Thank you for your service. I will leave it at that.

Mrs. EMERSON. Mr. Alexander from Louisiana would like to ask a question.

Mr. ALEXANDER. Not ask a question, but would you read the little card to us again?

Mr. GEORGE. Yes. And I will just skip right to the relevant questions. IRS estimates individuals whose wages are subject to withholding report 99 percent of their wages for tax purposes. Self-employed individuals who operate nonfarm businesses are estimated to report only 68 percent of their tax for tax purposes. And self-employed individuals operating businesses on a cash-only basis are estimated to report just 19 percent of their income.

This is IRS information.

Mr. ALEXANDER. Do we have a guesstimate at what those numbers would be, the number of self-employed out there and what the magnitude of that lack of income to the government would be?

Mr. GEORGE. Well, again, the official numbers that the Internal Revenue Service issues, and these are as of 2001, are $345 billion each year not paid to IRS on time and in full. We believe that is a lowball estimate. It does not—we believe it does not include in its totality the number of international entities that—money to the U.S. Treasury. Our guesstimate is it is closer to $500 billion a year that should be paid that is not paid. But there are even some that think the figure is much higher than that.

The IRS is doing—it is called the National Research Project—and the IRS is currently in the process of updating that, looking at subchapter S corporations and whether or not—what the compliance rate is with those. As you know, many businesses, small businesses especially, and some large ones, incorporate under subchapter S, which affects how much money they can claim that the owner and/or the business has actually earned.

Mr. ALEXANDER. I am just interested in why would you say self-employed non-farmers? Would the farmers be subjected to something different from other self-employed?

Mr. GEORGE. I will defer to my colleagues on that one.

That is just the way the IRS has captured the information.

Mr. ALEXANDER. Okay. Thank you.

Mrs. EMERSON. Thank you so much, Mr. Alexander.

I have some questions I would like to submit for the record, one including—I heard some complaints about how the IRS administers the Federal Historic Preservation Tax Incentive program. Hopefully, you can get back to us on that. If any of my other colleagues—we will submit all the questions for the record.

Thank you so much for being here. It is really a privilege to have you. Your experience on both sides, I think, makes you an exceptional person for this position. You have insights that others do not. I am grateful for your service and that of all of your staff. Thank you all for the work that you do.

Mr. GEORGE. Madam Chairman, it is really the work of the people all over the country who work with me. It has been an honor. They are talented.

Mrs. EMERSON. Well, we would be nothing without our staff, too. We don't give them enough credit. Quite frankly, we may get the glory, but they are really the people who do the work. Some of us actually really work, too. But our staff——

Mr. SERRANO. Be careful how you say that.

Mrs. EMERSON. We couldn't do it without our staff. We are all a team and it is very important.

I just appreciate you all looking out for taxpayer money and for doing that tough job. Thanks so much.

[The information follows:]

Financial Services and General Government Subcommittee
Hearing on Treasury - Inspector General for Tax Administration FY 2012 Budget

Questions for the Record Submitted by Chairwoman Jo Ann Emerson

IRS EMPLOYEE SECURITY

Following the event last year when an individual crashed a plane into an IRS building, and the recent event in Arizona, I firmly believe that it's important that we take steps to provide adequate security for IRS employees. It's my understanding that your organization plays a role in ensuring IRS employee safety. You recently noted that given the threats to IRS employees and the expanding role of the IRS, security has replaced the IT modernization effort as the top challenge facing the IRS.

Can you explain the exact nature of the role that your organization plays here? What steps have you all taken to address this?

The Treasury Inspector General for Tax Administration's (TIGTA) authority to investigate threats, assaults and related matters is derived from the provisions of Title 26 USC Section 7608(b), authority of internal revenue enforcement officers, the *IRS Restructuring and Reform Act of 1998*, the *Inspector General Reform Act of 2008*, and are further summarized in Treasury Order 115-01. All reports of assaults, threats, or forcible interference against IRS employees performing their official duties are assigned to the TIGTA Office of Investigations (OI). As a result of the February 2010 attack against a building in which an IRS facility was located in Austin, Texas, and also took the life of one IRS employee and injured several others, OI undertook a review of how we approach threats to IRS personnel, facilities, and critical infrastructure. In the months following the attack, OI developed an enhanced process of categorizing the various threats against the IRS, as well as, refining the coordination of communications between the TIGTA OI, IRS senior management, and the IRS Office of Physical Security and Emergency Preparedness (PSEP).

Today's threat environment is significantly different than it was ten years ago. Physical violence, harassment, and intimidation of IRS employees pose some of the most significant challenges to the implementation of a fair and effective system of Federal tax administration. TIGTA is committed to protecting approximately 100,000 employees and more than 700 facilities throughout the country, and OI continues to place a priority on its oversight of IRS employee safety and physical security.

OI has implemented several mitigation strategies to meet current challenges. We have forged new partnerships to strengthen our ability to deal with current and future threats that are directed against the IRS and its employees. To further enhance the safety and security of IRS personnel, OI has partnered with the following IRS Offices: the PSEP Office; the Office of Online Fraud Detection and Prevention; the Situational Awareness Management Center; the Office of Privacy; and the Computer Security Incident Response Center. As a result, the IRS Threat Information and Critical Response Initiative (TIRC) was developed to allow the effective review and dissemination of threat information to IRS stakeholders in support of the critical

employee safety mission. The TIRC serves as a focal point for the timely and efficient sharing of threat information, including cyber and Internet-based threats, to maximize the IRS's ability to engage in appropriate threat mitigation to include emerging threats, such as the Internet and other cyber-based sources of threats. This threat information allows the IRS to take the appropriate action they deem necessary, to include coordinating with the Federal Protective Service in extending the security perimeter around IRS facilities, shutting down operations, or just raising the alert level at the affected IRS locations. In addition, OI has established a full-time presence at the Federal Bureau of Investigation's National Joint Terrorism Task Force and the Domestic Terrorism Operations Unit.

Through the first half of this fiscal year, OI processed 4,315 complaints, and opened 1,822 investigations. OI remains dedicated to investigate integrity programs, threat and assault investigations, and other criminal and administrative investigations such as bribery, theft, impersonation, taxpayer abuses, and false statements. Between October 1, 2010 and March 31, 2011, OI closed 1,823 investigations, which included 705 cases of employee misconduct referred for action and 102 cases accepted for criminal prosecution. OI investigations also resulted in the identification of 437 taxpayers who may pose a danger to IRS employees and infrastructure. OI's contract and procurement investigations continue to produce high dollar recoveries. OI's investigative activities resulted in $60 million placed into the United States' treasury.

Additionally, OI provides armed escort service for IRS employees in certain dangerous situations. Upon request, TIGTA's special agents escort IRS employees when they require personal contact with a potentially dangerous taxpayer. Using armed escorts, TIGTA is able to provide a safe environment for the IRS employee to conduct tax administration functions.

INFORMATION SECURITY

The IRS processes and maintains sensitive taxpayer information in computer systems for millions of taxpayers. IRS has a duty to safeguard this information against both criminal motives and mere curiosity. The healthcare act not only expands the types of information that IRS collects, but also expands the number of organizations that IRS shares information with, such as state health insurance exchanges.

Does IRS do a good job of safeguarding the information it collects now? How is that job complicated by the healthcare act?

As indicated by the IRS, it remains in steady progress at securing the taxpayer data it collects, and improving the security posture over its systems and data. For example, the IRS issued its enterprise-wide Information Technology Security Program Plan in September 2009. This Plan, as stated by the IRS, is designed to enhance collaboration and guide all security efforts across the IRS community and serves as a roadmap and a basis for benchmarking information security performance toward attaining security objectives. Senior leaders of the IRS will be able to use the Security Program Plan as input to their strategic business planning process.

Computer security continues to be reported as a material weakness as it relates to the IRS's financial statements pursuant to the *Federal Managers' Financial Integrity Act of 1982*. The IRS further categorized the computer security material weakness into nine areas: (1) network access controls; (2) key computer applications and system access controls; (3) software configuration; (4) functional business, operating, and program units security roles and responsibilities; (5) segregation of duties between system and security administrators; (6) contingency planning and disaster recovery; (7) monitoring of key networks and systems; (8) security training; and (9) certification and accreditation. As of April 2011, the IRS has closed the security roles and responsibilities, the segregation of duties, security training, and certification and accreditation components. The IRS is working toward closing or downgrading the remaining open areas.

In addition, the *Federal Information Security Management Act of 2002* (FISMA) requires agencies to report to the Office of Management and Budget (OMB) and the Congress on the effectiveness of its information security program and practices. During the 2010 reporting period, we determined that the IRS's information security program was generally compliant with the FISMA legislation, OMB information security requirements, and related information security standards. Specifically, the IRS met the level of performance for certification and accreditation, incident response and reporting, and remote access management. The IRS information security program is generally in compliance with the FISMA legislation; however, improvements are needed in configuration management, security training, plans of action and milestones, identity and access management, continuous monitoring, contingency planning, and evaluations of contractor systems.

The IRS is still in the process of determining the full impact that the health care act will have on its programs and systems. As you state in your question, the health care act will not only expand the types of information that the IRS collects, but will likely expand the number of organizations with which the IRS shares information. These added responsibilities translate into additional requirements to the IRS's programs, systems, and personnel. Current policies, procedures, and practices should enable it to accommodate and incorporate the legislative demands into its computing infrastructure.

For example, the IRS has a disciplined system lifecycle process for all new systems being developed and includes the identification of security requirements, implementation of related security controls, and testing for security weaknesses. In addition, all critical systems, both old and new, require systems certification and accreditation in order to operate within the IRS architecture. As for the sharing of data with other organizations, the IRS currently shares its data with several Federal and State governmental organizations and requires those organizations to enforce comparable security measures and controls as a requirement to have the data. The IRS also has several organizations that monitor security compliance of these organizations, including the IRS Safeguards Office whose responsibilities include security oversight of Federal, State, and local Government agencies receiving Federal tax information and the Infrastructure Security and Review Office whose responsibilities include security oversight of contractors receiving IRS data.

For Fiscal Year 2011, the TIGTA has listed "Security" as its top concern in regard to the most serious management and performance challenges confronting the IRS. As such, we will continue to provide oversight and audit coverage over IRS security programs and to evaluate the on-going progress being made by the IRS on its security posture.

HEALTH CARE IMPLEMENTATION

When the IRS Commissioner testified before this subcommittee last month, he said that when new provisions are added to the tax code, such as the individual mandate, the IRS adds that new responsibility to the core, or existing, programs.

Are you aware of any new programs, offices, or positions that the IRS created to implement provisions of the healthcare act?

At least 42 of the 514 *Patient Protection and Affordable Care Act of 2010* (Affordable Care Act) provisions add to or amend the Internal Revenue Code, and at least eight require the IRS to establish new operations. Taken together, these provisions represent the largest set of tax law changes in 20 years. The Affordable Care Act contains $438 billion worth of revenue provisions in the form of new taxes and fees. It also contains credits, which provide incentives for medical research and for businesses to offer employees health care insurance. Additionally, new reporting requirements have been established for certain business transactions. The Affordable Care Act further imposes penalties administered through the tax code for individuals and businesses that do not obtain health coverage for themselves or their employees. Other provisions raise revenue to help pay for the overall cost of health insurance reform.

New programs will need to be implemented to address the provisions affecting hospitals and health exchanges, these provisions create new responsibilities for the IRS. Many of the other provisions will require new programming but will become part of existing but expanded operations. For example, the Affordable Care Act imposes an aggregate annual fee on businesses engaged in manufacturing and importing branded prescription drugs sold to specified Government programs. The fee is allocated to each entity according to its share of drug sales. The IRS's Large Business and International Division will manage the administration of this annual fee. Administration of the fee entails, for the first time, IRS's collection of data, computation of each entities fee amount, and assessment of the fee.

The Affordable Care Act Program Management Office has been created and staffed with existing IRS executives to oversee the implementation of the Affordable Care Act provisions. The IRS has reported filling 495 Affordable Care Act-related positions from enactment of the law to the present and has plans to hire at least 87 more during Fiscal Year 2011. These positions represent revenue agents, programmers, customer service assistors, and various other positions in the Business Operating Divisions to implement and/or staff Affordable Care Act provisions.

Our review of the IRS's Modernization and Information Technology Services (MITS) organization's planning efforts to develop information systems to implement Affordable Care

Act provisions found that MITS also established a new organization called the Associate Chief Information Officer, Affordable Care Act Program Management Office. The IRS Request for Organization Change shows the MITS Program Management Office is authorized to have 417 positions. As of April 2011, 244 of the positions were filled. Other MITS organizations are also authorized to hire employees and/or contractors to perform Affordable Care Act work. Based on the MITS Spend/Budget Plan, the target number of employees is 387 for 2011 and 537 for 2012.

The MITS Program Management Office will oversee the design, development, and deployment of Affordable Care Act-related information systems' projects. Based on legislative timelines, the portfolio of information systems projects is anticipated to require four to five years of dedicated management, although this timeline is subject to change. Once these projects are fully deployed, the Program Management Office will be transitioned into the MITS Applications Development organization.

We have also identified that the IRS has awarded nine procurements, all for information technology services, valued at approximately $10.7 million. As of January 2011, $4.4 million had been spent on these procurements.

Certain aspects of implementing health care reform are of concern for the security risks they may pose to IRS employees and infrastructure. Historically, implementation of a new government program increases the risk of new avenues for fraud, waste, and abuse. The number and type of risks are typically proportional to the size and complexity of the program. Due to the size and nature of the program, the potential for new types of fraud is present with health care reform.

To address these risks, TIGTA has developed an oversight strategy to evaluate the IRS's planning and implementation of the Affordable Care Act provisions. Some provisions required immediate implementation. We have initiated reviews of the implementation of the Small Business Health Care Tax Credit as well as the Qualifying Therapeutic Discovery Project. Our reviews of the IRS's overall implementation plans will include new and expanded operations and information systems, as well as, the IRS's development of the forms, publications, and outreach necessary to implement provisions as they become effective. While many of the provisions do not take effect for some time, the IRS's efforts to implement these provisions must start well in advance.

CONSUMER FINANCIAL PROTECTION BUREAU

The Dodd-Frank Act requires the Consumer Financial Protection Bureau to report instances of tax law noncompliance to the IRS.

To your knowledge, has the Bureau initiated contact with the IRS Enforcement Division or with your office in order to build an effective and productive relationship?

To our knowledge, the Consumer Financial Protection Bureau has not contacted either the IRS's Small Business/Self T Employed Business Unit or TIGTA regarding this matter.

Questions for the Record Submitted by Ranking Member Serrano

MANAGEMENT STRATEGIES

What are the top management challenges facing the IRS today?

The top management challenges facing the IRS today are:

- Security
- Modernization
- Tax Compliance Initiatives
- Implementing Health Care and Other Tax Law Changes
- Providing Quality Taxpayer Service Operations
- Human Capital
- Erroneous and Improper Payments and Credits
- Globalization
- Taxpayer Protection and Rights
- Leveraging Data to Improve Program Effectiveness

How have those challenges changed or grown in the last 7 years?

While their rankings have changed over the past seven years, the top ten challenges facing the IRS have remained fairly constant. Over the years, the top three challenges continue to be security, modernization, and tax compliance initiatives. Although not identified as a separate challenge in Fiscal Years 2010 and 2011, we identified complexity of the tax law as an underlying issue that has wide-ranging implications for both the IRS and taxpayers. This complexity, including frequent revisions to the Internal Revenue Code, makes it increasingly difficult for the IRS to explain and enforce the tax laws and more costly and time consuming for taxpayers who want to comply.

The chart below summarizes the top challenges faced by the IRS since Fiscal Year 2004.

Top Management Challenges Facing the IRS (and order of priority) since Fiscal Year 2004

Management or Performance Challenge	FY 11	FY 10	FY 09	FY 08	FY 07	FY 06	FY 05	FY 04
Modernization (of technology and organizational structures/processes)	2	1	1	1	1	1	1	1
Security (of data/information systems and employees/facilities)	1	2	2	3	3	3	3	3
Tax Compliance Initiatives	3	3	3	2	2	2	2	2
Implementing Health Care and Other Tax Law Changes	4	–	–	–	–	–	–	–
Implementing Tax Law Changes (during the filing season)	–	4	–	–	–	–	–	–
Processing Returns and Implementing Tax Law Changes	–	–	9	9	9	9	8	8
Providing Quality Taxpayer Service Operations	5	5	4	4	4	6	6	6
Human Capital	6	6	5	6	10	10	10	10
Erroneous and Improper Payments and Credits	7	7	–	–	–	–	–	–
Erroneous and Improper Payments	–	–	6	7	7	7	7	7
Globalization	8	8	–	–	–	–	–	–
Taxpayer Protection and Rights	9	9	8	8	8	8	9	9
Leveraging Data to Improve Program Effectiveness and Reduce Costs	10	10	–	–	–	–	–	–
Improving Performance and Financial Data for Program and Budget Costs	–	–	10	10	6	5	–	–
Integrating Performance and Financial Management	–	–	–	–	–	–	4	4
Complexity of the Tax Law	*	*	7	5	5	4	5	5

Note: Over the years, TIGTA refined the nature of some challenges and altered the corresponding descriptions somewhat (the prior titles are indented above.

*TIGTA added a special note about Complexity of the Tax Law in 2010 and 2011. In its report for FY 2011, TIGTA notes that: "Although not listed, complexity of the tax law remains a serious, underlying issue that has wide-ranging implications for both the IRS and taxpayers. This complexity, including frequent revisions to the Internal Revenue Code, makes it increasingly difficult for the IRS to explain and enforce the tax laws and more costly and time consuming for taxpayers who want to comply."

The IRS is not unique in that it faces a potential crisis of retirements – nearly 30 percent of the IRS workforce is eligible to retire at this point in time. Given that budgets will certainly be tight, how does this potential "brain drain" at the agency further affect the ability of the IRS to close the tax gap and provide efficient, effective services to taxpayers?

The pending loss of institutional knowledge and expertise at all levels and the challenge of retaining a highly skilled workforce increase the risk that the IRS may not be able to fully achieve its mission. While TIGTA has not specifically calculated the potential impact a "brain drain" could have on the IRS' ability to close the Tax Gap and deliver efficient, effective services to taxpayers, we have embarked upon a broad, multi-year human capital audit strategy for assessing the IRS's human capital efforts across the organization.

In addition, we have conducted reviews of specific human capital challenges within several IRS business units, most recently in the areas responsible for collecting tax revenues and

examining tax returns. Our reviews show that the IRS is already being impacted by retirements in the collections area. As a result, the IRS is having trouble collecting what it knows is due from taxpayers. For example, TIGTA conducted an audit of the recent revenue officer[1] hiring initiative. While the IRS did a good job of hiring over 1,500 revenue officers in a nine-month period and placing these new hires in the collection areas with the greatest need, the IRS estimates that the net gain after retirements and other attrition will only be about 125 revenue officers by the end of Fiscal Year 2012. In addition, it will take these new revenue officers time to gain expertise and become fully productive in collecting revenue. Meanwhile, more than half of the revenue officer workforce and 79 percent of its supervisors have 20 or more years of service with the IRS, which means the IRS will need to plan for additional retirements over the next ten years. Since Fiscal Year 2006, the percentage of revenue officers who are retirement eligible has been steadily increasing, and more than 60 percent of revenue officers retired during their first year of eligibility. All the while, delinquent account inventory appears to be outpacing the workforces' capacity to close cases. Despite closing delinquent tax accounts at higher rates since Fiscal Year 2005, the percentage of the delinquent tax accounts closed has steadily decreased because of greater increases in new accounts.

The IRS recognizes the seriousness of the human capital challenges it faces and is taking steps to maintain a skilled workforce in mission critical[2] positions to mitigate the risk that it may not be able to fully deliver its mission. IRS statistics show that:

- At the beginning of Fiscal Year 2010 the IRS employed over 107,543 individuals, which increased to 107,622 by the end of the fiscal year. Since Fiscal Year 2006, the number of IRS employees has increased by 3,695 employees (4 percent).
- IRS hired and placed 1,515 new revenue officers between June 2009 and February 2010.
- In Fiscal Year 2009, the IRS hired more than 2,000 revenue agents[3] and tax compliance officers, which is the largest hiring increase in the past five years. During Fiscal Year 2010, hiring continued at an increased pace with the addition of nearly 1,300 revenue agents and tax compliance officers. As of the end of Fiscal Year 2010, the total number of field Examination function personnel who conduct examinations of tax returns increased by 4 percent from Fiscal Year 2009. The number of revenue agents increased to 11,648, while the number of tax compliance officers increased to 1,400. Since Fiscal Year 2006, the number of examiners in field offices has increased by approximately 12 percent.
- The large staffing level increases in Fiscal Year 2009 and Fiscal Year 2010 resulted in the most tax returns examined in the past five years. The overall percentage of tax returns examined (including face-to-face and correspondence examinations) increased nearly 8 percent from Fiscal Year 2009. This is the largest overall number of tax returns examined over the past five years and an increase from Fiscal Year 2006 of 17 percent.

