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A CLOSER LOOK: THE INSPECTORS GENERAL ADDRESS WASTE, FRAUD, AND ABUSE IN FEDERAL MANDATORY PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, JULY 9, 2003

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A CLOSER LOOK: THE INSPECTORS GENERAL ADDRESS WASTE, FRAUD, ABUSE IN FEDERAL MANDATORY PROGRAMS

WEDNESDAY, JULY 9, 2003

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to call, at 10:05 a.m. in room 210, Cannon House Office Building, Hon. Jim Nussle (chairman of the committee) presiding.

Members present: Representatives Nussle, Gutknecht, Thornberry, Ryun, Hastings, Schrock, Brown, Putnam, Wicker, Bonner, Garrett, Barrett, Diaz-Balart, Hensarling, Brown-Waite, Spratt, Moran, Neal, DeLauro, Thompson, Baird, Cooper, Emanuel, Davis, Majette, and Kind.

Chairman NUSSLE. Good morning. If our guests and staff could take seats. This is the full committee hearing that we are titling "A Closer Look: The Inspectors General Address Waste, Fraud, and Abuse in the Federal Mandatory Programs."

Today we have a number of excellent witnesses to discuss this topic. We have the Honorable Phyllis Fong, Inspector General of the Department of Agriculture; we have the Honorable John Higgins from the Department of Education; we have Dara Corrigan, from the Department of Human Services, she is the Acting Principal Deputy Inspector General; and the Inspector General from the Department of Transportation, Kenneth Mead. We welcome all of you to the Budget Committee.

Let me open the hearing with just a few general remarks. A fair description of the Budget Committee, at least one that I use with my constituents back home, is that we are the architects and to some extent the general contractors of the Federal budget. Drafting the budget resolution is possibly akin to coming up with a blueprint. There are others who do the finishing work and the plastering and the painting and the carpentry and the plumbing, but we try and lay it out in a big picture format so that the American people can see the priorities come to life.

And in this year's budget resolution we included instructions for every committee, both House and Senate, to identify waste, fraud, and abuse within their mandatory spending programs. It is why this committee joined with the leadership, and committee chairmen have publicly announced their commitment to ending the tolerance for waste within the Federal budget and the Federal Government. It is why a few weeks ago we heard from the Comptroller General,

who shared with us several interesting examples of very substantial waste within the government found by the General Accounting Office in programs, and gave us some ideas on ways to improve in providing additional routine government oversight.

I am happy to report that several of my fellow chairmen and their committees have already responded to the effort that we ushered in this year, including the House Veterans' Affairs Committee and Government Reform and Oversight. Also, both the Energy and Commerce and Ways and Means Committee have had waste, fraud, and abuse hearings.

And, in fact, just—our last vote before we left for the Fourth of July recess, in, I believe Title 3 of the Medicare Reform and Modernization Bill, we eliminated $33 billion worth of waste, fraud, and abuse within the mandatory program of Medicare.

General Walker noted within our last hearing that a periodic reexamination and reevaluation of the government's activities has never been more important than it is today. Our Nation faces long-term fiscal challenges, increased pressure from world events, and increased demands from the American public for modern organizations and workforces that are responsive and agile, accountable and responsible. In other words, pressure on our government and its resources is growing, and it is continuing to grow. We have a spending deficit. Reducing waste in the government has got to be a continuing effort and one that we do, not because it makes headlines or because it is politically attractive, but because it is our job.

Today's hearing is another step in that process. On June 23, I sent letters to the Inspectors General of all of the major agencies governed by the Chief Financial Officers Act, requesting that they submit testimony describing problems within their agencies, and today we will hear from four. And I thank all of them for being here and sharing their ideas.

I also want to make a couple of other points. Why are we focusing on mandatory spending? The answer is that, as we discussed in the last hearing, it is a matter of 55 percent of the entire budget comes from mandatory spending. We will during the month of July spend a number of hours on the floor haggling and arguing and debating over a million here and a million there; and, yes, it does add up to real money.

But if you look at the budget, you can see that the real money is in the mandatory as opposed to the discretionary programs. And unlike discretionary spending, which is subject every year to the appropriations process, and where there is a built-in process for review, there is no built-in process for review of the mandatory spending initiatives. The spending is automatic. It just continues, typically with large annual increases in the budget, as you can see from the chart that we have up in front of us now.