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[1] Revenue Officers are employees who attempt to contact taxpayers and resolve collection matters that have not been resolved through notices sent by the IRS campuses.

[2] Mission critical occupations are occupations that comprise the unique core competencies of the IRS and/or have the greatest direct impact on the agency's ability to meet its mission.

[3] A revenue agent is an employee in the Examination function who conducts face-to-face examinations of more complex tax returns such as businesses, partnerships, corporations, and specialty taxes (*e.g.*, excise tax returns).

At the broad, organization-wide level, our human capital audits in Fiscal Years 2008 and 2009 revealed that, while the IRS had made improvements, it had not made substantial progress in developing and implementing a strategic workforce planning process to ensure the IRS will have the right resources in the right place at the right time to achieve its mission and goals. Since that time, the IRS has increased its focus on human capital issues, whether it be through implementing actions recommended by the IRS Commissioner's Workforce of Tomorrow Task Force,[4] taking corrective actions pursuant to TIGTA's reports, or making improvements to its operations.

However, the IRS's human capital challenge involves many complex internal and external factors which the IRS will need to address over the long-term. IRS leaders will need to be more proactive, embrace change, and think on a large scale. In addition, the work performed by IRS employees continually requires greater expertise as tax laws become more complex, manual systems used to support tax administration become computer-based, and attempts by taxpayers and tax practitioners to evade compliance with the tax laws become more sophisticated. The IRS must also compete with other government agencies and private industry for the same human resources, complicated by the fact that younger generations of employees move between jobs more frequently than employees in the past. Furthermore, budget constraints, legislative changes, and economic shifts can create unforeseen challenges for the IRS in addressing its long-term human capital issues.

Specifically, there are at least two key aspects in the IRS's long-term challenge to leverage resources to close the $345 billion gap between the taxes that should have been paid on time but were not (Tax Gap) and to deliver the level of services the taxpaying public expects. First, the time and cost of training personnel in mission critical positions can be substantial. For example, the training program for revenue agents can cover more than two years and consists of multiple phases of classroom and on-the-job training when simpler, lower yielding returns are audited. During some of this time, revenue agents who have a high level of technical knowledge and typically audit higher yielding returns are diverted to help train the new revenue agents. Thus, it is reasonable to assume that the increase in lower yielding returns and decrease in higher yielding returns could impact the Tax Gap, at least in the near term.

Second, current economic conditions may diminish the IRS's ability to make substantial progress in closing the Tax Gap and delivering top quality service. Currently, there are signs the country is starting to recover from the very serious economic conditions that threatened the stability of our financial system. However, many taxpayers are and will be struggling with very difficult financial hardships in the coming years and these taxpayers may be contributing to the IRS's growing delinquent account inventory. During Fiscal Year 2010, the IRS received more new tax delinquent accounts (unpaid balances due) than it closed, with the gap between receipts and closures increasing to nearly 50 percent (to over 2.2 million accounts). This is the first time in three years that the gap has increased, surpassing a high of approximately 1.9 million accounts during Fiscal Year 2007.

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[4] The goal of this Task Force was to make the IRS the best place to work in the Federal Government and ensure that in five years the IRS will have the leadership and workforce ready for the next 15 years.

TIGTA continues to believe that human capital management is one of the most significant management issues facing the IRS; therefore, we will continue to closely monitor and assess the IRS's efforts in this area, as well as the potential impact that human capital needs are having on the IRS fully achieving its mission.

IRS BUSINESS SYSTEMS MODERNIZATION

The IRS is engaged in a very long-term technology upgrade called the Business Systems Modernization project. In past years, we have explored this topic exhaustively from the IRS, GAO and OMB perspectives.

How involved has your office been in the oversight of this large technology upgrade?

TIGTA has been involved since the IRS began the Business System Modernization (BSM) effort in 1999 and has issued audit reports on BSM each year. During Fiscal Year 2011, we have focused our resources on the IRS's two highest Business System Modernization program efforts – the Customer Account Data Engine 2 (CADE-2) and the Modernized e-File.

What types of investigations or audits have you done of the BSM project?

During Fiscal Year 2011, we completed the CADE-2 Prototype Audit and are currently conducting four CADE-2 audits: Program Management Office, Daily Processing, Database Implementation, and System Testing. In addition, we reviewed the Modernized e-File program and plan to issue the final report in July 2011. We conducted these reviews through an online process which enables us to accomplish fieldwork and make recommendations during the same timeframe the IRS is developing the program(s) and meeting consecutive milestones. These online reviews are helpful to the IRS, as we can address findings and concerns to IRS executives who can then take immediate corrective actions. At the end of each Fiscal Year, we prepare an annual assessment report that includes our evaluation of the Business System Modernization program. We are currently preparing the annual assessment for Fiscal Year 2011 and expect to issue our final report in September 2011.

From your perspective, is the project gaining steam, or are we spinning our wheels? Are the proper controls in place to monitor the development of the system, the achievement of interim goals, and the expenditure of funds?

The IRS has made progress in modernizing its systems. TIGTA's audit reports have cited continued improvement in project management and systems development disciplines. From our audit fieldwork of the Modernization systems we have reviewed, there seems to be proper controls in place to monitor systems development. CADE-2 appears to be going in the right direction, although we will not know for sure until CADE-2 is in production, and the first phase (which is Transition State 1) is scheduled for implementation in January 2012. The next phase (Transition State 2) is schedule to roll out in January 2014, but IRS has yet to establish an implementation date for the final phase of CADE-2. Our reviews of CADE-2 are currently

ongoing and are showing that CADE-2 is adhering to the IRS's Enterprise Life Cycle and a supplemental system development framework. IRS executives are also revising key processes including risk management as circumstances warrant.

The IRS originally estimated the BSM Program effort would last up to 15 years and incur contractor costs of approximately $8 billion. The BSM Program has received approximately $3.24 billion for contractor services, plus an additional $474 million for internal IRS costs. The BSM Budget Request for FY 2012 is $333,600,000 in direct appropriations and 453 FTE's. The focus for the BSM program is to continue the development of the new taxpayer account database (CADE-2). Completion of the core taxpayer account database is the cornerstone of IRS's information technology program and, if implemented as planned, will expedite refunds to millions of individual taxpayers and will serve as a prerequisite for other major initiatives such as expansion of online paperless services. The ability of the IRS to support increasingly complex taxpayer service and compliance initiatives will be severely limited until the new taxpayer account database is completed and implemented.

Last year, before the Senate Financial Services Subcommittee on Appropriations, you identified four challenges that the IRS needed to overcome to deliver a successful modernization system. These included: 1. Improving key management processes and committing resources; 2. Managing the complexities and risks of the BSM program; 3. Use experienced leadership to maintain continuity and strategic direction; and 4. Ensure that contractor performance and accountability are effectively managed. Almost a year later, how do you feel that the IRS is doing on these four challenges?

1. Improving key management processes and committing resources:

The IRS is using the Enterprise Life Cycle and a supplemental system development framework for CADE-2, and making adjustments in the guidelines as needed to address key processes. IRS has committed significant executive and technical resources to CADE-2, and continues to monitor this area as a key risk to the program.

2. Managing the complexities and risks of the BSM program:

The IRS is actively monitoring complexities and risks to the CADE-2 program. Our recent audit, conducted in conformity with the standards of the Software Engineering Institute's Capability Maturity Model Integration (CMMI),[5] determined that the IRS has achieved a maturity Level 2, and it is applying these repeatable processes to its modernization projects.

[5] A maturity level is a well-defined evolutionary plateau toward achieving a mature software process. In CMMI models with a staged representation, there are five maturity levels: (1) Initial; (2) Managed; (3) Defined; (4) Quantitatively Managed; and (5) Optimizing. At maturity level two, the projects of the organization have ensured that requirements are managed and that processes are planned, performed, measured, and controlled. In addition, the status of the work products and the delivery of services are visible to management at defined points.

3. Use experienced leadership to maintain continuity and strategic direction:

Our reviews have concluded that the IRS Chief Technology Officer continues to provide key leadership and continuity to the CADE-2 program. The Chief Technology Officer is briefed consistently and timely on the status and progress of CADE-2 and works to ensure that strategic direction is maintained.

4. Ensure that contractor performance and accountability are effectively managed.

The IRS CADE-2 team is composed of executives and managers responsible for oversight of contractor performance, and they participate in bi-monthly meetings as contractor performance on various deliverables and work products are reviewed and approved. Managing contractor performance has been less of an issue since the IRS assumed the BSM Program integrator role in January 2005.[6] However, identifying and timely employing contractors continues to present a challenge to the IRS. This challenge includes the ability to ensure appropriate security controls are timely and completely implemented in employing contracted personnel.

Questions for the Record Submitted by Congressman Womack

IRS TAX CREDITS

Mr. George, you mentioned the Earned Income Tax Credit (EITC) and the Additional Child Tax Credit (ACTC)—the two largest refundable tax credits—and the issues the IRS is having in properly administering these credits. With respect to the EITC, you noted that the IRS has taken steps to address the issue; however, in your testimony, you mentioned that the IRS has made little, if any, improvement in reducing improper payments for the EITC. In addition, you noted the need for the IRS to develop an alternative process to protect revenue associated with erroneous EITC claims.

Can you explain, in detail, the steps the IRS is taking to address this issue?

Since Fiscal Year 2003, the IRS has initiated a number of actions that have improved its ability to administer the EITC Program. These actions have resulted in increased oversight and coordination and a more focused approach to improving compliance. Actions include:

- Developing a five-point EITC initiative in 2003 to improve service, fairness, and compliance with the EITC law. This initiative included reducing backlogs of EITC Program examinations, improving communication with taxpayers, increasing outreach

[6] Prior to January 2005, the prime contractor was responsible for the overall management and system integration for the BSM Program (ensuring modernized systems worked effectively within the tax administration system and was compatible with other automated systems that were already in production). Since January 2005, IRS management has taken over responsibility for BSM management and system integration roles, which has reduced the concerns and risks associated with the management of contractor performance.

efforts, enhancing compliance efforts, and testing a certification process for higher risk taxpayers.

- Establishing the EITC Program Office in 2003 and aligning the Office directly under the Commissioner, Wage and Investment Division. Direct reporting ensured that the Program received the emphasis needed to address its compliance problems and coordinated the oversight of many EITC activities under one executive. Activities include oversight of the EITC outreach efforts and compliance activities, such as the pre-refund audit program.
- Implementing Service Level Agreements between the EITC Program Office and its partner functions within the IRS to increase accountability for EITC activities performed by those organizations. These agreements outline commitments agreed to with other functions within the IRS to assist in EITC activities.
- Developing a Concept of Operations that provides a roadmap of the IRS's vision for the Program. The EITC Program Office regularly updates the Concept of Operations as new research and data are obtained and analyzed.
- Establishing long-term performance measures that reflect the Program's anticipated outcomes over time: percentage of eligible taxpayers who file for the EITC and percentage of EITC claims paid in error.

However, despite these efforts, the IRS continues to report that 23 percent to 28 percent of EITC payments are issued improperly each year. In Fiscal Year 2009, this equated to $11 billion to $13 billion in improper EITC payments. Although the IRS annually reports billions in EITC improper payments since it began reporting estimates to the Congress in 2002, little improvement has been made in reducing these payments.

If the IRS is aware of the improper payments for the EITC and taking steps to address the issue, why are we not seeing any improvement in the reduction of improper payments for the EITC?

Prior to 2004, the IRS focused on ways to identify EITC noncompliance. As a result, it has successfully developed a number of processes to identify erroneous EITC payments. However, compliance resources are limited and additional alternatives to traditional compliance methods have not been developed, resulting in the majority of the potentially erroneous EITC claims identified being paid in error.

We have conducted a number of audits that have identified opportunities to reduce the number of EITC improper payments. We have provided the IRS with specific actions that could be taken to reduce improper payments and allow the IRS to establish measurable reduction targets. While the IRS has implemented some of our recommendations, it has not taken actions to address key recommendations aimed at preventing and reducing EITC improper payments. For example, we reported in December 2008, the IRS has developed processes to successfully identify billions of dollars in erroneous EITC payments. However, the IRS did not have the

resources to address many of these cases resulting in the majority of the claims being paid in error.

The IRS needs to develop alternative processes that are less costly than an audit to protect revenue associated with erroneous EITC claims. The IRS agreed with our recommendation noting that it was continuing its ongoing efforts to identify new alternatives to effectively expand its treatment of erroneous payments. The IRS acknowledged that it cannot fully address EITC noncompliance by simply auditing returns and must pursue alternatives to traditional compliance efforts. However, the IRS has not made any significant progress in developing and implementing these alternatives. This continues to hinder the IRS's ability to reduce the billions of dollars in erroneous EITC claims.

Is the IRS in the process of developing an alternative process to deal with the erroneous EITC claims and payments?

The IRS stated in a June 14, 2010, report to the Treasury Inspector General for Tax Administration that it is focusing on tax return preparer compliance in an effort to further reduce erroneous EITC payments. The IRS notes that its new efforts to regulate tax return preparers will drive increased EITC compliance, decrease fraud, and reduce the improper payment rate. We agree the regulation of tax return preparers will have some impact on reducing EITC improper payments. Nonetheless, the IRS report does not provide details on when or how the IRS plans to measure the impact of the tax return preparer strategy on EITC improper payments. It is unknown whether regulation of tax return preparers will result in a significant reduction in the EITC improper payment rate. Further, the IRS has just begun implementing the tax return preparer strategy and does not anticipate the strategy will be fully implemented until 2014. Using IRS estimates for FY 2009, it is likely that the IRS will have issued anywhere from $55 billion to $65 billion in improper payments by FY 2014.

In addition, beginning in 1999, the IRS developed a strategy specifically focused on increasing tax return preparer compliance with the EITC due diligence requirements.[7] The IRS refers to this strategy as the EITC Paid Preparer Strategy. Representatives from the IRS indicated that the EITC Paid Preparer Strategy serves as a model for enforcement of tax preparer compliance within the new IRS Paid Preparer Strategy. The results of our review of the IRS's EITC Paid Preparer Strategy[8] show that Due Diligence visits[9] to tax return preparers as part of this strategy resulted in some reduction in erroneous EITC payments. The IRS projects these efforts will reduce EITC improper payments by $45 million in FY 2010. Although it appears that visits to problematic EITC tax return preparers are successful in changing the behavior of those preparers, the amount of EITC improper payments protected is insignificant (approximately $35 million in FY 2007 or 0.32 percent) when compared to the $11 billion to $13 billion in improper payments reported by the IRS annually.

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[7] Due diligence requirements provide guidance to tax return preparers for ensuring that information used to claim the EITC is correct.

[8] *Actions Can Be Taken to Improve the Identification of Tax Return Preparers Who Submit Improper Earned Income Tax Credit Claims* (Reference Number 2010-40-116, dated September 14, 2010).

[9] A Due Diligence visit is an examination to determine whether a paid preparer is in compliance with all four Due Diligence requirements of Internal Revenue Code Section 6695(g).

What can Members of Congress do to ensure the IRS is taking the appropriate steps to address this problem?

- Expand math error authority[10] or provide the IRS with similar authority to allow the IRS to adjustment EITC claims that it has identified as highly suspect based on its use of historical EITC and third-party data.
- Make it easier for taxpayers and the IRS to determine eligibility for the credit by simplifying the EITC eligibility requirements.

ADDITIONAL CHILD TAX CREDIT

You touched on the ACTC and the number of filers and recipients of the credit who are unable to obtain, or not eligible to receive, a Social Security Number. Instead of providing a Social Security Number, these individuals file tax returns using an Individual Taxpayer Identification Number (ITIN).

There was a similar problem with the EITC that resulted in a change in the law denying the EITC to individuals who were unable to provide a Social Security Number that is valid for employment. In your testimony, you note that the change in the law could be interpreted to apply to the ACTC or any refundable credit. However, the IRS does not believe the law gives the agency sufficient legal authority to deny the ACTC to ITIN filers.

If it has been determined that the law denying the EITC to ITIN filers could be interpreted to apply to the ACTC or any refundable tax credit, why is the IRS arguing it does not have sufficient legal authority?

IRS management's view is that *The Personal Responsibility and Work Opportunity Reconciliation Act of 1996* does not provide sufficient legal authority for the IRS to disallow the ACTC to ITIN filers. In addition, the Internal Revenue Code does not require a Social Security Number to claim the credit, and it does not provide the IRS math error authority to deny the credit without an examination.

Prior to 1996, filers using an ITIN were entitled to claim the EITC. However, concerns were raised by the Government Accountability Office, the IRS, and the Congress regarding noncompliance with EITC requirements. The law was subsequently changed to deny the EITC to individuals who file a tax return without a Social Security Number that is valid for employment. As such, filers using an ITIN are not eligible for the EITC. We believe the

[10] Math error authority allows the IRS to send a notice of assessment of additional tax without using deficiency procedures in which the IRS contacts taxpayers through the mail or by telephone when it identifies mathematical errors or mismatches of taxpayer information that would result in a tax change.

situation today with the ACTC is similar to the situation which preceded the prohibition of the EITC to ITIN filers. Billions of dollars in ACTC are being provided to ITIN filers without verification of eligibility, and IRS employees have raised concerns about the lack of an adequate process for identifying and addressing improper claims.

However, we believe the language of the law is such that it could be interpreted to apply to the ACTC or any refundable credit. It prohibits individuals residing without authorization in the U.S. from receiving most Federal public benefits with the exception of certain emergency services and programs.

In particular, what is the IRS's issue with interpreting the law to apply to the ACTC?

The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 prohibits aliens residing without authorization in the United States from receiving most Federal public benefits and defines a Federal public benefit as:

> Any grant, contract, loan, professional license, or commercial license provided by an agency of the United States or by appropriated funds of the United States; and any retirement, welfare, health, disability, public or assisted housing, postsecondary education, food assistance, unemployment benefit, or any other similar benefit for which payments or assistance are provided to an individual, household, or family eligibility unit by an agency of the United States or by appropriated funds of the United States.

In discussions with TIGTA, IRS management stated that the law does not specify or clearly establish the ACTC as a "Federal Public Benefit."

How many people who are unable to obtain, or not eligible to receive, a Social Security Number receive the ACTC?

I do not know the answer to this question, as we do not have data on individuals who are not eligible to receive a Social Security Number and do not file a tax return. But at least three million tax returns using ITINs filed in 2010, more than two million claimed and received the ACTC.

Are there any steps the IRS can take to address this problem, or is the agency waiting on Congress to act?

Legislation would be needed to clarify whether a Social Security Number that is valid for employment is needed in order to claim the ACTC, consistent with requirements for EITC. Both credits are calculated based on a percentage of earned income and both are refundable. If these credits may not be paid, legislation would be necessary to provide the IRS math error authority to disallow associated claims for the credits. We estimated that allowing the ACTC only to those filers who are eligible to live and work in the U.S. (*i.e.*, those with a Social Security Number that is valid for employment) would reduce Federal outlays by approximately $4.2 billion annually.

WEDNESDAY, MARCH 16, 2011.

DEPARTMENT OF THE TREASURY

WITNESS

HON. TIMOTHY GEITHNER, SECRETARY OF THE TREASURY

Mrs. EMERSON. The hearing will come to order.

Thanks to all of the subcommittee members for being here. And, Secretary Geithner, thank you so very, very much. As we speak, numeral doctoral theses about your tenure at the New York Federal Reserve Bank and the Department of the Treasury are being written. Both TARP and Dodd-Frank have made an indelible mark on financial markets, government policy, and U.S. history.

In January, the Special Inspector General for TARP concluded that while TARP prevented the failure of one of the world's largest banks, it also insulated risk takers from the consequences of failure, and thereby encouraged future high risk taking behavior. Whether Dodd-Frank can successfully address the moral hazard introduced by TARP remains to be seen.