Second, there was concern raised at our last hearing that we are only going after programs for low income or disadvantaged people in our Nation. Obviously that is not the case. Medicare, for example, is not a poverty program. Neither are veterans benefits or farm programs. Yet, we are looking for waste in all of these areas. It is a disservice to our veterans and our farmers and our seniors to waste even a penny in these programs and not apply it to benefits that are needed in order to make ends meet in many instances.

Let me just make one other observation. I am not the first one to say that our tax code is a mess and needs to be reformed. And while the tax code is not part of the mandatory spending, I believe that it is too complex and unpredictable. We have seen wild swings in revenue projections. That is not the discussion for today's hearing, but it is clear that our tax code, as part of the overall budget blueprint and design, needs attention as well.

So while we may differ on spending concerns and priorities, there is not one of us that sits at this hearing today that would disagree that a dollar wasted is inappropriate within our Federal budget and our Federal Government. I appreciate the work of the Inspectors General, because they oftentimes labor in absentia and anonymity without having the opportunity often for some of their work to get the spotlight and get the attention that it needs.

We are going to try and do that to some extent today. It should not end with this hearing. We appreciate the work that you do, and we want to have the opportunity to examine some of it today. We welcome you.

[The prepared statement of Mr. Nussle follows:]

PREPARED STATEMENT OF HON. JIM NUSSLE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF IOWA

Good Morning. Let me open this hearing with a few general remarks.

A fair description of the Budget Committee is that we are the architects and general contractors of the Federal budget architects in drafting the congressional budget resolution, which we often call the "blueprint" for our tax and spending decisions; and general contractors in monitoring the spending bills that come through Congress, to make sure they conform with the specifications laid out in the budget.

To push the metaphor a step farther, the structure also needs good maintenance after it's built. In budgetary terms, we have an obligation to make sure that once the spending is approved by Congress that it doesn't get wasted; that the taxpayers don't get ripped off by those who would cheat the system; and that it isn't intentionally misused by the people who handle it.

That is why this year's budget resolution included instructions for every committee both House and Senate to identify waste, fraud, and abuse in their mandatory spending programs.

It is why this committee, joined by House Republican leadership and committee chairmen, publicly announced our commitment to ending the tolerance for waste.

It's why, a few weeks ago, we heard from the Comptroller General, who shared with us several examples of the substantial waste the General Accounting Office has found in government programs, and who reminded us of the great importance of improving and maintaining routine government oversight.

I'm happy to report that several of my fellow chairmen and their committees have already responded to this effort, including the House Veterans' Affairs and Government Reform. Both the Energy and Commerce and Ways and Means committees have waste, fraud, and abuse hearings scheduled. It is a good start.

And as General Walker noted at our last hearing, "Periodic reexamination and revaluation of government activities has never been more important than it is today. Our Nation faces long-term fiscal challenges; increased pressure *** from world events; and increased demands from the American public for modern organizations and workforces that are responsive, agile accountable and responsible ***"

In other words, pressure on our government and its resources is growing, and it's going to continue to grow. This effort to get our oversight up to speed cannot be a one-time or short-term project.

Reducing waste in government has got to be a continuing effort. And, one that we do, not because it makes headlines, or because it's politically attractive, but because it's our job.

Today's hearing is another step in that process.

On June 23, I sent letters to the Inspectors General of all the major agencies governed by the Chief Financial Officers Act requesting that they submit testimony describing problems in their respective agencies.

Today, we will hear from several of them directly. I am happy to welcome:

• Phyllis K. Fong, Inspector General, Department of Agriculture;
• John P. Higgins Jr., Inspector General, Department of Education;
• Dara Corrigan, Acting Principal Deputy Inspector General, Department of Health and Human Services;
• Kenneth M. Mead, Inspector General, Department of Transportation.

I thank you all for being here.

A few other points are worth making or repeating as well.

First, why are we focusing on mandatory spending? The answer, as we discussed at the last hearing, is because it accounts for more than half—55 percent, in fact—of our total budget.

And unlike discretionary spending, which is subject to review every year by the Appropriations Committee, mandatory spending has no built-in process of review. The spending is automatic, it just continues typically with a large annual increases in the budget as you can clearly see from this chart.

Second, there was a concern raised at our last hearing that we were only going after programs for low income or disadvantaged people. Obviously, this is not the case.

Medicare, for example, is not a poverty program. Neither are veterans benefits, or farm programs. Yet we're looking for waste in all of these areas.

Of course, many of the larger mandatory programs are for lower-income people such as food stamps and Medicaid and the Earned Income Tax Credit. But if there's waste in these programs, it means a lot of money is not reaching the people it was intended to help. So yes, that has to stop.