For fiscal year 2012, the Treasury Department requests $14 billion of which $13.3 billion is for the Internal Revenue Service. The remaining $754 million is for, among other things, the offices of three inspectors general, the Community Development Financial Institutions Fund (CDFI), the routine cash and debt operations of the Federal Government, and various policy offices that oversee counterterrorism, anti money laundering, financial regulatory reform, housing finance reform, and small business initiatives.

The decisions made by these policy offices have an effect on American lives and businesses disproportionate to the level of appropriated funds that they receive. As such, the committee will review their funding levels and activities with great care and in great deal.

The Federal government's gross debt currently exceeds $14 trillion, and the administration's budget will lead to debt in excess of $26 trillion or 107 percent of GDP in 2021. In light of these estimates, the administration's lack of leadership to steer us towards a sustainable spending trajectory is disappointing. Inaction is unacceptable; and as such, this committee is going to do what it can within its jurisdiction to significantly reduce spending.

Once again, many, many thanks for being here, Secretary Geithner, and I look forward to your testimony. Now I recognize my colleague in arms, Mr. Serrano, for any opening statements he would like to make.

Mr. SERRANO. Thank you, Madam Chair.

I would also like to welcome the Secretary of the Treasury, Timothy Geithner, to this hearing of the Financial Services and General Government Subcommittee.

For 2012, the Treasury Department is requesting authority to spend a little over $14 billion, an increase of $562 million or 4.2 percent above 2010. As you know, I have been a long time supporter of strong funding for the Community Development Financial Institutions Fund. The CDFI fund has played an important role in increasing economic opportunity and community development in our most disadvantaged communities. I am also pleased that in your budget request, you are trying to find innovative ways to help our small businesses and to increase their ability to access credit.

Small businesses play a crucial part in job creation; and, thus, our continued economic recovery. With the passage of the Dodd-Frank Act, you were given many new responsibilities designed to help stabilize our financial system and prevent a repeat of the economic crisis. I am interested to learn more about how you are moving forward in carrying out these new mandates. I also want to make sure that you have included sufficient resources in your proposed budget to allow you to successfully implement these new requirements.

The Treasury Department also has an important role to play in stabilizing our housing market. We need to make sure that affordable housing options continue to remain available, and that our consumers are better protected from risky financing packages. I know that you are very involved in trying to find solutions to improve the health of our Nation's housing financial system, and I am hoping to discuss these important efforts with you today.

I would also note that you are seeking to fund the IRS in fiscal year 2012 in a very strong way. Taxpayer services and enforcements are a vital part of our effort to reduce the tax gap and stop those who seek to cheat the United States Government. Unfortunately, H.R. 1, the Republican continuing resolution, would cut more than $600 million for IRS operations.

IRS Commissioner Shulman was here just a couple of weeks ago and told us that this cut would mean that the United States would lose more than $4 billion in revenue from delinquent taxpayers. Cutting IRS funding in this manner makes little sense to me since the IRS provides the very funding that the rest of our government uses to operate. The Treasury Department has an important role to play in helping to address the concerns of everyday Americans in the areas of tax assistance, small business credit, mortgage relief, and the creation of economic opportunity.

I look forward, Mr. Secretary, to discussing your important work in all of these areas. I thank you before we begin for your service to our country.

Thank you.

Mrs. EMERSON. Thank you, Mr. Serrano.

I would now like to recognize Secretary Geithner. If you can keep your statement to 5 minutes, that will give us more time for questions.

Secretary GEITHNER. Thank you, Chairwoman Emerson, Ranking Member Serrano, and members of the committee. Thank you for coming here today. I just want to say at the beginning that I very much respect the process of oversight you are engaged in. I think it is a great thing for our country that you subject all of the actions of the executive branch to rigorous oversight and review. That is

what you should be doing, and it is my privilege to participate in that process. I think this is my 51st testimony today during the time as Secretary. I know it is a necessary part of what we are doing, particularly at a time when we are involved in so many difficult, complicated problems.

Our core priority in the Treasury budget is to help strengthen the recovery and help put more Americans back to work. We are undertaking a variety of initiatives to support those objectives. Let me just list a few.

We are providing help for small businesses through tax incentives, through the small business lending fund, the States' small business credit initiatives through the new market tax credit and the CDFI program. All of these share one feature in common as a strategy. They are designed to provide substantial leverage for any dollar of taxpayers' money we put at risk to leverage private resources alongside the taxpayers' money. So we are working with the market to help catalyze private investment.

Second, we are continuing our efforts to help repair and reform the financial system, not just the housing markets, housing finance market, but the broader financial system. And we are working to shape and design a broad reform of the corporate tax system that would lower the rate, broaden the base of revenue neutral tax reform, that would help improve incentives for business investments in the United States.

Of course, alongside these efforts, we play a critical role in helping advance U.S. security interests, and our national security interests abroad. Our budget request includes funding for implementing our targeted economic and financial sanctions programs against foreign threats to the United States, and I know these are very important to many of you on this committee.

In this year's request, as in the past, the overwhelming bulk of the resources we are asking Congress to appropriate are designed to support or directed to support the talented public servants who are charged with Treasury's important economic and financial responsibilities. Salaries and operating costs make up 96 percent of our budget. We are a little unusual in that context relative to other agencies. The rest of the budget is mostly for investments in technology that those public servants need to do their jobs.

Now in our request, we have asked for just above $14 billion for the Treasury; $13.3 billion, the overwhelming majority is for the Internal Revenue Service. Now, I just want to emphasize that we are very committed and very successful in finding ways to save resources and improve efficiency in the basic Treasury programs. In the last three budget requests, we identified more than a billion dollars in savings and offsets.

In this budget, we have identified another $1 billion in savings, of which there is about $336 million in direct cost savings and efficiencies. The balance of that, the roughly $630 million in offsets, is through assets seized as a result of violations of U.S. sanctions.

These savings help us finance what we think are targeted, valuable, investments that have a very high return. Let me mention a few. Investments in customer service and enforcement programs at the Internal Revenue Service generate revenue at many times the cost to the taxpayer. Every dollar invested in the IRS yields rough-

ly $5, and that is a pretty conservative estimate, in additional revenue from non-compliant taxpayers.

Our judgment is that the modest targeted investments in this budget that we are proposing for the IRS are expected to produce more than $1.3 billion in additional revenue once fully implemented in 2014.

We are also working to improve efficiency by moving to a more paperless transaction system, from automated debt financing to greater electronic filing of taxes. Overall, these paperless transaction initiatives with the public are expected to produce more than $500 million in cost savings and efficiencies over the next 5 years.

So we have designed our request to save as much as we can while preserving critical functions and programs. In our judgment, any substantial cuts to the IRS budget would hurt both our ability to collect enough revenue to meet our obligations and hurt our ability to serve taxpayers more quickly and efficiently. Cuts to our remaining programs would weaken our ability to support reforms that are very important to the economic recovery and the ongoing challenge of repairing our financial system.

Finally, cuts to the CDFI Fund would substantially damage our ability to attract private investment to communities hurt most deeply by the crisis, which are still suffering because of the broader damage caused by the crisis.

Now, I want to end by noting, as Madam Chair you did, that it is important to recognize the strategy that we embrace to address the financial crisis has been much more successful and at a much lower cost than we initially anticipated. Let me just give you a few facts on that.

On relatively conservative estimates about the future of the economy, over the next 10 years, we think the total costs of the taxpayer support to Fannie and Freddie will fall by about $61 billion, or 45 percent from the initial estimates. Since the August 2009 midsession review, the projected cost of TARP has declined by $293 billion, or 86 percent. Today I can say that based on the expected additional repayments we expect from several financial institutions, taxpayers will have recovered more than 99 percent of the funds disbursed for the TARP's bank programs.

In fact, outside of housing, the programs designed to help give Americans the chance to stay in their home, outside those programs, the TARP programs in banks, automobile companies, even in AIG on balance will show a significant positive return for the American taxpayer.

Now these savings, these hundreds of billion dollars in lower expected cost of TARP means we are returning hundreds of billions of budget authority unused and that creates greater room for us to meet our future challenges and reduce our deficits.

You are right, Madam Chair, to point out that when governments act to put out a financial fire, by definition, they create the risk of adding to moral hazard in the future. And the big test we face is the broader reforms in Dodd-Frank will be effective in helping limit that risk. I can tell you that I am very confident that those reforms will, if we are able to put them in place, allow us to substantially reduce the risk of future crises, and substantially reduce the risk of moral hazard that exists in any financial system.

One final word in closing. I have the privilege of working with a remarkably talented team of career professional service individuals at the Treasury, working very hard in the face of, I think, some of the most challenging economic and financial problems we have seen in generations. They have played a vital role in helping bring this economy back to growth, help restore financial stability, and I think we owe them a debt of gratitude and some recognition for their hard work and their commitment to public service. I want to say again how much it has been a privilege to me. Once a career civil servant in the Treasury, to have a chance to work with them again.

Thank you. I am happy to answer your questions.

[The information follows:]

Secretary Timothy F. Geithner
Treasury Budget Written Testimony
House of Representatives Committee on Appropriations
Subcommittee on Financial Services and General Government
Wednesday, March 16, 2011

Chairwoman Emerson, Ranking Member Serrano, members of the Subcommittee, thank you for the opportunity to testify about the President's Fiscal Year (FY) 2012 Budget for the Department of the Treasury.

Congress has given Treasury a very broad mission, with responsibilities that touch many aspects of the lives of Americans.

Treasury is responsible for raising the resources necessary to fund critical Government functions, from national defense to protecting national parks. As the government's financial manager, we process payments on a daily basis of almost $100 billion, including Social Security payments to 54 million Americans each month. We design and deliver tax credits to help support business investment and help families finance a college education. We design and enforce the financial sanctions necessary to prevent the spread of nuclear weapons and the finance of terrorism.

Treasury plays an important role in helping shape the President's overall economic policies. Our lead policy responsibilities include tax policy, the stability of the U.S. financial system (as Chair of the recently established Financial Stability Oversight Council), and overall international economic policy.

Unlike most Federal agencies, Treasury's annually appropriated budget is about people not programs, with most of the resources we seek from Congress directed to supporting the talented public servants charged with these important economic and financial responsibilities. Salaries and operating costs make up 96 percent of our budget, and most of the rest is for investments in technology they require to function.

Unlike most Federal agencies, we manage no spending programs, with the exception of the Community Development Financial Institutions (CDFIs) programs, which help catalyze private investment in communities across the country.

In the President's Budget for FY 2012, the Administration requested slightly over $14 billion, $13.3 billion of which is for the Internal Revenue Service (IRS). This request includes efficiency savings and program reductions across all Treasury bureaus, as well as a number of targeted investments to allow us to better address some of the most important economic challenges facing the United States.

Let me begin by summarizing the core economic and financial priorities that shape this budget request.

Strengthening Economic Growth

As we work to strengthen the economy and help get more Americans back to work, we are responsible for a range of initiatives designed to help support business investment.

As part of the Small Business Jobs Act of 2010, Treasury is implementing two new programs - the Small Business Lending Fund and the State Small Business Credit Initiative - designed to improve access to capital for small businesses.

We are working to encourage private sector investment in start-ups and small businesses operating in moderate and low-income communities through investments in the Community Development Financial Institutions Fund and the New Markets Tax Credit Program.

Repair and Reform of the Financial System

Our programs to help strengthen and reform the financial system have made very substantial progress, but we still face a number of challenges ahead.

The financial recovery bank programs under the investment portion of the Troubled Assets Relief Program (TARP) are now estimated to provide a substantial positive return to the taxpayer. We are working to manage down the remaining TARP investments as quickly as possible. We are also seeking to reduce the ultimate cost of the Government's support for the housing market through the housing Government Sponsored Enterprises (GSEs).

We are helping shape the rules to implement the comprehensive reforms to the financial system passed by Congress last year, including stronger protections for consumers and tougher limits on risk-taking by banks.

We are working with Congress to reform the housing finance system, by winding down the GSEs, encouraging private capital to return to the market, and providing more targeted support for affordable housing.

Tax Reform

The President has proposed to reform our corporate tax system to make America more competitive.

We look forward to working with members of Congress and the business community to design a comprehensive, revenue neutral reform of the corporate tax system that would lower tax rates, eliminate special tax breaks, and encourage investment in the United States.

Promoting U.S. Economic and National Security Interests Globally

Treasury plays a critical role in helping advance U.S. economic interests abroad and protecting against foreign threats to our economic and financial security. Our request sustains the Department's investment in counter-terrorism and financial crime programs. This includes funding for implementing targeted economic sanctions against foreign threats to the United States and stopping the flow of money to terrorist organizations and their support networks.

Improving the Efficiency of Government Services

As we pursue these core priorities, we are working to deliver savings, program reductions, and improvements in the overall efficiency of government. As a result of these savings, our budget requests for FY 2012 in five accounts are below the FY 2010 enacted levels, and in three accounts are below the FY 2008 enacted levels.

Tax payer services and tax enforcement

The customer service and enforcement programs at the IRS provide one of the best values in the Federal Government. Every dollar invested in IRS yields nearly five dollars in increased revenue from non-compliant taxpayers. The targeted investments in this budget request are expected to produce more than $1.3 billion in additional annual revenue once fully implemented in FY 2014.

In FY 2010, the IRS enforcement effort's brought in $57.6 billion in additional tax revenues. This is a 53 percent increase in enforcement revenue since 2003 and a clear example that the investment in the IRS over the past few years is producing significant returns.

Over the last decade there have been nearly 4,500 changes to the tax law, providing IRS with a challenging and constantly changing business environment. Despite this fact, service levels have increased and each year the IRS has delivered a successful filing season.

The IRS continues to implement information programs and online applications to help taxpayers find and understand information. Use of the popular IRS web tool, "Where's My Refund.com" has nearly tripled since 2006 to 67 million users. This modernization has not only helped improve IRS' daily interactions with taxpayers, but has also provided the platform for significant productivity increases in IRS operations.

Today we receive nearly 100 million tax returns electronically each year. In the past these returns would have been opened, sorted, and transcribed manually. Last year, nearly 70 percent of individual tax returns were filed electronically compared to a mere ten percent 15 years ago. The efficiency savings have allowed us to consolidate ten submission processing sites into six and reduce the need for manual submission processing jobs. We will repurpose an additional processing site later this year.

Our IT modernization effort will decrease the time it takes to process and post taxpayer information from two weeks to one day, allowing IRS to issue faster refunds and customer service representatives to answer tax payer questions based on more up to date information.

Treasury's Electronic Payments Initiatives

Modernizing processes and reducing waste are key components not only of the IRS portion of Treasury's budget but also of our overall efforts to make sure the Department operates more efficiently and effectively.

Treasury now makes 82 percent of its payments electronically. We are taking action to further increase electronic payments. Effective May 2011, all newly enrolled federal beneficiaries will receive payments electronically. By March 2013, we plan to move all existing beneficiaries to electronic payment.

Productivity increases have already allowed the Financial Management Service (FMS) to repurpose the Austin, Texas payment center as a debt collection center. Debt collection efforts last year alone totaled more than $4 billion, a 41 percent increase over FY 2000.

Automation of our debt financing functions has allowed the Bureau of Public Debt (BPD) to decrease staffing by more than 20 percent over the last five years. Additionally, we transitioned to an entirely electronic process for issuing payroll savings bonds earlier this year.

We are working to further automate debt financing.

In early 2012, we will no longer issue over-the-counter paper savings bonds. Instead, we will focus on supporting electronic means to issue bonds to individuals, reducing the cost of staffing, postage, paper forms, and processing fees.

Overall, these efforts to increase Treasury's paperless transactions with the public are expected to produce more than $500 million in cost savings and efficiencies over the next five years. These savings, which include reductions in personnel and facilities costs, will create a more efficient Department and allow us to increase the quality of the services we provide.

Reducing Fraud and Improper Payments

Treasury will also expand upon and maintain the Administration's VerifyPayment.gov portal to prevent ineligible recipients from receiving payments from the Federal government. Treasury will also continue to improve the management of the delinquent debt portfolio by implementing reforms that will increase collection of delinquent tax and non-tax debt, including child support, by more than $5 billion over the next ten years.

Overall Improvements in Efficiency

Treasury will cut the number of data centers we currently maintain by one-third by 2015, resulting in significant dollar and energy consumption savings.
These overall savings build on substantial improvements over the last two years.

Treasury's FY 2009, FY 2010 and FY 2011 Budgets collectively included a total of more than $1 billion in savings and offsets. Treasury's FY 2012 Budget alone identifies nearly $1 billion in savings, including $336 million in direct cost savings and efficiencies and $630 million in offsets primarily from assets seized as a result of violations of U.S. sanctions.

These savings allow us to finance some very important investments. Any substantial cut to the IRS budget will hurt revenue collection and service to taxpayers, resulting in unanswered phone calls and letters. Cuts to the remaining Treasury responsibilities would weaken our ability to support reforms that are critical to economic recovery and repair of the financial system. Cuts to the CDFI program would limit our ability to attract private investment to communities hit hardest by the economic crisis.

To carry out Treasury's responsibilities, we need to be able to retain and support the dedicated public servants that make up the career staff of Treasury and its Bureaus.

These are a very talented group of people, working extremely hard in the face of the most challenging economic and financial problems in many decades. They have played a vital role in helping restore economic growth and a measure of financial stability.

I look forward to working with you to ensure we continue to attract and retain a diverse, highly skilled workforce that delivers enhanced results for the American public.

Timothy F. Geithner
U.S. Department of the Treasury

On January 26, 2009, Timothy F. Geithner was sworn in as the 75th Secretary of the United States Department of the Treasury in a ceremony officiated by President Barack H. Obama, and Vice President Joseph R. Biden Jr.

Before his nomination to the Treasury, Secretary Geithner served as the ninth president and chief executive officer of the Federal Reserve Bank of New York, where he began on November 17, 2003. In that capacity, he served as the vice chairman and a permanent member of the Federal Open Market Committee, the group responsible for formulating the nation's monetary policy.

Secretary Geithner first joined the Department of Treasury in 1988 and worked in three administrations for five Secretaries of the Treasury in a variety of positions. He served as Under Secretary of the Treasury for International Affairs from 1999 to 2001 under Secretaries Robert Rubin and Lawrence Summers.

He was director of the Policy Development and Review Department at the International Monetary Fund from 2001 until 2003. Before joining the Treasury, Secretary Geithner worked for Kissinger Associates, Inc.

Secretary Geithner graduated from Dartmouth College with a bachelor's degree in government and Asian studies in 1983 and from the Johns Hopkins School of Advanced International Studies with a master's in International Economics and East Asian Studies in 1985. He has studied Japanese and Chinese and has lived in East Africa, India, Thailand, China, and Japan.

He and his wife, Carole Sonnenfeld Geithner, have two children.

Mrs. EMERSON. Thank you, Mr. Secretary. We, too, would like to thank all those who work with you. They make lots of sacrifices.

I am going to try to keep my questions to 5 minutes just so we have an opportunity to have as many questions as possible.

Shortly after the passage of Dodd-Frank, Mr. Secretary, you said that the Act would ensure that the risks undertaken by banks would not "threaten the health of the economy as a whole." But you also told Special Inspector General for TARP that it wasn't possible to create effective and objective criteria for evaluating systemic risk, but rather "you just don't know what is systemic risk and what is not until you know the nature of the shock."

In the absence of objective criteria for evaluating systemic risk, is systemic risk something you just know it when you see it? If so, how can the government and private businesses identify and remedy Too Big to Fail?

Secretary GEITHNER. An excellent question, and very important question. Let me try to give you my own personal view on how to think about this.

The most effective things you can do to reduce moral hazard risk in the system are really these two: One is to make sure that you have the authority to force financial institutions to hold more capital against the risks they run in their businesses. That is essential to reduce the risk of failure by large institutions. In general, our view has been we want to make sure that the largest institutions, the one whose mistakes can cause the most collateral damage, are held to a high standard in terms of risk management and higher capital. But that is not enough.

Even if you do that, to effectively reduce moral hazard risk, you have to have a system which allows you to allow institutions to fail. In fact, what this law does is prevent the executive branch or the Federal Reserve from coming in and intervening to help an insolvent institution survive, to live for another day.

What the law does is force us to, in effect, to unwind an institution whose failure has brought it to the edge of collapse, but unwind it in a way that we reduce the risk of loss to the taxpayer and reduce the risk of collateral damage. Those are the two most important things to do about moral hazard, and the law gives us the authority to do that. We did not have that authority before.

Now, you began with a very important question which is how do you judge what is systemic, what type of institutions might pose systemic risk to the system as a whole. I just want to make it clear that you cannot make that judgment with confidence without knowledge of the circumstances you are in at the time.

I will just give you an example. Bear Stearns, the first significant institution to really fail in this crisis, come to the edge of failure in this crisis, was not a very large institution. Why was it so consequential? Why was its failure so threatening to the system? It was, in part, because of the nature of institution, its business and how connected it was to other institutions. And it was, in part, because we were at that stage where the U.S. economy was heading into a very damaging recession. In an environment where there is much more risk of recession, much more risk of broader financial collapse, and even institutions that themselves don't look particularly large in that context, could cause a lot of collateral damage

and could accelerate a run. That is why I made the observation you quoted at the beginning in that you cannot know in advance of a crisis what particular types of risks might threaten a collapse of the system as a whole.

Mrs. EMERSON. A quick follow-up to that, if you knew that the nature of a shock was a scare from a municipal bond default, for example, how would Dodd-Frank protect the financial system or the economy in that situation?

Secretary GEITHNER. Again, the most important thing to do, to reduce the risk of future crises, is to make sure that the institutions at the center of the payment system, the ones that are central to the capacity of businesses to borrow and fund themselves, central to the housing finance system, to make sure those institutions hold much more capital against risk than they were required to hold before the crisis.

You need to make sure that you can impose those types of requirements on leverage, on capital, on institutions that look like banks and are performing banking functions even if they aren't in a legal sense banks. So, for example, in our crisis before Dodd-Frank, in our system we had regulations for capital over banks, but there was an entire parallel financial system composed of investment banks, finance companies, you could say GE, Fannie and Freddie, that were larger in the aggregate than the banking system as a whole, but no effective capital regulation to limit leverage. So what Dodd-Frank allows us to do for the first time is not just have more conservative, better designed capital standards for what we call banks traditionally, but make sure that we could extend those to institutions that are effectively doing the same thing and play that critical role in the payment system, in the financial system that causes the risk of broader collateral damage if they make mistakes.

Mrs. EMERSON. Of course, then you could say those municipalities don't often have to when you are doing bonds actually put their assets out on the table. And with the crises that we see happening in so many States with pension funds and the like, there is here another risk that I think needs to be taken into consideration.

Secretary GEITHNER. I think you are right to point out that ultimately the overall risk to an economy, to the financial system as a whole depends a lot on things like whether the fiscal foundation of the government, State and Federal level, is on a sustainable path. Absolutely. That affects the overall environment.

But I just want to emphasize one point again that no one will know with confidence in advance of a crisis what particular type of shock, mistake, source of risk, could cause a lot of damage. And since you can't know and fully anticipate that, we need to make sure that the system just runs with thicker cushions, thicker shock absorbers in terms of capital, again because you can't predict with confidence where they are going to come from.

Mrs. EMERSON. Mr. Serrano? Okay, I will go to Mr. Rogers, our big chairman.

Mr. SERRANO. I would rather you go, Mr. Chairman. I am not trying to be nice to you for any other reason than friendship because we don't have earmarks anymore.

Mr. ROGERS. Thank you.

Mrs. EMERSON. Please, Mr. Chairman, if you would like to make some opening remarks, please do.

Mr. ROGERS. Thank you, Madam Chair, for the courtesy, and my dear friend from the Bronx.

Welcome, Mr. Secretary. It is good to see you again.

Including stimulus funding, we have increased spending by 84 percent in the last 2 years. The deficit this year is $1.65 trillion or so. That over $14 trillion. We are in a deep hole. You agree with that. And we are borrowing 42 cents on the dollar we spend which troubles all of us. I was a little bit surprised the other day to see a Chinese government official quoted to the effect that they would have to reexamine their willingness to loan money—any more money to a country that might not be able to repay it. Did you happen to see that remark?

Secretary GEITHNER. I don't think I saw that particular remark. I wouldn't be particularly concerned about any remark that I hear from any foreign official about the United States because no one is going to care more about the basic challenge of restoring fiscal sustainability than the people in this room and the people who hold my job. We care about our fiscal position and how we dig out this deep hole because of how important it is to Americans, to sustain confidence of American investors, not just foreign investors, and in our capacity as a country to go back to living within our means.

Mr. ROGERS. Given the amount of money that we borrow from China, those remarks troubled me not only because of the fiscal question involved, but really the sovereignty of the country. I mean, if we get into some spat with China, for example, over Taiwan or whatever, I am worried that they would be able to use the leverage that they have because of the mortgage that we have given them, to affect our policy. The public is on to this. I think they said last November cut spending, discipline your spending.

The Chairman of the Joint Chiefs has told us of the importance of this to the Nation's security. The Chairman of the Federal Reserve says it is terribly important; and you, yourself, of course, have said so.

And yet we get the President's 2012 budget and it is long on rhetoric but it is lean on spending cuts. We are dealing only with 14, 15 percent of the budget which is discretionary appropriated spending, half of which is military or DOD. If we zeroed out all appropriations for the whole year, as we did last year, because we didn't pass a single bill, if we zeroed out all of the appropriations bills, we would still be deeply in the red.

Now there is talk about tackling the entitlements where 65 percent or so of the money is. What do you think?

Secretary GEITHNER. Let me just say that it is absolutely imperative that we find a bipartisan solution that will lock in the types of changes in policies that will bring down our long-term deficits dramatically over the next several years. It is critically important we do that. If we don't do that, then we will face the risk of broader erosion of confidence in ways that might hurt the sustainability of this expansion. So I welcome very much the importance you've brought to that issue, and I think you are right to highlight it today.

Now, that will require not just demonstrating that we are able to find a way to reduce spending in the discretionary part of the budget, that is necessary but not sufficient. Alongside those changes, and we are hopeful we can come to a bipartisan solution on how to make sure we demonstrate the necessary restraints in spending, we will have to go beyond that if we are going to bring down the long-term deficits.

In the budget you referred to, we proposed a detailed set of policies, revenues, entitlements, and discretionary spending that would reduce our deficit from 10 percent of GDP to roughly 3 percent of GDP over the next 5 years. 3 percent of GDP is the point at which you achieve primary balance, meaning revenues equal expenditures minus interest. And that is an important threshold because when you achieve that, then you stop the debt from growing as a share of the economy. If we are able to work together to develop constraints on Congress to live within that deficit reduction target, then our overall debt burden would stabilize as a share of the economy in roughly the range of 70 percent of GDP. Between 70 and 80 percent of GDP. Now that is high, higher than we would be comfortable with, but it is an acceptable range. Now, even if we achieve that, that is not sufficient because even if we stop there, because of the rate of growth in health care costs, even with the Affordable Care Act, our long-term deficits will start to grow again over the succeeding decades, so that has to be viewed as just a down payment.

But again, I would not underestimate the value to broader investor confidence and to confidence of the American people and the capacity of this town to work in putting in place multiyear constraints which would achieve that level of deficit reduction over time. You are very right, Mr. Chairman, to highlight the fact that you can't do that by focusing only on the discretionary part of the budget, certainly not on the nondefense discretionary part of the budget.

Mr. ROGERS. You know both, the White House and Members of the majority party in the House now, both groups have said almost the same thing, that we have to tackle the entitlements. It is as if, though, each is waiting on the other to take the first step and perhaps engender an attack. How can we get over that?

Secretary GEITHNER. Well, I think you are right to point that out. But I just would observe in the Affordable Care Act, in the judgment of the Congressional Budget Office, which is the nonpartisan, neutral scorekeeper we all rely on, they show unreasonably conservative assumptions that the Affordable Care Act, if left in place, reduces the deficit by $140 billion roughly over the next 10 years and another trillion over the next decade beyond that.

So in our judgment, we have already put in place the largest reform that affects the rate of growth of health care costs, the biggest part of our long-term deficits than we have done in generations. Of course, we recognize that is not enough. But we feel that is a pretty good foundation on which to build. Now I agree with you, and I know the President does, to do this, to do a broader, comprehensive multiyear deficit reduction program, we have to do it together. We can't legislate this just with Democrats or Republicans. We have to do it together, and it is going to require us to come together.

We laid out a proposal. I know there are some on your side who want to go deeper in deficit reduction even in the near term, and I know that Chairman Ryan will have a chance in the next couple of weeks or so to lay out a 10-year budget resolution, in some sense giving the view of the House leadership, what an alternative strategy is to the one we laid out.

Our view is we have a moment, and I will take the optimistic side of this, there is a lot of support now on both sides of the aisle, both houses of Congress, to try to find something on a bipartisan basis that will make a very substantial contribution to reducing the deficit. We would like to find a way to do that on common ground. Of course, it is going to be important to us, as I assume it will be to you, to make sure that we do that in a way that doesn't hurt the economy.

One of the reasons why you have to do this on a multi-year basis is because if you pull it all forward, then you will do a lot of damage to the recovery. You can't do it by making that gradual path, something we try to do in 1 or 2 years. It has to be gradually phased in over time. Otherwise, you hurt growth, hurt revenues, and future deficits rise, even apart from the effect that we have on things that we believe are important to our capacity to grow in the future, like education or incentives for innovation and incentives for investment and things like that.

Mr. ROGERS. Well, as you say, we have both heard Republicans and Democrats say virtually the same thing, that we have to do this. And we are all worried about who gets blamed for taking the first step.

Secretary GEITHNER. I think it is fair to say that we are all going to be blamed.

Mr. ROGERS. Let me suggest, why don't we meet at the top of the Empire State Building on June 3 at 12:03 and see who jumps off.

Secretary GEITHNER. I agree with you, there is no way to solve this problem which is not going to leave everybody somewhat unhappy, and everybody unhappy with us. But that is our obligation in some sense. That is what governing is about. And if we don't act, if we don't do something together, we will face the risk that we will see a broader erosion of confidence that could really hurt.

Mr. ROGERS. Is the Erskine Bowles-Simpson Commission suggestions a starting point or an ending point?

Secretary GEITHNER. I think what they did was a remarkably important accomplishment. They put a lot of good ideas on the table, and a lot of innovative ways to solve some problems that we have had a hard time thinking about in the past. So I think that that report, combined with—there is another report by what we call the Rivlin-Domenici Commission that has a lot of ideas that I think any group would want to draw from to find something that we can get the votes for.

That is our challenge. Our challenge is to find something that we can get the votes for. I hope we can take advantage of this moment where there is so much commitment on both sides to try to do something; and again, not just to reduce spending on that 12 percent of the budget, but reduce deficits, lock in deficits long term as well.

Mr. ROGERS. Mr. Serrano, can you see the Bronx from the Empire State Building?

Mr. SERRANO. I was going to comment that if June 3 is a Sunday, I can't join you in the jump. That is the Puerto Rican Day parade. I won't be able to join you for the jump.

Mrs. EMERSON. Mr. Serrano, go ahead.

Secretary GEITHNER. Usually we use the boat analogy. If we are going to step into the boat, we have to step in all together.

Mr. SERRANO. That is for the Interior Committee.

Mr. Secretary and Madam Chair, a lot of people would be disappointed if I didn't ask this question first, knowing me. And out of respect for my friend, Mr. Diaz-Balart, I will ask this question first.

Mr. Secretary, I was pleased to hear the President announce a policy change concerning the Cuban embargo. A policy change in the final rule from OFAC indicated a commitment to allowing much freer travel and trade between the United States and Cuba. It has now been 2 months since the initial announcement, and we have not seen the final guidelines setting out how people will apply to travel.

Two quick questions: When can we expect to see these final guidelines? Are there particular problems hindering the release of these guidelines? Do you expect that the final guidelines will reflect the openness indicated in the President's original announcement and allow regular hassle-free travel for those authorized to do so?

Secretary GEITHNER. Yes, we will meet the policy objectives set out in the President's announcement. In terms of timing, I will only say "soon." There is no date in soon, but my expectation is relatively soon. I have not yet heard of any particular problem that we face in finalizing the guidelines. I will consult with my colleagues and see how things are going.

Mr. SERRANO. I would appreciate finding out what the problem is other than 10,000 phone calls coming in perhaps telling you not to do it once the President decided to do it.

Secretary GEITHNER. As you know, we take the obligation to make sure that we not just meet the test of the policy, but the constraints of the law very carefully. We are very careful in refining these things. Again, my expectation is we will move forward reasonably quickly.

Mr. SERRANO. Mr. Secretary, you have proposed two initiatives from the CDFI fund that were proposed last year but not acted upon: $50 million for the Bank on U.S.A. initiative to promote affordable financial services and credit to those without bank accounts; and $25 million to increase availability of healthy, affordable foods in underserved urban and rural communities. Can you give us details on how these programs will be run and how they differ from existing programs at Treasury and other agencies?

Secretary GEITHNER. I will be happy to do that in writing in more detail. But let me respond briefly now. The Bank on U.S.A. initiative that you referred to is very important. I think anybody who looks at what happened in the United States over the last 10 years to the financial system, you can see why this is so important.

One reason why so many Americans were vulnerable to predation, abuse, and fraud by financial institutions was because they

operated outside the banking system without even the protections which existed with respect to people who had relationships with banks. I think it makes a lot of sense not just encouraging more responsible saving behavior, more responsible use of credit, it is more efficient, often less expensive to deal with banks, but we are better able to make sure that those individuals enjoy the protections that come with consumer protection in that area.

So that is a very important and the kind of initiative that has a very high return in terms of reducing future costs.

Now, in terms of the healthy foods initiative, this is a program that uses the combined instruments of new market tax credit and CDFI fund proposals to try to make sure that in parts of the country where there are no supermarkets, no access to affordable, reasonably nutritious healthy food options, that we are making sure that some of those resources go to help catalyze private investment in those communities.

Again, for those of you new to these programs, these are programs that at their core rely on the strategy of trying to leverage private capital to catalyze and attract private investment to communities where investors are often reluctant to go without that additional support.

Mr. SERRANO. Briefly, Madam Chair, on the Healthy Food Financing Initiative, I think it is important to note that more than 23.5 million people, including 6.5 million children, live in low income metro areas that are more than a mile from a supermarket, and 2.3 million people in low income rural communities live more than 10 miles from a grocery store. We are not just talking about access to healthy food, but we are also talking about access to food, period. As I understand it, entities like farmers' markets and bodegas will be considered partners in bringing food to underserved communities, as appropriate. Can you comment on the proposed implementation of this initiative? How are you working with other agencies to accomplish the Healthy Food Financing Initiative?

Secretary GEITHNER. This is something that we are doing in close cooperation with USDA, and others, and I will be happy to give your staff a more detailed report on how things are going. Again, and you said it very well, the basic idea is in communities where investors have been reluctant to come and establish what most Americans would view as like a normal part of a neighborhood, to try to make sure that those investments come on terms that have a very good record. These programs have a very good record for the taxpayer. We think that they justify your support.

Mr. SERRANO. Madam Chair, in closing, let me just say that I never cease to be amazed at the fact at these hearings we learn so much about each other. Chairman Rogers and I always comment on the fact that we represent two of the poorest districts in the Nation, and they are totally different from each other. I thought our situation in the Bronx and other urban areas was tough. I had no idea that some folks don't have a grocery store anywhere near 10 miles from where they live. These are issues that this great Nation should address, and address now once and forever.

Mrs. EMERSON. You need to come down to rural Missouri where I live where people live 50 miles, in many cases, from a grocery store.

With that, I will take it to Mr. Womack from Arkansas.

Mr. WOMACK. Thank you, Madam Chairwoman. Thank you, Mr. Secretary, for your appearance here today. I look forward to your visit to the great State of Arkansas in a little over a week. We will roll out the red carpet for you and make you feel welcome and show you the great things we are doing in that region of our country.

Secretary GEITHNER. No red carpets.

Mr. WOMACK. No red carpets, okay. We will save on that.

It didn't take long for Madam Chairwoman in her opening to talk about TARP. That is the subject of my first question. It is a controversial topic, and I am not here to judge necessarily. History will judge that program. But you have articulated that it has presented about a 99 percent payback I suppose, and if you take the housing out of it, it operates in the black. We understand the numbers that you have articulated here today.

What is left for TARP to do? There are still a number of people involved in TARP. We spoke with someone earlier this week, and it came to our attention there are new contracts and extensions of already existing contracts. Why are there still a significant number of people working TARP?

Secretary GEITHNER. That is a very good question. I am glad you raised it. We still have a very substantial investment outstanding in—most of these are now common equity, but not just common equity in, for example, GM, Chrysler, AIG. We want to make sure that we get the highest return for the taxpayer in those investments. These are very complicated transactions to deal with. So part of the resources still remaining are designed to make sure that we can manage our remaining investments down carefully at the highest possible return to the taxpayer. There are a bunch of programs which have a slightly longer fuse in terms of the investment profile, and we want to maximize return. We are still trying to make sure that we can reach as many homeowners as we can through the housing programs.

As long as we have a dollar of taxpayer money outstanding and at risk, we want to make sure that we keep in place a core group of people who can manage that risk carefully. So even though on the overall numbers we are way ahead of any reasonable expectation in terms of getting the money back for the American taxpayer and getting ourselves out of those companies, we still have enough of a residual investment left to justify the need for a staff of people over time.

Now the numbers we have at Treasury today I am quite confident will be the peak in terms of staffing. In fact, we have been discussing a little bit what is a reasonable pace in which to start to wind that down. I can give you more details on that if you would like. Of course, we want to make sure that we are keeping talented people there as long as we need them. So we have to manage those things carefully. But those resources are coming down, and they are very modest.

Mr. WOMACK. We all understand the concept of diminishing returns. As I drill down on this subject, I want us to be careful of, while there may be funds outstanding, there are staff allocations dedicated to getting as you say the best rate of return. But at what

point in time do we achieve a state where we are in diminishing returns?

Secretary GEITHNER. Again, an excellent question. That is something we take very seriously. Let me explain a little bit again why with the overall amounts coming down dramatically, the complexity of the challenge still does not diminish quite as much as that. Again, we are a very large country, very large financial system. Even though we have gotten most of the money back, we still have resources outstanding in a lot of programs and in a lot of individual institutions.

We want to be very careful to make sure that we are doing as good a job as we can for the taxpayer. But the people managing this program have done a remarkably effective job; a clean audit on a complicated program, and we want to make sure that we hold to the highest possible standards.

But we are not going to be in these institutions a day longer than we need to be. Again, I believe we will be able to start to gradually wind down the resources we have in these programs as quickly as we can.

Now, I should point out that this is not really the best measure of the complexity of the challenge, but if you look at what the oversight bodies have asked for in terms of resources, if you look at SIGTARP's proposed budget, for example, you can see from the people doing oversight, in their budget requests, they still see a very substantial oversight need, and that is another measure of the complexity of the challenge.

Mr. WOMACK. Fannie and Freddie. What is the government's role in the mortgage industry?

Secretary GEITHNER. Today, because the crisis caused this huge, the private market to recede completely from writing new mortgages, Fannie and Freddie, the FHA, USDA and VA are about 90 percent of the market for new mortgages today, and that is untenable for the long term, of course.

Our basic strategy is to gradually wind down the government's role, wind down Fannie and Freddie completely, and gradually have the government recede and have private capital come in and replace the government's role. And we will do that through a carefully designed program of lowering conforming limits, raising guarantee fees, and toughening underwriting standards so that the private market can come back in again. For that to be possible, we need to make sure that these financial reforms, for example, capital requirements, underwriting standards, servicing standards, risk retention, disclosure requirements and securities markets, those all are laid out and put in place so that the investors have clarity about what the rules of the game are in the future. Those are sort of two conditions you need to meet to get private capital to come back in again.

Mr. WOMACK. What is the overall impact of doing away with GSEs?

Secretary GEITHNER. If you tried to turn off the lights tomorrow, you would have catastrophic damage. Taxpayers would lose billions and millions of dollars, more than we expect to have to absorb, and you would have a huge increase in the cost of borrowing for homeowners; the risk of substantial further reduction in house prices,

and that would be dramatically damaging. I don't think there is any credible argument that would be a responsible path for us to take.

We do think, though, that over a gradual period of time, perhaps 5 to 7 years, we can have the private sector come back in and take over that market and return to a market in which they are a dominant provider of mortgage finance.

Mr. WOMACK. My last question is on corporate tax reform; where are we going?

Secretary GEITHNER. It depends a little bit on what we find up here in terms of receptivity. But I have been consulting very broadly with your colleagues on the tax writing committees in this body and in the Senate, and with the business community, of course, and we think that we have a reasonable chance of getting people to come together on a comprehensive reform that would lower the corporate tax rate quite substantially.

Mr. WOMACK. Do you have a number?