Finally, there were a lot of questions at our last hearing concerning corporate tax provisions. Some Members wondered why we weren't concentrating more on those. And don't get me wrong, I'm not the first one to say our tax code is a mess and needs to be reformed. The tax code is too complex and too unpredictable as we have seen with the wild swings in revenue projections.

But that discussion is not the purpose of these hearings. Today is about furthering the effort to identify and eliminate the billions of dollars wasted each year in our Federal mandatory programs.

And while we all may differ on spending concerns and priorities I'm certain that we can all agree that there should be no tolerance for waste. Reducing it, and if possible, eliminating it, is a goal we should all share.

I appreciate the work the Inspectors General have already done on this matter, and I look forward to hearing your testimony today.

Thank you.

Chairman NUSSLE. And I now ask Mr. Spratt if he has any opening comments.

Mr. SPRATT. Thank you, Mr. Chairman.

I want to echo what our chairman has said, and reemphasize once again that Democrats wholeheartedly support efforts to eliminate waste, fraud, and abuse. That is why Democratic Congresses past and Democratic presidents signed into law bipartisan reforms like the Inspector General Reform Act of 1978 and the Government Performance and Results Act of 1993.

And that is why we are eager to hear from today's panel of IGs about the progress you have made in rooting out waste, fraud, and abuse and protecting the Federal FISC and about what more can be done in the future.

I have to say that I am a bit surprised that a major area of waste, fraud, and abuse is not within the scope of the panel that comes here today. And let me say to the committee that I don't think any comprehensive effort to root out waste, fraud, and abuse can overlook the elephant in the room; that is, the Pentagon with its $400 billion budget.

Just last January in its report, the General Accounting Office, dealing with the Department of Defense, found that quote, "long-standing financial management problems adversely affect DOD's ability to control costs, ensure basic accountability, anticipate future costs and claims on the budget, measure performance, main-

tain funds control, prevent fraud, and address pressing management issues." that covers just about the whole spectrum of management responsibility.

And let me say, as someone who worked 2 years for the comptroller for the Department of Defense, the problems that existed 35 years ago, still exist today, and we absolutely have to face up to them if we are in earnest about dealing with waste, fraud, and abuse.

In fact, if you stop the average person on the street, or for that matter, the average Congressman and ask him or her what would be the instances of waste, fraud, and abuse that they would point to, everybody would recall the $600 toilet seat cover for the PC–3. Everybody will recall the $200 allen wrench, and case after case after case.

There is no question about it, we can't help but deal with this problem, and I think that the panel today is—conspicuously absent from the panel today is somebody from DOD. I know we are just dealing with mandatory spending, but let's not forget that half of all discretionary spending gets spent by the Pentagon—and some of it not spent well.

I would also remind the committee again, as the chairman did, the waste, fraud, and abuse that exists on the tax side of the government's ledger. We need to consider carefully the savings that can be realized by reducing legal and illegal tax avoidance, by reexamining abusive practices like offshore corporate tax shelters and many more.

We look forward to the testimony today and appreciate the fact that the committee called the witness we recommended, Dr. Leonard Burman, who will address this particular area of abuse, which is enormous. Nevertheless, while noting all of these concerns, I want to underscore our support for the whole effort of tackling waste, fraud, and abuse in the Federal Government.

We welcome our witnesses. We are appreciative of the work you do as our watchdogs, and we look forward to your testimony.

Chairman NUSSLE. Thank you, Mr. Spratt. I would just share with you, Mr. Spratt, and the rest of the committee, I received a letter in response to a question I asked Secretary Rumsfeld at one of our briefings here.

Recently I complained to him, and again while this is not a mandatory program, and the subject of today's hearing, I complained to him that we still have not been able to account for some of the money in the supplemental funds appropriated as a result of the September 11 attacks. And I will provide this for the record, but as he responds to me, he says, "As you know, the accounting systems of the Department have long needed consolidation and modernization. With respect to supplemental appropriations, though, we have initiated several procedures to account for all funding received."

[The information referred to follows:]

LETTER SUBMITTED FOR THE RECORD BY MR. NUSSLE, FROM THE SECRETARY OF DEFENSE, DONALD RUMSFELD

DEPARTMENT OF DEFENSE,
July 1, 2003.

DEAR CONGRESSMAN NUSSLE: You mentioned in a meeting last month that the Department of Defense has been unable to account for some of the money in supplemental funds appropriated since September 11, 2001.

As you know, the accounting systems in the Department have long needed consolidation and modernization. With respect to supplemental appropriations, though, we have initiated several procedures to account for all funding received. Our fiscal year 2003 spending plan to Congress will highlight the accounting of these funds. Dr. Dov Zakheim, Under Secretary of Defense (Comptroller), is available to brief you and your staff in greater detail.

Sincerely,

DONALD RUMSFELD,
Secretary of Defense.

Chairman NUSSLE. In other words, they still have not been able to account for them. We will have a hearing on this in September and delve into this a little bit further. But, again, and I will be glad to share this with you and we will continue to delve into this, as far as I am concerned, there is no stone that should go unturned.

But, as is the focus today, we want to try and hone in slightly on the mandatory side of the ledger. I would just note that some of the witnesses had indicated that they have got so much that they have in their areas of jurisdiction that they wanted just a little bit more time on the shot clock. So we have put on 10 minutes on our new shot clock that we have for you. I don't know if the rest of you can see it, but the members can see our new device. I don't know if that is to try and rein us in or not. But we will see how it works.

At any rate, we would invite our witnesses to go into slightly more detail than usual, just because we know this is not only complex, but there are a number of stones to turn over. I believe that we are going in order.

STATEMENTS SUBMITTED FOR THE RECORD OF HON. JOSEPH E. SCHMITZ, INSPECTOR GENERAL, U.S. DEPARTMENT OF DEFENSE; HON. JOHNNIE E. FRAZIER, INSPECTOR GENERAL, U.S. DEPARTMENT OF COMMERCE; HON. DANIEL R. LEVINSON, INSPECTOR GENERAL, U.S. GENERAL SERVICES ADMINISTRATION; HON. GORDON S. HEDDELL, INSPECTOR GENERAL, U.S. DEPARTMENT OF LABOR; HON. KENNETH M. DONOHUE, INSPECTOR GENERAL, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT; HON. EARL E. DEVANEY, INSPECTOR GENERAL, U.S. DEPARTMENT OF THE INTERIOR; HON. GLENN A. FINE, INSPECTOR GENERAL, U.S. DEPARTMENT OF JUSTICE; HON. HUBERT T. BELL, INSPECTOR GENERAL, U.S. NUCLEAR REGULATORY COMMISSION; HON. PATRICK E. MC FARLAND, INSPECTOR GENERAL, U.S. OFFICE OF PERSONNEL MANAGEMENT; HON. JAMES G. HUSE, JR., INSPECTOR GENERAL, U.S. SOCIAL SECURITY ADMINISTRATION; HON. ANNE M. SIGMUND, ACTING INSPECTOR GENERAL, U.S. DEPARTMENT OF STATE; HON. PAMELA J. GARDINER, DEPUTY INSPECTOR GENERAL FOR AUDIT,

U.S. TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION; HON. EVERETT L. MOSLEY, INSPECTOR GENERAL, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT; HON. RICHARD J. GRIFFIN, INSPECTOR GENERAL, U.S. DEPARTMENT OF VETERANS AFFAIRS.

PREPARED STATEMENT OF HON. JOSEPH E. SCHMITZ, INSPECTOR GENERAL, U.S. DEPARTMENT OF DEFENSE

Mr. Chairman and members of the committee: Thank you for the opportunity to provide the views of the Office of the Inspector General of the Department of Defense (DOD) regarding fraud, waste, and abuse in various mandatory spending programs within the DOD, specifically the TRICARE and the military retirement pay and survivor benefit programs.

TRICARE

BACKGROUND

For fiscal year 2003 Congress appropriated $14.8 billion for the Defense Health Program. Of that amount approximately $6.9 billion is spent for purchased health care to include pharmacy, TRICARE managed care support contracts, and other purchased health care. In addition to the Defense Health Program appropriation, DOD estimates that it will spend approximately $4.1 billion from the DOD Medicare Eligible Retiree Health Care Fund in fiscal year 2003 for recently enacted benefits, including $3.3 billion for purchased care.

TRICARE, formerly known as the Civilian Health and Medical Program of the Uniformed Service (CHAMPUS), is a regionally managed health care program for active duty and retired military members of the uniformed services, their families, and survivors. TRICARE is administered by the Assistant Secretary of Defense for Health Affairs and governed by Title 32 C.F.R. Section 199. TRICARE consolidates the health care resources of the Army, Navy, Air Force, and Marine Corps and supplements them with networks of civilian healthcare professionals to provide better access and high quality service while maintaining the capability to support military operations. TRICARE is being implemented throughout the United States, Europe, Latin America, and the Pacific as a way to:

- Improve overall access to health care for beneficiaries;
- Provide faster, more convenient access to civilian health care;
- Create a more efficient way to receive health care;
- Offer enhanced services, including preventive care;
- Provide choices for health care; and
- Control escalating costs.