Secretary GEITHNER. Not yet. It would broaden the base, do so in a revenue-neutral way, and leave us in a position where we have a more competitive tax structure, better able to help support investment, and incent investment in the United States.

I think we have a chance to do this. Some people say you can't do this unless you do individual. I don't agree with that. I think there is a chance you can do it without doing individual. And some people think it is something we should wait on. I think it is worth taking a run at. Again, we are not going to be able to solve all of the problems facing the country. We are going to disagree on a lot of things. The country is still very divided on some basic things governments do. It is good for us to find some things we can try to do together to help the economy. I think corporate tax reform is one of those.

Mr. WOMACK. Thank you, Mr. Secretary. I yield back.

Mrs. EMERSON. Ms. Lee.

Ms. LEE. Good afternoon, Mr. Secretary. It is no secret that I want to talk to you also, like other officials about earmarks, from the administration. I know that is not a popular word around Washington, D.C.; but back in my district and in some of our communities throughout the country, congressionally-directed funding, earmarks, provide jobs and services where these gross disparities exist. The reality is that communities who are in most need of help, whether they face high rates of poverty or lack of economic opportunity, are also the least well equipped to apply and compete for Federal grant opportunities. We also know that earmarks are 3 percent or less than 3 percent of our budget. So in terms of deficit reduction, which we all want to see take place and know has to happen, this is a drop in the bucket.

Now, it is not because these programs don't do great things, but it is because the knowledge and expertise required to navigate the grant-making process is expensive to hire or to develop, and most of these programs spend every dollar they have in helping others creating jobs and providing services. Also, they leverage millions of dollars. One earmark of $250,000 to a nonprofit to create jobs and to provide services where these gaps exist can and do leverage millions of dollars in private sector funding and in foundation funding.

I know that these are programs in communities that the President supports and wants to reach out in helping. These are communities that I know the President and your administration and you want to provide a pathway out of poverty into prosperity. So let me ask you, in terms of this decision to support a total or to lead a total ban on earmarks, did anyone at Treasury do an analysis of the economic impact of eliminating earmarks and what it is going to do in terms of the loss of jobs and the loss of services in many of our districts around the country?

Secretary GEITHNER. We at Treasury have not done such an analysis. But we do have a substantial number of programs in the President's budget that he has proposed, and many of those are the ones which we have referred to that are before you today, which go directly at the type of problem you are trying to solve. The programs that we are responsible for, at the Treasury, including not just our housing programs, but the CDFI fund, new markets tax credit, and a range of small business credit programs, those programs are designed to do exactly what you are concerned about, which is to make sure in communities that are hardest hit by the recession, that are at greater risk of taking a much longer time to come out of this, get private investment in there more quickly to help mitigate those problems. We very much share that objective. And I think we have a comprehensive set of programs in the President's budget that would help advance those objectives.

Ms. LEE. Mr. Secretary, you have targeted CDFI for some cuts, as well as some of these other programs.

Secretary GEITHNER. We absolutely are in a period where we have limited resources. We have to recognize that. So we are proposing savings in a variety of areas. But the request we have for CDFI is a very strong funding request. It would leave us somewhere between, if I am not mistaken, two and three times the funding level at the end of 2008. H.R. 1 would cut it to half the level. We are proposing in the 2012 budget what I would regard as a very strong funding level for CDFI. Maybe not as much as you would like.

Ms. LEE. But given the lack of earmarks and the ban on earmarks and cutting CDFI, as well as some other cuts, I think that is going to make matters worse.

Secretary GEITHNER. It may. It is a good question. Again, my impression is if you look at, and let's take these types of programs that are designed to target low income communities with tax incentives, guarantees, credit programs, things like that. My sense is, if you look at the combined size of the programs, as proposed in the President's budget, we have, even after the Recovery Act expires, very, very substantial funding levels relative to certainly where we were in 2008, which is appropriate because I think the returns are very high in those programs.

Ms. LEE. Mr. Secretary, with regard to the programs, and I know again that you and your President, this administration gets it and understands that these communities need jobs and the support. What is happening and will continue to happen is that the organizations and the nonprofits that congressionally-directed earmarks are addressed toward, they are going out of business. They can't compete. They don't have lobbyists, Mr. Secretary, and they can't

do these grant applications. They can't do these competitive packages. I mean, this is hard stuff to do. They do the work with seed money or a little bit of funds from the Federal Government as a foundation.

They are able to maximize the Federal tax dollars that go into these areas. I don't know how you are going to backfill this and make sure that jobs aren't lost and services aren't cut.

Secretary GEITHNER. I understand that concern, and I think it is definitely a reasonable concern. But let me try it from another perspective. And you know the President's view on this. But think about it this way. We are living in a period where we have unsustainably high deficits, limited resources. It is going to be very hard for us to get these deficits down to a sustainable level over time. It is going to require cutting things that many people believe in and have a huge record of success over time.

In some ways our ability to convince the American people that investments in these programs are necessary and important, does depend in part on our willingness, our ability to demonstrate that by doing earmark reform, we can demonstrate more confidence to the American people that the decisions we are making about where these resources should be spent meet the highest test first.

Ms. LEE. Mr. Secretary, this is less than 3 percent of, first of all, of the budget. Secondly, if you look at a 400,000, 300,000 earmark, you are talking about $3 million, perhaps.

Secretary GEITHNER. I completely agree with you about that. And I think even Chairman Rogers says this. You are not going to balance our budget on the backs of discretionary spending. It is just not going to happen. But I was making a slightly different point which is that if we are going to be able to demonstrate to the American people at a time of 10 percent of GDP deficits, these programs we think are so important to justify their support, then we have to be able to demonstrate we are willing to reform how we make these decisions over time, because they will be more confident that these are decisions that we made on the basis of what is in the interest of the country as a whole. That is one of the rationales for earmark reform.

But you are right to point out that in many of these, we are talking about very small pieces of the budget, very good records of return, very strong cases for doing it. We are not going to have reasonable recovery in the United States across the country as a whole, until we get the unemployment rate down. Even though unemployment is at roughly 9 percent nationally, that dramatically understates the level of employment in many, many parts of the country.

Part of our success in restoring confidence in this country is to demonstrate that across the country in communities most affected with high poverty and high unemployment, that we are going to make as much progress there as we are across the Nation as a whole.

Ms. LEE. Thank you, Madam Chair. Thank you, Mr. Secretary.

Mrs. EMERSON. Mr. Alexander.

Mr. ALEXANDER. Thank you.

Mr. Secretary, many of my community banks have expressed a concern over the recent proposed Fed regulation for the inter-

change fees that would cut into their profits and into their capital. Should there be a concern over the effect this might have on the credit available to small businesses?

Secretary GEITHNER. Congressman, that is a very important question. I have heard that concern from lots of different people.

This was a requirement of law that was imposed on the Fed. The Fed tried to design a rule that complies with the law. They have had a lot of feedback advice on how best to reduce the risk you have referred to. And I don't have a sense yet about whether they feel that they have the scope within the law to help mitigate that risk.

Mr. ALEXANDER. So you don't know if there was ever a study made by anyone, then, to gauge the potential effect of this law?

Secretary GEITHNER. I know there were a lot of congressional hearings around this whole issue before this amendment passed. But the law establishes an obligation on the Fed, and the Fed is trying to figure out how to comply with that obligation and how to do so in a way that minimizes the impacts to which you referred. I don't know how much flexibility they have.

Mr. ALEXANDER. I appreciate your honesty there. There is a lot of talk about a potential vote in the future for raising the debt ceiling. What happens if that doesn't pass?

Secretary GEITHNER. Congress has to do it. There is no alternative. It would be catastrophic for the United States for us to default on our obligations as a country. It would be catastrophic in terms of the effect on growth and borrowing costs for all businesses and families. I laid this all out in a lot of detail in a letter early in the year in response to a request from the Congress. I would be happy to walk through that again. But there is no alternative.

I very much welcome the statements made by leadership on both sides of the aisle, both Houses, recognizing that we are the United States of America. We meet our obligations, and it would be unthinkable for this country not to make sure that we have the continued capacity to meet our obligations.

Mr. ALEXANDER. Do you think the financial crisis now taking place in Japan will have an effect on that? Will that mean that we——

Secretary GEITHNER. On our recovery here?

Mr. ALEXANDER. Yes.

Secretary GEITHNER. Oh, I think that is a hard judgment to make a decision. I think our focus now is, as it should be, on trying to do as much as we can to help them mitigate the humanitarian cost of the catastrophe. Of course, we will offer them every assistance we can and help make sure, again, that they can—that the restructuring effort itself is handled as carefully as possible.

Mr. ALEXANDER. I have got one other question. The Treasury Department has—one of the duties under the law is to certify and oversee payments from the Judgment Fund, a law passed in 1956 by Congress to make payments for judgments rendered against the Federal Government. The Judgment Fund is one of the main sources of funds to use to pay litigation costs of settlements against the government. Can you provide us with a record of an explanation of the Judgment Fund and how it is funded and maintained at some point?

Secretary GEITHNER. I would be happy to do that.

[CLERK'S NOTE.—The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.]

Mr. ALEXANDER. And it seemed to me like if you look at Article I, Section 9 of the Constitution, it provides that a regular statement and an account of receipts of all public money shall be published from time to time. It is what seems like the Constitution prohibits the current management of this Judgment Fund since we don't know for sure what goes on in that Judgment Fund, it is not transparent.

Secretary GEITHNER. Well, again, I would be happy to make sure I understand your concern in more detail and be as responsive as we can.

Mr. ALEXANDER. Thank you.

Mrs. EMERSON. Thank you, Mr. Alexander.

Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you very much, Madam Chairwoman.

Mr. Secretary, it is good to see you again. You said that I think you have been through 51 of these hearings.

Secretary GEITHNER. This is my 51st, I think.

Mr. DIAZ-BALART. I have been with you on a couple of them, and rest assured, you are getting better and better at it.

Secretary GEITHNER. I think only in a small fraction of them actually.

Mr. DIAZ-BALART. That is exactly right, that is exactly right.

A couple issues, and first I wasn't going to talk about it, but since it was brought up by Mr. Serrano, there is no secret that he and I have serious differences on the issues of Cuba. By the way, those disagreements are always respectful and debated with the great respect, as should happen in a democracy. But what is clear, and what is more important than whether he and I may have differences, is what Congress has stated than what the law is. And you said it, and the President has stated it, that obviously tourism is not permissible, it is unlawful.

You were very kind and when you stated in a previous subcommittee hearing, a different subcommittee of appropriations, that if I— I am paraphrasing it, but we talked about if I saw a violation, a possible violation, of law, to bring it to your attention, and that you would obviously enforce the law. And so I obviously don't have to hold you to your word because I know that you are a man that will hold yourself to your word, and I just want to thank you for that courtesy.

I have some serious concerns regarding some proposed regulations against the IRS, which I guess somebody talked to you about it, that would require U.S. bank deposit interest paid to any non-U.S. resident to be reported annually to the IRS. Now, according to the IRS, the IRS says that it is solely for the benefit of the foreign governments where those people come from.

Now, you know, I represent south Florida. Obviously there are a lot of reasons why I think we could be concerned about that, about capital risk, the potential of what that would do to our banks. But more specifically and more directly let me use the case, for example—and we could use others, Venezuela. We all know the issues going on in Venezuela where, you know, the Chavez govern-

ment has nationalized a number of companies; they have closed down the press; they have closed down television stations, Globalvision; they have arrested judges for being judges, and then they have mock juries and mock trials for those judges that they don't like. So I don't have to tell you about the issues in Venezuela.

So my concern is imagine if now and in south Florida where we have thousands of others, but also Venezuela, nationals who are business people, jurists, journalists, whatever, who have homes and bank accounts, if that information goes back to Mr. Chavez, what nefarious purposes could that be used for to hold against them, to blackmail them, to confiscate. So that is obviously a concern that not only I have, but I think all the banks in the region have that concern. If you have any comments or suggestions on that, obviously those rules are now being promulgated.

Secretary GEITHNER. As you said, this is about preventing tax evasion and preventing money laundering. We believe we have a very strong set of protections to protect the confidentiality of any such information. I would be happy to ask my staff to review those with your colleagues so that you can judge those for yourself. We think we found a reasonable balance. What we are trying to do is to make sure that we—and this is our obligation under the law, too—that we are taking every step we can to reduce the risk of broader tax evasion or money laundering for reasons that I know you respect. We would be happy to explain why we think those protections are adequate and listen to any concerns you have with them.

Mr. DIAZ-BALART. And again, Mr. Secretary, I appreciate that, because obviously you do understand the concern of those banks and, frankly, more so the individuals who are highly concerned, and these could be issues, I hate to put it in these terms of life or death, for some of these individuals if we don't get it right. And so we just need to make sure we get it right.

Very briefly you mentioned that in many instances the President said as well that we are on an unsustainable path. And I am a simple-minded guy, I just want to make sure. You have gotten so good at these hearings, I want to make sure I understand what you are saying.

Is it possible to solve our problem without reforming entitlements?

Secretary GEITHNER. No. We have two types of fiscal problems. We have a big problem, a deep big hole to dig out of, over the next 5 to 10 years. And beyond that we have a very different, much more severe long-term fiscal problem. We have to solve both those problems.

The long-term problem is driven by the rate of growth in health care costs and, to a much smaller extent, by a very modest gap in Social Security. The 5- to 10-year problem is a huge problem, and it is not driven by entitlement costs; it is driven by just too large a gap between commitments and resources and the rest of our budget. That is why in the proposed budget to the President we lay out a path to bring those deficits down very dramatically over the next 3 to 5 years, down to level where we stop the debt growing as a share of the economy. That is the minimum necessary thing

to try to do. And you will find, of course, that that is a very hard thing to do. That is necessary, but not sufficient.

Mr. DIAZ-BALART. It is not sufficient because, as you just stated then, again it starts shooting right back up.

Secretary GEITHNER. It starts shooting right back up.

Mr. DIAZ-BALART. So we can either, to use the President's analogy, kick the can down the road, or we can look at, you know, where we have to go. And again, I think you have answered, but I just want to make sure I understand. You can't do that without looking at it and——

Secretary GEITHNER. You have to do both those things. And again, it is very important to—it is better to do it sooner rather than later, because you need to give people time to adjust, businesses and individuals, to adjust the big changes in policies over time. You need to be able to phase them in gradually over time, like we did, for example, with the commission on Social Security that President Reagan initiated some time ago.

So there is a lot of value in trying to reach consensus on these kind of things ahead of the point where they start to escalate dramatically.

Mr. DIAZ-BALART. Thank you, sir.

Thank you, Madam Chairman.

Mrs. EMERSON. It would be nice to be able to get bipartisan agreement on this so that one side doesn't beat up the other, wouldn't it?

Secretary GEITHNER. Well, we can't do it without bipartisan agreement. And as I said before, we can be confident that whatever we agree on is going to be unpopular with people on both sides of the aisle.

Mrs. EMERSON. Indeed.

Mr. Bonner.

Mr. BONNER. Thank you, Madam Chair, Mr. Secretary.

I would like to go back to the big chairman first, with a statement he made, because I want to make sure I understand that.

Could you repeat, Mr. Chairman, the amount of money, the increase in spending that we have seen over the last 2 years?

Mr. ROGERS. The last 2 years spending has increased by 84 percent.

Mr. BONNER. Mr. Secretary, do you disagree with that number?

Secretary GEITHNER. Oh, I mean, there is—no, it is black and white. There is no doubt we have, as the chairman said, a deep hole, completely unsustainable fiscal position. Our deficits are roughly 10 percent of GDP, the highest level in generations. The deficit is, of course, the product of lots of things. They are the product of the choices made the last decade on taxes and spending, including entitlements. They are the choices made in terms of how we dealt with two wars. They are the product of the recession, and they are the product of the short-term emergency cost of fixing the crisis. And they are the products of some other things that are in the budget, too. But those are the most important drivers of the near-term deficits.

Mr. ROGERS. Would the gentleman yield?

Mr. BONNER. I would be happy to.

Mr. ROGERS. The 84 percent is an increase in discretionary spending. It doesn't take into account the increases in the entitlement spending programs. But just in the 33 percent of the budget that is discretionary spending, we have increased it by 84 percent in 2 years.

Mr. BONNER. Well, I know there are a lot of things in the past that have contributed to it. Certainly you can't increase spending 84 percent just over 2 years and that contribute to all of the problems that we are facing. But I guess the logical question that our constituents in Alabama, Kentucky, New York, wherever, might have is can we spend ourselves out of this hole?

Secretary GEITHNER. Absolutely not. But in some ways the harder question is how we reduce spending and reduce deficits without killing the economy.

Mr. BONNER. Well, and that raises a good point. Senator Kyl—and House Members are not prone to quote Senators unless we are running for the Senate, and I am not—Senator Kyl this weekend brought an analogy. You know, Washington, I think—maybe you disagree—I think this city is so disconnected from real America because we talk about billions and trillions. Most of us don't even know millionaires in our communities; we certainly don't know many billionaires. And so Senator Kyl put it in perspective that a family that is dealing with a budget, $10,000, 40 percent of that borrowed money, and yet the amount of money that we are trying to cut through H.R. 1, that we have gotten very little support from our Senate colleagues on the other side, although the Republican plan got more votes than the Democrat plan did, but if you cut—to give the analogy that most people can relate to, that would be a $28 cut out of a $10,000 budget. That is something most people in Camden, Alabama, where I grew up, can appreciate better than the fact that last month we recorded a $223 billion deficit for 1 month.

So you agree, you can't spend yourself out of this, and yet I believe as just one Member that the President and the administration has been very timid to embrace even the President's own—he was the one who appointed the commission, and yet we have seen very little vocal support for the tough choices that are going to have to be made. Chairman Rogers mentioned that in his questioning. I am just curious from your perspective because you have a very important seat at the table as the Secretary of the Treasury.

Secretary GEITHNER. Well, the President believes, and I believe, and we both believe this very strongly, that we need to take advantage of this opportunity to find a bipartisan consensus on ways to lock in changes in policies that would bring our deficits down over time. As you said, and the chairman said, you can't do that by focusing only on what we call nondefense discretionary. And you don't want to do that, because if you only allow nondefense 2 percent of the budget to carry all of the burden for deficit reduction, then you will end up, as some people say, eating our future.

You know, a family living within its means is not going to cut tuition payments for its kids before it cuts spending on things that are really a luxury.

So we have to make those choices together, but I think you are right to emphasize that you have to—for us to do this sensibly over

term, it has to be a multiyear plan, it has got to be broader, it has got to involve policies beyond that very small slice of budget. I completely agree with that.

Mr. BONNER. Just one last question. I want to go to follow up. Mr. Womack started this in terms of Fannie and Freddie and the GSEs. In the report that the Treasury Department issued on February 11th, as I understand it, you lay out three options for reforming the GSEs. But with respect to the second option, how is the backstop different from the implicit guarantee exploited by Wall Street in this recent crisis? And is this middle option, which the report appears to position as the most acceptable mandate response between the two extremes, how is it different from the status quo?

Secretary GEITHNER. Well, it is not positioned as the more attractive option. I wouldn't actually view it that way. Each of those three options we try to frame neutrally, and they each have merits and disadvantages. I will try to explain what the difference is both from the status quo and from the other options.

In the current system, private shareholders in these two public companies were able to benefit from an implicit guarantee. The government did not charge for that guarantee. It was not compensated for that guarantee. Taxpayers who end up holding the bag for what I said was ultimately tens and tens of billions of dollars for losses, that is a completely unacceptable way to run a financial system, and none of it should be—will not be supported in the future.

Now, what we proposed among the options we considered was an option where alongside what the Federal Housing Administration would do in providing support for affordability to low- and moderate-income Americans, which I think there is broad support for, as a complement to that—and that is a guarantee, but the government charges for that guarantee, and there is a bunch of tough conditions on that guarantee. But you would complement that by something you would deploy only in an emergency to make sure that housing finance didn't dry up completely in a crisis. And that is a very important thing to do, because if you don't do that, then the risk is that even a modest recession would turn into deep recession because people would not be able to borrow to finance a house, house prices would decline, costs of borrowing would go up, and you would have a lot more damage as a whole.

So in that type of model, which is just a backstop in emergencies, the government would charge for the guarantee. It would only be available to ensure there would be financing and financing wouldn't dry up completely. So it is a very different system than the system we have with the GSEs.