The TRICARE Program serves over 8.6 million beneficiaries. Those who are eligible for TRICARE benefits are:

- Active duty members and their families;
- Retirees and their families; and
- Survivors of all uniformed services members who are not eligible for Medicare.

MAGNITUDE OF HEALTH CARE RELATED INVESTIGATIONS

Since fiscal year 2000, the Defense Criminal Investigative Service (DCIS), the criminal investigative arm of the Office of Inspector General, has initiated 427 health care related investigations. During the same period $45,082,821 in recoveries was returned to TRICARE as a result of DCIS investigative efforts, often in concert with other investigative agencies. During this period of time health care related investigations have comprised approximately 16 percent of the total number of investigations initiated by DCIS.

NATURE AND HISTORY OF THE PROBLEM

Since 1981, DCIS has participated in many health care fraud investigations, projects and undercover operations within the United States and abroad to thwart a myriad of health care related schemes. DCIS has established a broadband of cooperation with the TRICARE Management Activity and other Federal, State and local law enforcement agencies to actively investigate health care related fraud. In many locations, our efforts have resulted in the creation of Joint Healthcare Fraud Task Forces under the direction of the applicable United States Attorney. Our mutual goal is to identify trends, programs, processes, providers and individuals who

commit acts that are conducive to fraud, waste, and abuse in the TRICARE Program and related health plans.

DCIS has identified several significant areas in which TRICARE has been victimized. Although some systematic schemes have been curtailed, other vulnerable areas of the medical industry still need to be pursued.

A growing concern within the medical industry is the dramatic increase in "harm to patient" cases. With the development of significantly more powerful, highly addictive narcotics, over prescription of these drugs by TRICARE providers (or any other doctors) could have devastating effects. For example, in February 2002, a TRICARE provider was convicted of four counts of manslaughter, five counts of drug trafficking, and one count of racketeering, in connection with the deaths of five patients, who overdosed on drugs that had been prescribed by the provider, who was sentenced to 755 months incarceration. This case generated a great deal of national media attention.

Another area of concern is corruption and kickbacks within the medical arena, which undermine the entire healthcare system and jeopardize the health and safety of TRICARE recipients. Corruption, in terms of kickbacks, is a serious crime and a major impediment to the proper administration of the TRICARE Program. TRICARE has a strict prohibition against the payment for patient referrals. For example, a $486 million global settlement was reached with a medical corporation headquartered in Lexington, MA. The settlement was the result of a 5-year, multi-agency investigation into allegations that the corporation conspired to defraud the United States through the submission of false claims and the payment of kickbacks to healthcare providers for the payment of patient referrals. This remains an area of interest for DCIS.

TRICARE provider fraud continues to be fertile ground for criminal investigators to uncover new systematic ways to commit fraud. Since 1981 DCIS has opened 869 cases involving provider fraud. Those providers that choose to deceive and commit fraud against the DOD will continue to be investigated. Recently a medical doctor was sentenced in U.S. District Court in Kansas City, KS, to 72 months incarceration and 36 months of supervised probation upon release. The scheme to defraud in that case included subjecting TRICARE patients, and others, to: unnecessary surgery; billing for multiple complex surgical procedures that could not have performed; and falsifying tests to justify the surgeries. The provider was found guilty in a jury trial on 33 counts of health care fraud, 7 counts of mail fraud, and three counts of perjury.

A less pronounced area of fraud that has decreased over the years is fraud involving active duty military family members, retirees or ineligible recipients. Since 1981 DCIS has initiated 180 cases involving the aforementioned case categories and represents a fraction of the total case inventory. Beneficiary fraud is typically investigated by the Military Criminal Investigative Organizations (MCIO's), and there is little need for DCIS involvement.

ACTIONS BEING TAKEN TO ELIMINATE OR REDUCE TRICARE PROBLEMS

DCIS has historically taken a proactive approach to the detection, investigation, and prevention of health care fraud impacting DOD. DCIS has aggressively pursued proactive investigative projects and undercover operations, and has been an active participant in a number of health care fraud task forces as well as the National Healthcare Anti-Fraud Association (NHCAA). DCIS participation in these proactive efforts has been a major factor in the successful resolution of significant health care related investigations impacting the DOD.

ADDITIONAL ACTIONS REQUIRED

Despite returning more than $45 million to TRICARE, DCIS has received little additional funding to further its investigations into allegations of health care fraud impacting the DOD. While other law enforcement organizations have the ability to receive a portion of the monetary recoveries resulting from healthcare fraud investigations,[1] including many conducted by DCIS, DCIS has no direct ability to recover any of these funds. Were Congress to approve a system of sharing investigative recoveries resulting from DCIS investigations with DCIS, this Office of Inspector Gen-

[1] The Health Insurance Portability and Accountability Act of 1996 (42 USC Sec. 1320a–7c(b), Fraud and abuse control program) provides that the "Inspector General of the Department of Health and Human Services is authorized to receive and retain for current use reimbursement for the costs of conducting investigations and audits and for monitoring compliance plans when such costs are ordered by a court, voluntarily agreed to by the payor, or otherwise."

eral would be able to more effectively participate in ongoing and future efforts to combat fraud, waste, and abuse in the TRICARE Program.

MILITARY RETIREMENT PAY AND THE SURVIVOR BENEFITS PROGRAM (SBP)

BACKGROUND

Military service members who remain on active duty or serve in the Reserves or National Guard for a sufficient period of time may retire and receive retired pay. Generally, members who remain on active duty for 20 or more years are eligible for retirement under Title 10, United States Code, Sections 3911 through 3929. The primary survivor benefit applicable to survivors of military retirees (and, in some situations, active duty members) is the Uniformed Services Survivor Benefit Plan (SBP). The SBP is a benefit program authorized under Title 10, United States Code, Sections 1447 through 1455. The SBP is designed to make-up for retirement income lost by survivors of deceased military retirees as a result of the death of the military retiree.

The Military Retirement Fund has a total liability of $730 billion as of September 30, 2002. Of this amount $554 billion is unfunded. For the last 5 years the Military Retirement Fund has been audited by and has received an unqualified opinion from the public accounting firm of Deloitte & Touche, LLP, under the oversight of this Office of Inspector General. This unqualified opinion is the only unqualified opinion that the Department received during the last fiscal cycle on a major DOD financial statement.

MAGNITUDE OF THE FRAUDULENT RETIREMENT AND SBP PAYMENTS PROBLEM

In fiscal year 2002, there were approximately 1.6 million military retirees and 267,000 individuals receiving survivor benefits. DOD spent approximately $35 billion in fiscal year 2002 for benefits to military retirees and survivors. Since fiscal year 2000, the DCIS has initiated 27 cases and recovered approximately $587,495 in total monetary recoveries relative to investigations involving allegations of fraudulent military retirement and SBP payments. The average alleged dollar loss concerning these cases was approximately $31,559. As evidenced by the above statistics, the potential impact of fraud in the area of military retirement pay and SBP is relatively small and, accordingly, investigations into these types of allegations represent a very small percentage of the total workload of the DCIS (as measured by dollars received).

NATURE AND HISTORY OF THE PROBLEM

The Defense Finance and Accounting Service (DFAS) administers retired military pay, including payments under the SBP. As a part of the process of making such payments, DFAS requires that retirees or their survivors complete a Certificate of Eligibility (COE) in order to continue to receive annuity payments without interruption. According to the DFAS guide to survivor benefits, dated November 2002, a COE is sent to annuitants each year prior to their birthday. If the COE is not returned within 90 days, the account will be suspended.

Since 1994, auditors from this Office of Inspector General and DCIS Special Agents have supported Operation Mongoose, an internal control initiative of the then Deputy Secretary of Defense involving the use of computer matching techniques to detect fraud in DOD financial systems, including the area of military retiree pay and the SBP. This initiative uses the combined efforts of the DFAS, the Defense Manpower Data Center, and this Office of Inspector General to develop fraud indicators that can be used to spot discrepancies among various automated systems. For example, Operation Mongoose compared active military retiree pay and SBP annuitant accounts to death indices maintained by the U.S. Social Security Administration (SSA). The comparison of these two automated systems identified numerous instances of potential fraudulent payments and resulted in several DCIS case initiations.

Some cases initiated as a result of this proactive initiative have successfully uncovered large scale criminal activity and resulted in significant criminal prosecutions. For example, an investigation was initiated based on allegations that a military retiree had continued to receive full retirement benefits for 12 years after his death on January 17, 1987, totaling $186,866. Investigation disclosed that the retiree's daughter continued to receive the full military retirement payment, which was electronically transferred to a joint bank account held by the retiree and his daughter. No death notifications were ever provided to DFAS and the retiree's daughter never removed the retiree's name from the account after his death.