Even that, though, would be challenging to design. All these options are very complicated to design in part because of the risk that we allow political factors to color the judgment about how to price the guarantee, how to set the eligibility criteria. And so you need to take the politics out of it to have any chance of getting it right.

Mr. BONNER. Madam Chair, I said that was my last question. The only thing I would ask the Secretary in closing, do you think that the economy has recovered to the point where—I mean, new housing starts were down last month, what, 30 percent? Something like that. It flashed up on the TV today as I was meeting with Ala-

bama Home Builders. Do you think that people in rural America can go out and borrow money to buy a house or start home construction?

Secretary GEITHNER. Well, two slightly different issues, and you are right to say housing is still weak, and construction is very weak. Housing starts are very weak in part because there are too many houses out there relative to demand. It is going to take several more years to heal the damage caused by this crisis.

If you look at the cost, the ability to borrow to finance a house now, under the limits set by Fannie and Freddie and FHA, mortgage finance is very attractive now; in fact, much lower than it was, has been, over the last several years. That is a good thing.

It is a little different for a builder, and in commercial real estate it is still very hard and very tough financing out there still. Just all again, just the echos and the aftershocks of the initial crisis, and that is going to take some time to heal. That is one reason why you want to make sure we move very carefully in reforming the housing finance market, because if we are going to get the market, the private market, to come in and replace the government's role, we need to move cautiously.

Mr. BONNER. Thank you, Madam Chair.

Mrs. EMERSON. Thank you.

Mr. Yoder.

Mr. YODER. Thank you, Madam Chair.

Mr. Secretary, thanks for the opportunity to be here today. I know you have done a lot of these, it sounds like, so I will try to ask you a few questions here that maybe haven't been fully been vetted.

I want to follow up where the previous speaker, the previous Congressman, the gentleman was asking. I want to ask you a more philosophical question. I am one of the new Members in Congress from Kansas, and what I have noticed in this city and across the country is that there is really a great divide in philosophy on what we should be doing right now in terms of spending, regulations, taxation, debt. And I kind of want to get a feel for where you are philosophically on these issues so I can understand sort of how you approach issues within the Treasury, and how your comments are related to questions before the panel.

On one side I think you have the argument that what the economy needed was greater regulation; that there was too unregulated, that we needed new consumer finance protection bureaus, we needed greater regulation in markets, we needed greater government involvement in free commerce in this country, and that that was one of the things that was causing economic stagnation.

You also have on that argument the idea that greater spending in Washington creates jobs, that cutting spending in Washington is a job killer, that borrowing more money and raising taxes can be a creation of jobs in Washington. And then clearly on the other side, you have the belief that government borrowing and spending is a net loser, that free enterprise and free markets are what built this country, and that we need to do everything we can to restore those principles and push rather for greater regulations, push for greater free trade, greater opportunities for folks to contract with one another.

I will tell you back in the district what I hear from almost every small business and bank in the community is that they feel government breathing down their necks at every turn, whether it is the health care bill, whether it is it Dodd-Frank, or whether it is new EPA regulations, whether it is a whole host of things that are so destabilizing and so unpredictable for the bottom line for these businesses that they are telling me, we have capital, we are not going to create jobs, because we are waiting to figure out what the government is doing to us. I hear that from my community bankers, I hear that from small businesses, I hear that from entrepreneurs.

And so I guess I would like to get an idea of do you agree with the sentiments of those entrepreneurs, small business owners, community bankers; do you think it is a fair assessment on their part? Do you think that the course of action in this city of greater regulation, spending and taxation is the proper way? And I know you made a statement before that the cuts that this Congress has looked at in H.R. 1 would be a job killer. Do you still believe that cutting government spending and putting more cash back in the hands of individuals and small business owners is a job killer?

Secretary GEITHNER. Okay, a thoughtful question, but let me just try to give you a sense of what I feel about these basic fundamental questions about strategy.

The most important thing we can do for the economy is to create better incentives for businesses to invest and to hire, and as we do that—and that is a complicated thing to do. It requires, again, making sure that tax policy creates better incentives for investment. It requires that businesses can hire people with the skills they need to be able to be competitive in this world. That is why education is so important. It requires investments by the government in basic things like research and development and science. Those things are fundamental to the capacity of any community to grow, any business to function and thrive in this competitive world. Infrastructure is hugely important to the basic competitiveness of the American economy. Those are core government functions that we have not been as good at as a country. We need to get better at that.

Part of it requires expanding opportunities for trade and exports, and that is why you are going to see before you an agreement not just with Korea, but if we get the change that we need with some other important trade agreements, we think those things would be very productive and very consequential.

Now, you referred to a couple of other things which I think I should respond to. In terms of the financial sector, you know, this is a crisis fundamentally caused in part by basic failures in financial oversight. And we all had an obligation to fix those problems.

Now, community banks were not the source of that problem, and community banks are largely insulated from the broader forms of Dodd-Frank. Those are targeted except for interchange, which your chairman referred to. Community banks were left largely outside of the scope of those changes and regulations. Those were directed, as they should have been, to the large institutions and the major markets at the center of the crisis, and all businesses were victimized by those failures. It wasn't just individuals and communities

where predation and fraud were rife, but businesses were the victim of the basic failures in the financing. It is why businesses stopped hiring, why financial markets seized up, why the economy was shrinking at the annual rate of 6 percent of GDP a year at the end of 2008.

So getting the financial system better, more stable, and more efficient, better to be able to provide capital is a central function of government. And it is absolutely the case that parts of our financial system had too much regulation, but parts had too little. And fixing that is really important to the broader task of trying to make sure that businesses were able to grow again, expand again in that context.

Now, of course, that to wait for this all to work, you have to bring the deficits down over time, and they have to kind of come down dramatically. If we don't do that, then you will risk higher interest rates, and you will make it harder for businesses to grow and expand. It is so important for all of us to recognize we have to do that. And you can't do it simply by doing the necessary reductions in spending and discretionary. We believe there are savings there we can do in support, but you are not going to be able to bring the deficits down over time without taking a broader multiyear approach, and that is going to be very important to confidence.

So to summarize, I don't know you, you don't know me. I doubt we disagree quite as much as your question suggested. And you can measure our intention and our values on these things by looking at the things we proposed. Again, if you look at our proposals in education, in tax incentives for business investment, in innovation in basic research and development, and infrastructure and trade, we think we have good ideas, but if we have broad support across the political spectrum in the past, it would make a big difference in terms of strength and recovery.

Mr. YODER. To follow up on the last question I had as part of the philosophical section here, do you believe that cutting government spending in any manner, such as the manner in which we have cut discretionary spending, and returning that money back to small business owners and individuals is a net job killer?

Secretary GEITHNER. Are you asking me about H.R. 1 specifically? I think if you cut that deeply in the way you are cutting in H.R. 1, it would be very damaging to the economy, near term and long term. Again, you need to look broadly, as I am sure you will, at what the government is doing. And you want to look at where those savings are used. And so you want to look at not just where you can cut, but where you need to protect investments and where you use those savings to make sure that we are like educating children with better skill sets.

Mr. YODER. Let me be a little more specific on the question here. I guess my question goes to the issue of jobs. This is a philosophical question, depends which you go here, but we hear folks in this town say that when you are cutting spending in Washington, you are killing jobs.

Secretary GEITHNER. No, I don't think that is necessarily the case. It depends on what you are cutting. There are absolutely things you have to cut, should cut. We can't afford a lot of——

Mr. YODER. I am not talking about the deficit.

Secretary GEITHNER. No, no, no the spending.

Mr. YODER. When we reduce spending and reduce the amount of Federal employees that we have in this city, the argument is, well, then we have eliminated jobs, and we have hurt the economy. I guess I question you as to whether reducing those Federal jobs in a way in which we are reducing Federal expenditures and returning more money to small business owners and entrepreneurs, individuals isn't a net job benefit.

Secretary GEITHNER. Well, again, I think it depends on what you cut. You are absolutely right that there are some programs that you cut would not be—hurt the economy, even if they temporarily reduce jobs. But again, it depends, what are you going to use the savings for? If the savings go to finance tax cuts for the richest Americans, you are not helping job creation. If you achieve those savings, but we are still living with very large deficits, then you are not helping the economy as a whole. You could be hurting the economy. It depends what you are doing to the overall path of——

Mr. YODER. Let us get into taxes, if we could, Mr. Secretary. You discussed in your statement that the budget that has been proposed by the administration would reduce the deficit from 10 percent of GDP to 3 percent of GDP over 5 years.

Secretary GEITHNER. Yeah. I can't remember if we do it in the 4th year or the 5th year, but over roughly that period of time.

Mr. YODER. What percentage of that reduction is related to tax increases?

Secretary GEITHNER. A pretty modest proportion is related to taxes. But you are right, we do in the deficit—in the budget propose to allow the tax cuts that apply to the top 2 percent of Americans to expire on schedule a year and a half from now, 2 years from now, and we also propose to limit in a very modest way tax expenditures for those richest same 2 percent of Americans. So, for example, we propose to limit the tax deductibility, the deductions, for those top 2 percent of Americans. Those are the principal tax reforms recommended, and we think they are sensible. We don't think we can afford those taxes. And if we don't allow those reforms to go into place, then you will be left with higher deficits. That is why, again, I know there are people on your side who think we didn't go deep enough in the budget.

I will make an observation. I don't think you will be able to find a way to get the deficit lower as a share of GDP in that time frame without doing anything in terms of tax reform. I think it is infeasible to do it without killing the economy.

Mr. YODER. I think you will find broad-based support for tax reform certainly as strong or stronger on the other side of the aisle. I guess I would ask, then, if you believe that we should increase taxes on the upper 2 percent. What do you feel the proper tax rate is for this country, specifically related to the upper 2 percent? It assumes your philosophy being that when we can take money to the richest 2 percent, and we can send it to the Federal Government and create programs, that is a benefit for society.

Secretary GEITHNER. No, I wouldn't say it that way. I would say that we can't afford them. We don't say this with any enthusiasm; it is just more in sorrow and in reality. You should not ask me to

go out there and borrow a bunch more money, a trillion dollars over 10 years, to make those tax cuts—leave those taxes in place. That would be irresponsible for the country, can't afford it. What we are proposing to do is to allow those taxes changes to take effect and use those to reduce the deficit.

Mr. YODER. Why is that the magic number, though? Why not increase taxes beyond that? It is seems sort of political, I guess. I know you look at these things from a very serious economic analysis here, and I want to, I guess, understand why this is just letting the 2 percent increase—what has the economic theory behind just that specific provision? Why is it not higher than that? Why does it not expand another 2 percent?

Secretary GEITHNER. Here is the philosophy of how we do it. We want to have the lowest taxes possible consistent with our obligation to run a sustainable fiscal position and fund core critical functions of government.

You say why those rates? The Bush taxes were designed to be temporary, to expire, and we think that the economy can withstand them reverting to the level they prevailed in the late 1990s, where we had, frankly, the best record of economic performance in terms of private investment, job growth, income growth, productivity improvement that we have seen in a long period of time. So looking back over history we think that this economy thrived at a time when the tax rates for the top 2 percent were at that level.

Mr. YODER. That was for all rates. You want to go——

Secretary GEITHNER. No, we are proposing only to go back to the——

Mr. YODER. I understand, sir, but you were talking about the 1990s in which all rates were at a higher rate.

Secretary GEITHNER. They were a higher rate.

Mr. YODER. And this gets back to a philosophical question. There are some in this town who believe that these higher tax rates and greater spending in Washington ultimately is better for jobs and better for the economy, and there are others who believe that the tax reductions in the early 2000s led to economic gain. And it is just this question of whether we think ultimately higher taxes create greater economic gain, or we think lower taxes create——

Secretary GEITHNER. I guess I would say if you describe both sides that way, they are both wrong, both substantially wrong. Of course, you want to make sure the commitments we make as a country are ones we can finance and afford, but you can't have everything, and you cannot sustain those tax rates with deficits this large. And you cannot achieve a reasonably responsible fiscal position without those types of tax reforms. Maybe you can, but I think it would be hard to do that.

Mr. YODER. Thank you, Madam Chair. You have been generous with the time. I yield back.

Mrs. EMERSON. Mr. Secretary, we have one vote, and I don't believe there will be more shenanigans. We hope not. But if you would be so kind as to allow us to recess for 10 minutes, and we will run over and vote, and we will be right back. Thanks.

[Recess.]

Mrs. EMERSON. Okay. We will go ahead and resume our questioning.

Mr. Serrano.

Mr. SERRANO. I will be ready in 5 seconds.

Mr. Secretary, you are familiar with H.R. 1, and I don't mean Mickey Mantle's first home run or 900th.

Mrs. EMERSON. Yes, okay. As long as you make it straight that——

Mr. SERRANO. Mickey Mantle is your favorite?

Mr. WOMACK. The gentleman knows that I am a Cardinal fan.

Mrs. EMERSON. Yes, it is 2 to 1. And we have an Oakland fan, so 2 to 1 to 1.

Mr. WOMACK. My treat sometime, Mr. Serrano.

Mr. SERRANO. We have already heard from Commissioner Shulman of the IRS this hearing season, but I think a couple of points bear repeating. As I am sure you know, H.R. 1, the proposal to complete the 2011 appropriations process, contains severe cuts to the IRS. But I know Chairman Emerson and her staff did their best to avoid layoffs and furloughs. The IRS took the bulk of the cuts.

I think a cut to the IRS budget is completely contradictory to everything that we are doing. How do we begin to solve a budget crunch by reducing resources to the agency that collects our tax revenue? What are the long-term ramifications, from your perspective, of reducing the ability of the IRS to accurately and efficiently collect tax revenue?

Secretary GEITHNER. Well, I think they are very stark and compelling. If you reduce resources for enforcement and customer service, then two things happen. We collect less revenue. It means our future deficits are higher. It means to reduce deficits, you have to either raise more taxes on other people or cut other spending to make up for that. But the other effect you have is equally damaging. You reduce the capacity of the IRS to make sure that people who have the privilege of being Americans pay their fair share of taxes. So in some ways, if you reduce resources for enforcement and customer service, you make Americans less confident that the system is fair to them, too. So both of those effects are very damaging.

Mr. SERRANO. Now, Commissioner Shulman told us at the March 1st hearing that—he stated a $603 million cut to the IRS proposed in H.R. 1 would mean $4 billion less in revenue for the United States Treasury. The lost revenue is seven times larger than the supposed savings. Do you agree with that assessment?

Secretary GEITHNER. I do. I trust his judgment on that. He got a very good record of trying to make sure that we are satisfying the obligations Congress gives us with the lowest costs in terms of enforcement and customer services resources. But again, a dollar of enforcement resources raises roughly $5 in revenue, it more than pays for itself. And if you don't do that, you are going to have higher deficits.

Mr. SERRANO. Yeah. I am going to bring up the word nobody wants to mention around here: shutdown. No one wants to see a shutdown of the Federal government. However, we must accept that this is a possibility and plan accordingly. What has your agency done to prepare for a potential shutdown?

Secretary GEITHNER. Well, across the executive branch, at the President's direction, agencies have been looking carefully at what the law requires, what the law permits, how to make sure that we plan for that eventuality. But, Congressman, we are all working to avoid that. I think we should be able to avoid that. It would not be good for the economy now to put us through that kind of reduction in critical government services.

Mr. SERRANO. But across the government you say plans are being put in place. And I don't know if we are late into the season, but there was talk about refunds, tax refunds, being in jeopardy. Is that a possibility?

Secretary GEITHNER. Again, I don't think I should at this point, Congressman, walk through the precise implications of a shutdown. It depends a lot on the legal judgment about what is possible and what is not possible in that context. But I think it is very important that we all try to work to avoid that, because, it is not good for us to put an economy still emerging from crisis through the trauma that would come from loss of critical government services.

That would be one example that could be implicated. But I don't want to go into those details now. And again, we are doing what you expect us to do which is to work to avoid it. But, of course, we all always look at these kind of contingencies.

Mr. SERRANO. Madam Chair, I know that the time is running short, and I know we have other Members, so I will stop here for now.

Mrs. EMERSON. Thank you so much, Mr. Serrano.

Let me ask you a really quick question, Mr. Secretary. Could other factors such as business cycles affect receipts more than the size of the IRS's budget, for example?

Secretary GEITHNER. No. I think in this context anybody—well, not anybody. I believe it is fair to say that Republicans and Democrats who have looked at this question over time would say that enforcement and customer service resources have a substantial effect on revenue. Of course, lots of things affect overall revenue, how strong the economy is, but you know one thing for sure. If you cut it, your deficits will be higher, other things being equal. You don't make——

Mrs. EMERSON. The other things being equal key, because——

Secretary GEITHNER. No, but you won't make the economy stronger by cutting enforcement resources. That will have no effect on that. Now, of course, the economy will be stronger long term if you get our fiscal position resources and—but you are not going to do that by cutting enforcement resources from the IRS.

Mrs. EMERSON. Well, I mean, this is why I think business cycles might impact, because when we—at two different times, in 2008 and 2009 and then, I believe, 2001-ish, receipts were down in spite of the fact that the IRS budget was up.

Secretary GEITHNER. Yes. But I think it is fair to say the right way to think about this is that for a given economy and a given tax policy, Congress sets the tax rates for the country. You will collect more revenue in a more fair way if you have adequate enforcement resources with the IRS. If you cut those, you will have less revenue, and it will be less fair. And that is why it is worth doing.

I know you have been very supportive of this in the past. Of course, we all have to make tough choices in this context, and we are trying to, as I said in my testimony—trying to find areas where we can save, so where we are making investments, we think of higher return, we are funding those investments to the extent we can with savings efficiencies.

Mrs. EMERSON. Appreciate that.

Mr. Womack.

Excuse me, let us keep to 5 minutes, okay, on this round of questions if you all don't mind. Thanks.

Mr. WOMACK. I should be able to yield back time, because I only have a couple of follow-up questions.

One, when you look at the glide path of our debt, the size of our debt, and the glide path of what that debt means in the outyears, I am concerned about the numbers that our side crunches and, I am sure, your side crunches, and the relative interest rates that figure into the projections. And my understanding is those are factored in, I don't know, 4 to 5 percent levels, somewhere in that neighborhood.

What happens in a period of high inflation? Suppose for a moment we went into that, and interest rates spiked to more astronomical levels? And you can pick a number. What does that do to the mandatory piece of our spending pie as obviously it gets elevated exponentially?

Secretary GEITHNER. Well, you are right to say that lots of things affect that overall burden, interest burden, over time, how fast we grow, what happens to interest rates. But the biggest factor really is just the rate of growth in health care spending. With an economy aging and people able to live longer, that is the biggest overwhelming factor.

Now, we have an independent Federal Reserve, and their job is to keep inflation low and stable over time, and they have got a very good record of doing that in the last three decades, and I am very confident they can do that. But even if they do, that is not going to save the Congress and the executive branch from the obligation of trying to put in place reforms that will reduce those long-term deficits.

Mr. WOMACK. And then related to the debt ceiling, it has already been talked about in the previous line of questioning, you have indicated that the path that you hope to have us on is down to about 3 percent, a 3 percent factor of GDP.

Secretary GEITHNER. At least.

Mr. WOMACK. At least 3 percent. And you call that relative balance.

Secretary GEITHNER. Primary balance.

Mr. WOMACK. I understand the concept there. And through normal growth we can begin to trim our debt. I fully get that.

I don't want to put words in your mouth, but because we have to continue to go back statutorily and raise this level of debt every time that we start bumping up against it, is that a call for a more indexed debt ceiling?

Secretary GEITHNER. Well, that is really a question for you and your colleagues. We are the only country in the world that I am

aware of, or any serious country, that requires its elected representatives to periodically go back and raise the limit.

Remember the limit, we are only allowed to borrow to finance things Congress has obligated us to finance. Congress sets the obligations for the country; we just raise the money to finance it. And we are the only place in the world I know that has a separate obligation on Members of Congress to come back periodically and raise it.

I don't know why you want to live with that. It is tough enough making some of the other choices you have to live with. As you know, it is not proven to be of any value in forcing choices Congress hasn't been able to force on itself through other means, because fundamentally we will never default on our obligations. No Congress will ever let us default. It provides no leverage in that context, and it has had no value in bringing discipline to fiscal choices of the contribution of the past.

So my own sense is that it is not a particularly useful tool relative to political costs it imposes on each of you. That is why many of your colleagues in the past have tried to find ways to reform that obligation.

The important thing is for Congress to agree on multiyear commitments that lock in improvements in the deficit over time in ways that don't kill the economy, and that is the important thing to do.