Another investigation was initiated based upon allegations that a military retiree continued to receive his full retirement benefit for many years after his death in March 1990. The investigation determined that DFAS paid the deceased retiree approximately $100,509 after his death. It was later determined that the retiree's daughter had received the payments knowing that she was not entitled to them and she subsequently pleaded guilty and was ordered to pay $100,509 in restitution to the U.S. Government.

However, more often than not, these investigations involve relatively small dollar amounts. Cases initiated between October 1, 1997, and the present involved an average alleged loss of approximately $32,877. Most of these investigations (85 percent) failed to undercover sufficient evidence of criminal intent to warrant prosecution and many were ultimately settled administratively based on publicly available information. For example, an investigation was initiated based on information received from Operation Mongoose that indicated a retiree had continued to receive full retirement benefits for several months after his death in February 1997. A Certificate of Eligibility was sent to the last known address of the retiree after his death. Information subsequently obtained from the U.S. Department of Treasury revealed that the checks that had been mailed to the retiree's last known address had never been cashed. The Military Retirement Trust Fund was subsequently credited for the amount of the unnegotiated Treasury checks and the investigation was closed.

While DFAS requires that a COE be completed and returned annually by annuitants who are receiving military retirement or SBP payments, anecdotal evidence uncovered during the course of DCIS investigations suggests that this process does not effectively prevent erroneous or fraudulent payments from being made. For example, an investigation was initiated based upon information received through Operation Mongoose indicating that the spouse of a military retiree had continued to receive payments under the SBP for more than a year after the spouse's death in February 1998. The payments were suspended for several months in 1998 after the spouse failed to return a COE. However, the payments were resumed when a COE was received that ostensibly had been signed by the deceased retiree's SBP annuitant. The investigation ultimately disclosed that the annuitant's son had forged the COE causing DFAS to fraudulently pay an additional $20,096 in benefits that would not have otherwise been paid. This case example is illustrative of a basic flaw in the system that fails to require a positive identification by military retirees and SBP annuitants such as a signature guarantee similar to that which is required by many private financial entities before executing a routine financial transaction relative to a customer's account.

ACTIONS BEING TAKEN TO ELIMINATE OR REDUCE THESE PROBLEMS

The DCIS continues to maintain effective liaison with Operation Mongoose. Additionally, DCIS continues to investigate allegations of significant fraud in the area of retiree pay and SBP annuities. However, consistent with the DOD's emphasis on the international war on terror, the DCIS has dedicated significant resources to the prevention, detection, and prosecution of terrorism-related matters impacting the DOD. Consequently, fewer investigative resources are now available to devote to the investigation of criminal conduct with a relatively low monetary impact, such as fraudulent retirement and SBP payments.

ADDITIONAL ACTIONS REQUIRED

Although DFAS regulations require that a COE be completed annually, there are numerous examples in the DCIS case inventory where payments were made for years without the completion of the required COE. Additionally, when COEs were sent to annuitants, there was nothing to prevent an unauthorized person from forging the annuitant's signature, mailing it in, and continuing to receive payments under false pretenses. A statutory requirement that COEs must be completed annually in order to receive benefits would carry more weight than DFAS' current administrative requirement and might ensure that such certifications are accomplished. Additionally, requiring some form of positive identification, such as a signature guarantee, relative to the execution of COEs would likely reduce the number of forged COEs that result in fraudulent payments being made.

Additionally, retiree military identification cards are presently issued without an expiration date. Issuing retirees military identification cards with expiration dates would require retirees to positively confirm their status on a periodic basis and serve as a secondary control to ensure that payments do not continue for years beyond a retiree's death.

DCIS STAFFING LEVELS AND POST SEPTEMBER 11, 2001 COMMITMENTS

After the events of September 11, 2001, the mission of the DCIS, like most Federal law enforcement agencies, changed radically. In response to those events, DCIS modified its operational goals and objectives to be consistent with those of the department by establishing anti-terrorism efforts as a top priority. Pursuant to a post-9/11 "memorandum of understanding" with the Federal Bureau of Investigation, DCIS has 39 agents assigned full-time and an additional 51 agents assigned part-time to 66 Joint Terrorism Task Forces (JTTF) throughout the country. The realigning of priorities has coincided with an approximate 17 percent decline in authorized and on-board agent staffing levels. Increased responsibilities combined with a significant decrease in available resources have had a profound impact DCIS operations and our ability to conduct investigations into allegations of fraudulent conduct within the DOD. In order for DCIS to resume its pre-9/11 level of involvement in the detection, investigation, prosecution, and prevention of fraudulent activity impacting the DOD, it is critical that the Congress provide the necessary funding to support additional full-time equivalent positions for the DCIS.