Mr. WOMACK. My colleague here in his line of questioning talked a little bit about the Dodd-Frank Act and the community bank side of the house. We all agree that community banks are very important to local communities, in particular rural Arkansas, rural Missouri and other areas. Is it possible we threw the baby out with the bathwater in Dodd-Frank with regard to community banks?

Secretary GEITHNER. No, no risk of that. In fact, again, we were very, very careful, completely committed to make sure that the reforms in this bill were targeted on the parts of the system that were broken. We were very successful in doing that.

Now, there are things like interchange with people worried about that in that context, but if you look at all the basic dimensions of the bill in terms of what changed, we appropriately followed a simple principle, which is let us focus on the things that were broken and on the institution that caused the problem, not on the ones that were mostly caught up.

Now, of course, community banks were not innocent completely. A lot of them got way too exposed to commercial real estate. They are trying to dig their way out of that. They have to reduce lending to their business customers because of that. And we can help them get through that a little bit. But I think Dodd-Frank has a pretty good balance; not perfect, but pretty good.

Mrs. EMERSON. Thank you.

Mr. WOMACK. I am going to stop there. I just want to say one thing, Madam Chairwoman. I was digging through my unlimited funds here, and I found this $1 bill, it is all I have, with the Secretary's name on it. But I know because his name is on it that he cares deeply about what is happening in America and our fiscal health. And I appreciate his testimony here today, and I have enjoyed the conversation that we have had today.

Mrs. EMERSON. I am sure the Secretary would be happy to sign that for you.

Mr. WOMACK. I don't know if that is a violation of Federal law or not. I certainly——

Mr. SERRANO. I think it is against the law.

Mrs. EMERSON. Actually I will say that I found at a colleague's home this past week that Secretary Snow had actually signed a dollar bill for he and his wife so—in honor of their marriage.

Ms. Lee.

Ms. LEE. Thank you very much.

Okay. Going back to the point you were making about earmarks in terms of making the point that the public wants us to reduce spending and reduce deficits. I agree. But I also believe that the public understands that while everyone must share in the pain, not—it is given, all things being equal; given all people, given all districts, given entire countries in terms of middle-income individuals having the kind of wherewithal to sustain some of these cuts. So I don't believe all things are equal.

And given that, the 3 percent in terms of the earmark, the 3 percent reduction to me doesn't seem fair. It doesn't seem fair because once again it is hitting the most vulnerable communities the hardest, communities that need jobs and need services, which unfortunately our government nor State governments provide. And so while the public wants us to do this, reduce the deficit, reduce spending, I am sure the public does not want us to wreak havoc, mind you, and I don't think the President wants that to happen on these communities that need this type of support.

Secondly, I believe that, and I think that many concur, that the deficit is caused by three factors, the Bush tax cuts for the wealthy, two wars that did not need to be fought, and the recession was, of course, caused in large part by Wall Street.

Secretary GEITHNER. Part D and Medicaid contributed.

Ms. LEE. Yes. Part D and Medicaid. The prescription drug deal.

So given that, that seems to be where we should go to find revenue. That seems how you begin to dig us out of this hole and reduce the deficit. When we talk about going back to 2008 domestic discretionary spending, cutting back, some agree, some disagree, but if we do that we should go to defense. Why not? Again, $700-some billion. And I think most experts who study this, most economists and most military experts, will identify 100-, 150 billion in defense that could be cut without jeopardizing our national security.

And so what I can't quite figure out is why would we talk about reducing or develop economic policy and strategies to reduce the deficit on the backs of those who can least afford these kinds of hits?

Secretary GEITHNER. I don't think we should do that. And that is why the President proposed in his budget a very substantial, very ambitious deficit-reduction program with a balanced approach that preserves critical investments in things that matter, not just the most needy Americans, but also to things that are very important to our capacity to grow in the future.

You know, the hard thing to do is not to figure out a way to cut spending or reduce deficits. The hard thing is to find a way to do

it in a way that does not hurt the capacity of the country to grow, to expand opportunity, and it is done so in a way that is just as fair, fair across the country. That is the challenge, that is the political challenge in this context. That is why, again, in the President's budget we proposed a balanced approach, multiyear package of phased-in reductions in spending in areas where we can afford to cut spending, but while preserving in some cases increasing investments in things that this government has not done well enough and has to do better in the future if we are going to grow and prosper in the future.

Ms. LEE. What are the numbers in terms of health care reform how that would hit our Treasury? If, in fact, we repealed health care reform, of course, we are going to create a larger hole. What are those numbers? Do you have that?

Secretary GEITHNER. Apart from what it does to coverage and incentives to use health care more wisely, reduce cost growth, what it does is it reduces the 10-year deficit by $143 billion, the Affordable Care Act reforms, and it reduces the deficit over the next decade by a trillion dollars. And most health care estimates look at those estimates and feel that CBO is reasonably conservative in giving us credit, giving the government credit, for the savings that are ahead.

Now, of course, for those savings to be realized, Congress we have to hold to them, not walk them back over time, leave them in place and let them work. So if you repeal, your deficits will be higher by 150-, a quarter billion dollars the next 10 years, then higher by a trillion in the next decade.

Ms. LEE. Thank you very much, Madam Chairman.

Mrs. EMERSON. Thank you so much, Ms. Lee.

Mr. Yoder. No more questions?

All right. Mr. Serrano.

Mr. SERRANO. Thank you.

In my final round, I think, I just want to help us set the record straight. It seems to me, Mr. Secretary, that there is some confusion about TARP with new Members and some returning Members of Congress. So let us set the record straight, and you tell me if I am wrong.

As recently as yesterday on the floor of the House, my friends on the other side were accusing the Democrats of dreaming up TARP. Let us be clear. TARP came about under the Bush administration, and it was the Bush administration that told us that the entire American economy would collapse if we didn't vote for it. TARP is a program that you inherited, not one that this administration created. Am I correct?

Secretary GEITHNER. That is absolutely correct.

Mr. SERRANO. Now that we have that clear, let us talk about the real cost of TARP. Beyond anyone's wildest expectations, the cost of TARP, as analyzed by the nonpartisan Congressional Budget Office, keeps declining. We are finding that the investment that we made in certain industries actually paid off. Can you tell us what the original estimate was for the cost of TARP and what we expect the program to actually cost now?

Secretary GEITHNER. At its peak it was $350 billion. That was without the risk that we might have to come back to Congress and

ask for more authority. And relative to that initial estimate, as I said, outside of housing we are going to earn money for the taxpayer. I think CBO's latest estimate is total costs are—I can't remember what the exact number is, something closer to $20 billion, but I think that is probably a little high.

Mr. SERRANO. Not every program within the TARP has been successful, though. The HAMP program, your signature program for foreclose mitigation, has produced far fewer mortgage modifications than anticipated or hoped. In fact, the House voted to defund the program just last week, claiming that it is better to give up on solving the foreclosure crisis than to try to fix the program.

What are your plans for reforming the HAMP program? How can you make it more useful for homeowners who are struggling?

Secretary GEITHNER. Very good question. And let me just say that we are all disappointed and frustrated by the speed at which we reach people through this basic program, but—and again, I would say that the servicers and banks are not doing nearly enough to make sure they can determine whether people are eligible for these programs and make sure they get the benefits of these programs as quickly as they need to, and they need to do a much better job of that.

Appalling performance by servicers generally still not nearly good enough. But this program has reached 600,000 Americans with permanent modifications and lowered their monthly payments by an average of $500 a month. That is a very substantial amount of money, and the reforms put in place have helped set an industry standard that led to more than 2 million additional modifications outside this program. Again, a very substantial improvement in reducing the rate of avoidable foreclosures.

And we have a number of programs in place that are designed to help make sure we reach more people as quickly as we can. But by law, by the constraints of law, this is a voluntary program, and we do not have the capacity to compel banks, to force banks to deliver these reductions. We can push them to do what we are doing, encourage them to do it with incentives. And, you know, we publish detailed metrics every month to show how banks are doing on meeting the basic customer service obligations in this program. They are getting better, but not nearly good enough yet.

Mr. SERRANO. Go ahead, one more, or are we short?

Mrs. EMERSON. Two minutes left.

Mr. SERRANO. I did have a quick question about the Bank Secrecy Act.

Mrs. EMERSON. Go ahead.

Mr. SERRANO. In the 2012 budget issue, February 18th, the Treasury Department proposes to eliminate all State and local direct access to the Bank Secrecy Act, BSA, portal maintained by the Financial Crimes Enforcement Network. You are familiar with that issue. So the question is, is the degradation of the capacity of States and cities to combat terror, fraud, corruption and crime justified by a proposed savings of a little over $1 million? Did the Treasury Department conduct any study of the secondary cost of this proposal in terms of increased inefficiencies, loss of revenue, or the cost of the likely increase of uncaptured fraud that will re-

sult from this proposal? If so, what were the results of this study; if not, why not?

Secretary GEITHNER. Excellent question. Of course we looked at this very carefully before proposing it. And again, we are trying to find savings everywhere we can justify them. But I did not believe this proposed reform would have any material effect in the capacity of State and local authorities to carry out those basic obligations. But we would be happy to give your staff a little more information on what went into that judgment.

Again, this is just another example of how we can't do everything. We have to make some hard choices. We have to reduce some things that have a—where we think we can better use the money. But in this case we think the reforms are justified, and we don't think they affect the capacity of State and local governments to carry out that responsibility.

And I want emphasize something your colleague said, which is, again, we want to be very careful that where we are saving resources, we are not hurting the most vulnerable or taking away from programs that have, again, a demonstrated very good record over time in using taxpayers' money, supporting private investment.

Mr. SERRANO. Well, in closing let me just say you should take a look at that, Mr. Secretary, because I can tell you one city where they feel they will be hampered in their ability to do what they need to do. Thank you.

Mrs. EMERSON. Thanks, Mr. Serrano.

Bless you.

In response to the question that Mr. Serrano asked you about HAMP, and it reminded me of this e-mail that I just got from a friend of mine who is a banker, a community banker in one of my counties. And I am actually going to read you what he said, because this is somewhat problematic. But basically, just to pick and choose, in theory the program, HAMP, seemed like a viable option to help borrowers stay in their homes in times of financial difficulties, but the cumbersome process of getting a borrower qualified for the program made it almost impossible to help those who are in most need in general. The servicers are required to solicit those borrowers and provide them with information regarding the HAMP options available. The borrower then must complete and return the forms required in order for the servicers to proceed. The borrower's information is then input into the HAMP Web site and transmitted electronically to Fannie Mae, who handles the applications for Treasury Department.

Navigating the loan input Website was nearly impossible, the users guide alone being 64 pages. Issues with calls to the support line when assistance was needed included long wait times and conflicting answers from the staff members once the call was answered. The incentive offered to participate did not seem to interest any of our borrowers—blah, blah, blah. So I tell you this primarily because it needs to be streamlined and made more efficient.

Secretary GEITHNER. I am really glad you raised this, but let me explain to you why we are in this position. Any time we put taxpayer resources on the table—in this case it is to encourage banks to put some of their own money on the table to modify a loan for

a homeowner who is better off staying in their house—we have to be very careful that those resources go to people who are eligible for the program, and that requires making sure we can defend to you and your colleagues up here that we have good protections against fraud and people can prove income in this context.

And as you know we have a crisis where part of the crisis was the country was filled with examples people were given loans without having to prove income, without having to document assets, capacity to pay. And part of our challenge in designing this program in applying was to make sure that again where we are qualifying people for a program and putting taxpayers money on the table that we could demonstrate to you and your colleagues up here that we are being exceedingly careful.

Now, that does slow down the pace of conformance, and banks do complain about it, but look how well the banks are doing at qualifying and even loan programs. Ask people how they feel about the basic quality of service of banks for loan programs, and you will find people with still terrible examples of lost documentation, long waits, inability to find a live person to help them navigate that complicated process. But I agree with you it is still hard and complicated, but where it is hard and complicated is because we are trying to be careful custodians of the taxpayers' resources.

Mrs. EMERSON. I do understand that, but 64 pages of user guide seems a little excessive, and it begs the question then, if we are going to talk about banks just for a moment, and it frustrates probably all of us across the board that the Office of the Comptroller of the currency doesn't come under the Appropriations Committee, in spite of the fact they are authorized to charge whatever they want in order to run their own operation, and yet we have the FTC, the FCC, SEC, and I could go on and on and on, who are funded through fees and we actually do have some jurisdictions.

But given the importance of the OCC and its performance over the past several years, do you think there is any justification at all for allowing bank regulators to be outside of the congressional oversight?

Secretary GEITHNER. That is a dangerous question for me to answer in a subcommittee of the Appropriations Committee.

Mrs. EMERSON. This is not just we want our hands on it. It is a serious question because the regulators did not do their jobs in many cases, obviously. We all know that.

Secretary GEITHNER. We had a system to which a really appalling extent we allowed institutions to choose who their regulator was. They could choose who their regulator was based on how soft or permissive the regulation was, and in some ways what was more expensive in terms of fees and that kind of thing. That is a crazy way to run a country's financial system.

What happened was people just flipped their charters to take advantage of lower costs and lower standards, and that was disastrous for us. And it is just an untenable way to run a country in this context.

Now, part of that is how we fund our supervisors, and it is very important for the country that we have a funding mechanism that allows them to attract and retain quality people and to maintain an adequate supervisor resource base. And so my own view in this

case, and I know it is a little bit controversial in a body like this, is I would try to retain as much independence as possible so you can make sure that they can attract and retain qualified people. And I would eliminate as much as I can the capacity for arbitrage across different regulators. To some extent, we have done that in Dodd-Frank. But funding is part of that.

Mrs. EMERSON. I have ethical issues with fee-based regulators anyway because generally speaking, the people who end up being the top regulator come from the industry which they are entrusted to regulate.

Secretary GEITHNER. I am against that, too. I think in general, particularly for a regulator, they have unimpeachable credentials not just for toughness, but for independence, and it is a very important thing that we instill in the system.

Mrs. EMERSON. Indeed. I have numerous questions to submit for the record that we would like to ask you to respond to within 10 days, if possible.

Let me ask one quick question, and then we will close it down because I know you have to leave. This is about the Consumer Financial Protection Bureau (CFPB).

What happens to the CFPB if there is no director confirmed by the Senate by that time in which it is supposed to be stood up?

Secretary GEITHNER. At a date we call a transfer date, a date I set but the statute defines that authority, a bunch of authority from existing bank regulators transfers to the CFPB, but not all of the authority under the law. Some of the authority does not happen until there is a confirmed director in place.

So the short answer to your questions is that the CFPB would not be able to operate with the full authority established in the law, part of it, but not all of it. The consequence of that would be that you leave the financial system left with a huge amount of uncertainty about who is in charge, and a lot of duplicative, overlapping function in this area. And you leave the system, I think, to some extent, to a significant degree, without the ability to make sure, for example, that small community banks don't face a lot of competition from people that are not required to adhere to the basic standards for consumer protection we try to apply to banks as a whole.

So it would be—of course, it would substantially impair the capacity of this bureau to do what the law requires, which is establish and enforce sensible standards for consumer protection across the system. Again, in this crisis, what happened was you had banks subject to consumer protection, not always perfect, a lot of mistakes in that, too. But the more appalling failure was you allowed a bunch of institutions to compete with banks that were not subject to consumer protection.

So you don't want to put community banks or any banks in a situation where they see their business just move to people who are not subject to that fair regulation. So that level playing field obligation is a critical objective, critical rationale for the establishment of this bureau, and you lose that objective, lose that advantage the longer you leave this entity in limbo.

Mrs. EMERSON. I appreciate that, and I don't believe there is anyone who believes that non-bank banks shouldn't be treated the same as banks when they are doing more or less the same thing.

Thank you very much for being here. Thank you for staying over time. We appreciate it. This hearing is adjourned.

[The information follows:]

Financial Services and General Government Subcommittee
Hearing on the Treasury Department FY 2012 Budget

Questions for the Record Submitted by Chairwoman Jo Ann Emerson

FSOC AND INSURANCE REPRESENTATIVES

Under Dodd-Frank, the Financial Stability Oversight Council (FSOC) is required to have three insurance members:

1) a voting member with insurance expertise appointed by the President and confirmed by the Senate;
2) the Director of the Federal Insurance Office; and
3) a state insurance commissioner representative designated by the state insurance commissioners.

But even though the FSOC and its committees have been meeting for months, now, two of its insurance seats remain vacant – the FIO Director and the voting member with insurance expertise have not yet been named. Insurance Director John Huff from my home state of Missouri is currently the only insurance representative on the FSOC, even as the council is developing the process through which non-bank financial companies, like insurers, will be designated as systemically risky.

What limitations are being placed on Director Huff and his ability to access resources and consult with his colleagues in the National Association of Insurance Commissioners?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Is Director Huff being supported in a manner similar to other FSOC participants?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Your budget request includes resources to fund the Federal Insurance Office (FIO) and activities of the FSOC. Are there efficiencies which could be captured by allowing the sole state insurance regulator representative to access resources available from his fellow state regulators, which would not come out of the federal budget?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

What is the status of the appointment of the FIO Director and the insurance expert; please explain any delay in the appointment process?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

TREATMENT OF INSURERS IN DODD-FRANK IMPLEMENTATION

Recognizing the distinct differences between large banking institutions and insurance companies with small ancillary depository institutions, Congress included language in the Dodd-Frank Act stating the Volcker Rule should "appropriately accommodate the business of insurance." Is it your understanding of the DFA Volcker Rule provisions that insurance companies should be able to continue to sponsor and invest in private equity pursuant to this insurance exception? Mr. Secretary is this something that you think will be addressed in the process of preparing a proposed rule?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

The Volcker provision in the law has created a number of questions for insurers. "Private Equity" and "Similar Funds" as used within the Volcker Rule to limit investment activity are loosely defined, which could result in disruption in the marketplace. While maintaining the core concepts of the provision, are you open to clarifying some of the terms?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

TAX REFORM

The Administration's budget does not include a tax reform plan, but instead includes three paragraphs inviting Congress to work with the Administration on corporate tax reform. Why is corporate tax reform a higher priority than individual tax reform?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Can corporate tax reform be implemented independent of individual taxes? Won't corporate tax reform inevitably affect individuals? For example, both corporations and individuals are eligible for some of the same tax expenditures. Won't sole proprietors or partnerships incorporate to take advantage of lower a corporate tax rate?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Wouldn't a comprehensive tax reform plan, such as the one proposed by the National Commission on Fiscal Responsibility and Reform be preferable?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

VALUE-ADDED TAX

The Tax Policy Center believes a Federal value-added tax, or VAT, should be implemented as part of deficit reduction strategy. Is the Administration giving consideration to a VAT? If so, would the VAT be in addition to or a replacement for the existing income tax?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

CONSUMER FINANCIAL PROTECTION BUREAU

The President's budget calls for $392 million of funding in 2012 for the new Consumer Financial Protection Bureau, which is a significant sum for the government to extract from the economy. It's almost as much as the IRS plans to spend on implementing the healthcare law. But the IRS explains how it would spend its funds in 159 pages; whereas the Bureau explained how it would spend its funds in only 7 pages. It's ironic that an agency created to make financial firms accountable and transparent to consumer lacks accountability and transparency to taxpayers.

Do you think the Bureau's budget is as transparent as it could be to Congress and the American taxpayer?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Since the Bureau's expenses will be on the Treasury's 2011 financial statement, does the Bureau's budget live up to the Department's standards for accountability, objectivity, and excellence?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

How does the Bureau's budget compare with the past expenditures of other financial regulatory agencies on consumer protection activities?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

CONSUMER FINANCIAL PROTECTION BUREAU

Last year, Federal Reserve Bank of St. Louis President James Bullard expressed reservation about the Fed as a source of funding for the Bureau. Specifically, he said:

The amount of money allocated in the law is not based on any careful assessment of what the needs of the Bureau will be as it attempts to fulfill the mandate of the Congress with regard to

consumer protection. Nor is there any mechanism for changing these amounts going forward, should market conditions change, or if the needs of the Bureau change.

Do you share President Bullard's concern?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

ECONOMIC ASSUMPTIONS

The President's budget assumes a rosy growth scenario for the economy relative to forecasts made by the non-partisan Congressional Budget Office and by private forecasters. Yet, despite assuming stronger GDP growth, the administration shares the view with others that unemployment will remain unacceptably high. Differences in economic assumptions are non-trivial given the budget's sensitivity to these assumptions.

Why does the Administration believe that GDP growth will be stronger than others believe, yet does not believe that labor markets will correspondingly be stronger?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

TERRORISM AND FINANCIAL INTELLIGENCE

The budget request reduces funding for the Department's Terrorism and Financial Intelligence activities by $10 million, or 10 percent. Will this reduction in funding make the American people and financial system any safer?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Is Treasury doing everything it possibly can to enforce sanctions against Iran, North Korea, drug cartels, WMD proliferators, and terrorists?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

IRS BUDGET AND GOVERNMENTAL RECEIPTS

In your testimony, you express concern that "cuts to the IRS's budget will hurt revenue collection." We are not aware of any studies that have established a causal relationship between inflation-adjusted IRS funding and inflation-adjusted government receipts. Has the Department conducted a statistical causality test to determine whether increases in the IRS's budget leads to increases in government receipts, controlling for inflation, population, and changes in tax laws?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

If so, how does the Department explain a 17 percent decrease in receipts when the IRS's budget was increased by 6 percent between 2008 and 2009? Or a 2 percent decrease in receipts when the IRS's budget was increased by 7 percent between 2000 and 2001?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Questions for the Record Submitted by Ranking Member Serrano

COMMUNITY DEVELOPMENT FINANCIAL INSTITUTIONS

The budget proposes zeroing out two existing CDFI programs: the Bank Enterprise Award Program which provides assistance to banks that have demonstrated increased lending activity in low-income neighborhoods, and the Capital Magnet Fund which provides competitive grants for constructing, preserving, rehabilitating or acquiring affordable housing in low-income neighborhoods as well as other economic development projects in communities where the housing in question is located. Can you explain why the Administration is not requesting funding for these programs?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Both the Recovery Act and this year's appropriations bill waived the requirement for CDFI applicants to have matching funds. This year's budget request, however, would end the waiver. Although the economy is showing some signs of improving, the communities served by CDFIs will likely be the last to recover from the economic woes this country faces. The new fiscal year starts in seven months. Why does the Department feel that this is the correct time to reinstate the matching funds requirement?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

We all know that credit markets have been all but frozen for 2 years now, and that underserved communities have been hit the hardest. The CDFI Fund provides capital to these markets at a time when they cannot find it anywhere else. This is evidenced by the record number of applications that the CDFI Fund received in FY 2010 – 1,265 applications received, which is a 63% increase over the FY 2009 number. If the CDFI Fund is cut, as was proposed in HR 1, how will these communities receive the capital needed to create jobs?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Even in these tough economic times, the CDFI funding produces incredible leveraging. In FY 2010, CDFI grantees produced $13 in private funding for every $1 invested into the program. What is the value of this leveraging in terms of job creation and economic development in underserved communities?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

IMPLEMENTATION OF DODD-FRANK

Treasury is charged with multiple new responsibilities under the Dodd-Frank Act. Please explain how the agency is preparing to take on these responsibilities?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

The Treasury Secretary is now the Chair of the new Financial Stability Oversight Council. How is the agency building the expertise to oversee the stability of the United States financial system?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

What is the impact of not having funding for the FTEs to implement the Dodd-Frank Act? As Dodd-Frank is the law, Treasury is bound to implement it. If you do not receive the resources necessary to fulfill the new law, what options does Treasury have for accomplishing the important rulemaking and regulations that result from Dodd-Frank?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

BANK SECRECY ACT

In its 2012 budget, issued February 18, 2011, the Treasury Department proposes to eliminate all state and local direct access to the Bank Secrecy Act ("BSA") portal maintained by the Financial Crimes Enforcement Network (FinCEN) and instead drive all state and local users to "state coordinators" for a stated cost savings of roughly $1.35 MM. State and local law enforcement and counter-terrorism agencies have strongly condemned this proposal, claiming that they use this data to root out terrorist rings and combat every type of criminal activity they confront, including large-scale malfeasance by corporations and financial institutions, government corruption, health care frauds, and even street-level crimes such as homicides and kidnappings.

Is the degradation of the capacity of states and cities to combat terror, fraud, corruption and crime justified by a proposed savings of little over $1 million? Did the Treasury Department conduct any study of the secondary and tertiary costs of this proposal in terms of increased

inefficiencies, loss of revenue or the costs of the likely increase of uncaptured fraud that will result from this proposal? If so, what were the results of this study? If not, why not?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

In light of the 9/11 Commission's findings on the critical role played by information sharing between federal, state and local law enforcement agencies on preventing a catastrophic terror attack within the United States, did the Treasury Department consult with the Departments of Justice, Homeland Security, or the Director of National Intelligence prior to making this proposal? If so, with whom did you consult and what was the response? If not, why not?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

In light of how important this crime-fighting tool is to our state and city counter-terror and law enforcement community, did the Treasury Department seek input from states and cities prior to making this proposal? If so, with whom did you consult and what was the response? If not, why not?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Questions for the Record Submitted by Congressman Womack

CHILDREN'S HEALTH INSURANCE

Secretary Geithner, as you know, in April 2009, Congress enacted and the President signed into law the Children's Health Insurance Program Reauthorization Act -- commonly referred to as CHIPRA. The reauthorization bill was financed by increasing the Federal Excise Tax (or "FET") on all tobacco products by a minimum of 158%. The FET on five of the six tobacco categories (i.e., cigarettes, little cigars, smokeless, chewing, pipe and roll-your-own tobacco) are assessed on a unit basis (per thousand or per pound) and large cigars are taxed at an ad valorem rate--a percentage of the sale price.

Many of those opposed to the tax increases in CHIPRA expressed concern that dramatic increases in tobacco taxes would lead to similarly dramatic increases in illegal smuggling, counterfeiting and tax evasion. In the nearly two years since the tax increase went into effect, illegal activity and excise tax evasion have materialized resulting in less revenue collected by the federal treasury.

With regard to cigarettes, there is little question that higher tax rates have led to increased contraband activity. Chinese counterfeiters have taken advantage of the high U.S. retail cost of cigarettes resulting from the high taxes rates and are now openly exporting billions of fake American branded cigarettes to the U.S. every year. No FET is paid on these cigarettes.

The impact of these illegal, untaxed sales is staggering. It is now estimated that some 5% of all cigarettes sold in the U.S. lack the payment of federal and state taxes. Whether counterfeit, smuggled or manufactured by unlicensed companies, that amounts to some16 billion cigarettes and a loss of some $2 billion in federal and state revenues every year.

Another unintended consequence of the dramatic tax increases is potential tax rate manipulation with imported large cigars. CHIPRA increased the tax on large cigars from 20.719% with a 5 cent per cigar cap to 52.75% with a 40 cent per cigar cap. Prior to the tax increase, virtually all large cigar manufacturers paid at the 5 cent cap, thus making the tax a de-facto unit tax. Since the CHIPRA tax increase and cap increase, large cigar manufacturers have begun calculating their ad valorem taxes.

Here is how the taxation of large cigars should be working: for both domestic manufacturers and importers, the FET computation should be straightforward. When a domestic manufacturer sells large cigars to an unrelated wholesale distributor, the FET is computed on the basis of the sale price in that transaction. Similarly, an importer of large cigars who purchases large cigars from a foreign source and then resells those cigars to an unrelated wholesale distributor should be paying FET on the basis of the sale price to the unrelated wholesaler.

There is concern that some imported large cigars may be receiving a tax advantage over cigars manufactured by companies in the United States. There may be a strong incentive for manufacturers to use various means to assign a low sale price to imported large cigars. This may include using a "customs agent" to take title to imported cigars, pay the FET as the "importer" making the first sale in the U.S. (even though the sale is not to a distributor, but to a U.S. affiliate) and pay the FET on the basis of a much lower "sale price". In contrast, for domestic manufacturers, the excise tax is based on the sale price when the cigars are sold to a distributor. If a tax disparity exists, it would adversely affect domestic manufacturers and American jobs.

Will you direct TTB to immediately investigate whether imported large cigars are receiving an unintended tax advantage and further will you direct the TTB to provide clarification to the industry on whether or not domestic and imported cigars are meant to be taxed at a different point in their distribution and based upon different sale prices?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Can you tell me what concrete steps the Administration will be taking this year to stop illegal and untaxed sales of cigarettes? Most immediately, I would like to know what the Administration is doing to stop the flow of counterfeit cigarettes from China?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Questions for the Record Submitted by Congressman Alexander

JUDGEMENT FUND

Mr. Secretary, the Department of Treasury has as one of its duties under the law (and through your Bureau of Financial Management) to certify and oversee payments from the Judgment Fund. In 1956, Congress enacted a permanent, indefinite appropriation ("the Judgment Fund") for the payment of final judgments which were "not otherwise provided for." This fund was intended to provide a mechanism that would alleviate the procedural burdens of judgment payment, allow for prompter payments, and reduce the assessment of interest against the United States (where such was allowed by law).

Isn't this—the Judgment Fund--one of the main sources of funds used to pay litigation settlements and judgments against federal agencies? Provide for the record an explanation of the Judgment Fund and how it is funded and maintained.

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Do you know how much is paid out in a given year in judgments, settlements, and attorney fees to successful plaintiffs? Provide for the record these amounts by year for the last 10 years and by agency jurisdiction.

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Management in the private sector closely tracks litigation settlements and judgments to determine who is suing them and what they are being sued for. They analyze this data to help develop and implement cost and risk reduction measures.

Does your Department (or individual Departments who are impacted by these settlements) track payments from the Judgment Fund to determine who is suing the Federal government (or a particular Federal agency), the nature of their claims, how often agencies settle and agree to pay plaintiffs' legal fees, and so forth? Is this information tracked and maintained in a usable, transparent and reviewable format by the Treasury Department, the public, as well as the Federal agencies that are impacted by the settlement or judgment?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

JUDGEMENT FUND WEBPAGE

Mr. Secretary, it is our understanding this important information on the Judgment Fund is not readily apparent from the (Department of Treasury) Judgment Fund webpage.

If you go to the webpage under the Bureau of Financial Management it is very difficult to navigate. Then if you can get to actual overall data on reports on these Judgment Fund cases you get a series of coded entries that apparently mean something to accountants within the different agencies. However, these codes do not help us understand loss rates or develop and implement effective cost and risk reduction measures for the federal government.

There is a web site access point that the average person can reach that is entitled Search Judgment Fund Transactions that says claims be searched by responsible agency or responsible department and you must have a submitted date or payment amount. But it also says the information displayed on this website is for the purpose of tracking the status of submitted Judgment Claim funds only and it states this is "FOR FEDERAL AGENCIES ONLY."

Is there a reason you do not or could not post on the Fund website for the general public and taxpayers the names of plaintiffs, a copy or the nature of the complaint, and copies of the settlement agreement or judgment in each specific case so that Congress and the public can see who has made a claim, what the nature of the claim was, and the amount of taxpayer money that is being spent in damages or for plaintiff's attorney fees?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

If Congress had access to this information in a useable form, we could identify problem areas and work to save taxpayer money by bringing loss rates down. No one in the private sector runs a company without having clear information about its litigation losses at management's fingertips.

Shouldn't your Judgment Fund website be set up so that Congress and the public can operate accordingly?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Article I, section 9 of the U.S. Constitution provides "that a regular Statement and Account of the Receipts of all public money shall be published from time to time." It seems that the Constitution prohibits the current management or operation of the Judgment Fund, which given the lack of public information and transparency surrounding it and the payments made, is in effect a secret, permanent, unlimited, fund for the payment of claims.

Mr. Secretary, how can we immediately make the payments under this fund open and more transparent to the American people? Your own website (Bureau of Financial Management) states **"In brief, Treasury's role is to "oversee" the use of this appropriation."**

Mr. Secretary, can you get this Subcommittee an answer back quickly on how long it would take and when the Department can provide Judgment Fund payments and/or settlements in an easily accessible web site in the following manner for each case:

Names of plaintiffs

A copy of the nature of the claim (brief description)

The amount of the total payment for each claim or settlement, including the specific amount of the damages, interest, and attorney fees listed in a separate breakout

Copies of the settlement agreement or judgment in each specific case

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Questions for the Record Submitted by Congresswoman Lee

EARMARK BAN

Given the Administration's support for an earmark ban, can the Treasury give us an assessment of what the economic loss would be for our districts?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

How can Members work with the Treasury to ensure that organizations most impacted by the ban and which serve low income communities will be able to compete for federal grant opportunities?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Will Treasury be able to provide direct technical assistance to those types of small non-profit organizations who have relied on earmarks in the past?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

EARMARKS AND CDFI's

Is the Administration coordinating their budget requests to make up for this dramatic shortfall in federal support for local groups who provide our hardest hit neighborhoods with critical services during the worst recession of our times?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

In light of the decision to limit the impact of earmarks on our hard hit neighborhoods, why has the Administration targeted CDFI's for cuts in their budget proposal?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

When so many programs that assist and support our most vulnerable communities are threatened with cuts, it is even more critical to support funding for CDFI's that work to create economic opportunities in those very communities.

The financial crisis has hit Minority Depository Institutions especially hard and they need our support because of the critical work that they do and the positive impact that they have on vulnerable communities across the nation.

Mr. Secretary I want to make sure that we continue to leverage the work of CDFI's and maximize the impact of our tax dollars at work in economically distressed communities, how can we work together to make sure that the dollars that support CDFI's have the most impact for our constituents?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Mr. Secretary, last year you launched the Community Development Capital Initiative to increase low cost capital to CDFI's. Will you update us on the impact of that program?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

GOVERNMENT-SPONSORED ENTERPRISES

Mr. Secretary, you recently released a report with three separate possible plans to wind down Fannie Mae and Freddie Mac and completely reform the Federal Housing Finance Agency (FHFA).

I would just like to take this opportunity to remind you and the subcommittee that the FHFA came into being because the private markets were failing to create enough opportunity for Americans to own their own homes.

They were critical in reducing the impact of industry practices like "redlining" that discriminated against minorities and kept many neighborhoods across the country segregated well past the enactment of the Civil Right Act.

This most recent wave of predatory loans and subsequent wave of foreclosures were concentrated in the lower income and minority communities that confirm that the problems that we faced decades ago have not gone away and that we need to continue to be vigilant.

Mr. Secretary, as we work together on reforming our mortgage industry and keeping it safe from collapse in the future, can I rely on you to work with Members of Congress and outside stakeholders to make sure that the core public mission of the FHFA is preserved and even strengthened through any reform effort?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Mr. Secretary, as you study how best to reform the GSE's to reduce risk to the American taxpayers while protecting and even strengthening the performance of their core mission, would this also be an opportune time to enact programs that improve the impact of the Treasury's efforts on mortgage modifications and especially toward principal reductions that allow homeowners facing severely depleted home values and underwater mortgages some relief and a reason to stay in their homes?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

As mortgages are sold off to some private investor or holding company, can we ensure that only mortgages that are sound and fair for the homeowner are sold off?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

SMALL BUSINESS AND MINORITY PARTICIPATION IN TARP

Thank you for working with me and other members on ensuring access to contracting opportunities in the Troubled Asset Relief Program (TARP) and the Term Asset-Backed Securities Loan Facility (TALF). I appreciate your engagement on the issue and the commitment of everyone at Treasury to providing fair and open opportunities for small businesses. Can you update the subcommittee on some of the results of your small business and minority and women owned business efforts related to TARP and TALF?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

I appreciate that the Treasury Department made sure that prime contractors had small business subcontracting goals included in their contract proposals. Can you tell us if any contractors were subject to liquidated damages due to a failure to meet those goals?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

When small business subcontracting goals are developed, are the goals broken out by minority owned, women owned, veteran owned and disabled owned subcontractors or all of those categories lumped together as small businesses in meeting the goals?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

If they are lumped together and the ultimate performance measure is not disaggregated as to the inclusion of these distinct communities, is it possible for Treasury to require that they be separately recorded and that any bonus or liquidated damages be applied to these goals separately so that each targeted community is given an equal measure of support?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

MINORITY HIRING AND ADVANCEMENT

Last year you provided very detailed responses to my questions regarding the efforts of the Treasury Department on minority hiring and contracting. I appreciate your commitment to diversity and I believe that you understand and value the positive impact of diversity in the workplace and what diversity means for the success of our nation as a whole. But I think we all can agree that we can all do more. While the Treasury overall is very diverse, the presence of minorities is lower in the more professional ranks.

What can you do to make sure that minority and women candidates have access to career development and promotion opportunities?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Let me also thank you again for your commitment to improving the inclusiveness of contracting and subcontracting opportunities for minority and women owned businesses. When small business subcontracting goals are developed, are the goals broken out by minority owned, women owned, veteran owned and disabled owned subcontractors or all of those categories lumped together as small businesses in meeting the goals?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

If they are lumped together and the ultimate performance measure is not disaggregated as to the inclusion of these distinct communities, is it possible for Treasury to require that they be separately recorded and that any bonus or liquidated damages be applied to these goals separately?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

OFAC AND CUBA LICENSES

The Administration has made very positive changes in their licensing requirements to allow Cuban Americans freedom to visit their families and re-instated some general license categories for American educators, medical personnel and religious institutions to visit Cuba. There is broad consensus that Cuba poses no strategic threat to the United States. Even General Barry McCaffrey, the former Commander of Southern Command has stated for the record during at Congressional Hearing.

Has the Office of Foreign Asset Control completed the thorough risk based assessment that the GAO recommended several years ago and reallocated their limited resources to maximize their impact on increasing the national security of the United States?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Would you support changing other categories of travelers from specific licenses to general licenses to further decrease the Cuba related workload of the limited staff at the Office of Foreign Asset Control, which would free them up to focus on the inspection and sanctions programs of nations that actually do pose a security threat to the United States?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

EXECUTIVE COMPENSATION

Last year, I presented some questions for the record regarding the impact of the limits on executive compensation for companies that needed to be bailed out by the TARP program. You responded that the companies with compensation authority given to Special Master Kenneth Feinberg seemed to be performing well and that 2 of the 7 companies have successfully repaid their TARP funds. Can you update us on the impact of TARP limits on executive pay for all of the companies that received "exceptional assistance from the TARP?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Additionally, can you give us your early assessment of the impact of making compensation committees at large firms more independent?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Further, do you have any sense of what the impact will be of "Say on Pay" on reigning in executive compensation and strengthening connection between the pay of executives to the actual performance for investors?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Questions for the Record Submitted by Congressman Bonner

IMPACT OF THE DODD-FRANK ACT

Recognizing the distinct differences between large banking institutions and insurance companies with small ancillary depository institutions, Congress included language in the Dodd-Frank Act (DFA) stating the Volcker Rule should "appropriately accommodate the business of insurance." Is it your understanding of the DFA Volcker Rule provisions that insurance companies should be able to continue to sponsor and invest in private equity pursuant to this insurance exception? Mr. Secretary is this something that you think will be addressed in the process of preparing a proposed rule?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

The Volcker provision in the law has created a number of questions for insurers. "Private Equity" and "Similar Funds" as used within the Volcker Rule to limit investment activity should be defined more precisely so as to not create regulatory uncertainty, which will result in disruption in the marketplace. While maintaining the core concepts of the provision, are you open to clarifying some of the terms?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Dodd-Frank allows for a Senate-confirmed position of Independent Insurance Expert on the FSOC. Can you give us a status report on that position? When do you think the President will have a nominee, and do you think it will be before any regulations that may affect the insurance industry are voted on?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

FINANCIAL LITERACY

While causes of the financial crisis are too many to list today, the lack of financial literacy of the public concerns me as much as anything. Too often, young people enter the workforce with minimal, if any, understanding of how to manage their financial lives. What is the department doing to address this serious concern?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

How much time, effort, and resources will be dedicated at the department to ensure a better understanding of our financial system among the common citizen? Can we count on you to work with universities and state and local service groups to develop and distribute programs that will have the needed impact on both K-12 students as well as young adults in the workforce?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Questions for the Record Submitted by Congressman Yoder

CDFI – NEW MARKET TAX CREDITS

What are the criteria used to select recipients of the New Market Tax Credits?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

Did any Kansas based entities apply for a NMTC for 2010? If so, were any of them eligible to receive a NMTC based on the program requirements?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

The latest report from the Community Development Financial Institution (CDFI) lists 4 entities with a total of $140 million in tax credits for Kansas – are any of these entities physically located in Kansas? For example, it is my understanding that largest credit ($77 million) went to a regional entity that is supposed to share these funds with projects in 6 states.

Can CDFI provide a list of Kansas based entities that have been a recipient of a NMTC in the last eight years, either directly or through a regional disbursement?

The Department of Treasury is either incapable or unwilling to answer this inquiry and provided no response.

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