CONCLUSION

In conclusion, I would like to thank the chairman and the members of this committee for the opportunity to present this testimony here today. Notwithstanding the increased demand on the limited resources available to this Office of Inspector General, we have continued to enjoy a high level of success relative to important issues affecting the Department. Fraud, waste, and abuse continue to pose significant threats to the readiness and capabilities of the DOD, and we remain committed to the detection, investigation, and prevention of any matter posing such significant threats to the Department.

PREPARED STATEMENT BY HON. JOHNNIE E. FRAZIER, INSPECTOR GENERAL, U.S. DEPARTMENT OF COMMERCE

Mr. Chairman and members of the committee, I appreciate the opportunity to provide the following information about the Department of Commerce's mandatory spending programs.

The Department of Commerce's annual budget authority is in excess of $5 billion; mandatory spending programs represent less than 2 percent of that total. The schedule below summarizes the Department's mandatory and discretionary budget authority for the past 3 fiscal years.

DEPARTMENT OF COMMERCE BUDGETARY AUTHORITY

[In thousands of dollars]

Fiscal year	Mandatory	Discretionary	Total
2000	$80,397 (0.9%)	$8,672,943 (99.1%)	$8,753,340
2001	$75,900 (1.5%)	$5,098,304 (98.5%)	$5,174,204
2002	$104,861 (1.9%)	$5,441,015 (98.1%)	$5,545,876

Following is a list of the audit work we have conducted during those years that is related to the Department's mandatory spending programs:

FINANCIAL STATEMENTS AUDITS

• Fiscal year 2000 Department of Commerce Consolidated Financial Statements Audit (Report No. FSD–12849–1, 3/01).
• Fiscal year 2000 National Oceanic and Atmospheric Administration Financial Statements Audit (Report No. FSD–12855–2, 3/01).
• Fiscal year 2000 Bureau of the Census Financial Statements Audit (Report No. FSD–12850–2, 3/01).
• Fiscal year 2001 Department of Commerce Consolidated Financial Statements Audit (Report No. FSD–14474–2, 2/02).
• Fiscal year 2001 National Oceanic and Atmospheric Administration Financial Statements Audit (Report No. FSD–14475–2, 2/02),
• Fiscal year 2001 Bureau of the Census Financial Statements Audit (Report No. FSD–14473–2, 2/02).
• Fiscal year 2002 Department of Commerce Consolidated Financial Statements Audit (Report No. FSD–15214–2, 1/03).

OTHER AUDITS

• Departmental Fund Management Practices Need Improvement Audit (Report No. FSD–14271, 9/01).

No problems specific to any of the Department's mandatory spending programs were detected in this audit work.

This concludes my written statement. If you need additional information, please do not hesitate to contact me.

PREPARED STATEMENT OF HON. DANIEL R. LEVINSON, INSPECTOR GENERAL, U.S. GENERAL SERVICES ADMINISTRATION

Dear Mr. Chairman, thank you for the opportunity to provide to the committee information regarding the nature and scope of waste, fraud, and abuse within programs and operations of the General Services Administration (GSA). As further requested, I will also discuss actions taken to eliminate or reduce these problems.

For clarification, GSA does not have major mandatory spending programs.[1] Instead, GSA is principally a service organization whose mission is to help Federal agencies by arranging for the acquisition of goods, services and facilities they need to carry out their own unique program missions. Agency operations are underwritten from the fees received from customer agencies supplemented by small amounts of appropriated funds covering some administrative and staff costs.

THE GSA ORGANIZATION AND PROGRAMS

I believe it is useful to the understanding of the issues to first explain the nature and size of GSA's major programs.

Federal Supply Service. The Federal Supply Service (FSS) has more than 10,000 commercial suppliers under contract ready to provide Federal customers any one of over 4 million products and services when needed. In 2002, this contract program generated over $21 billion in sales. In addition, FSS also manages a $1 billion supply activity which stocks items critical to national defense, natural disasters and other strategic purposes as well as managing a 188,000 vehicle fleet which last year experienced business volumes of over $2 billion.

Federal Technology Service. The Federal Technology Service provides telecommunications services, information technology and information security services to Federal agencies on a fee for service basis. Revenues for fiscal year 2002 were: (1) Telecommunications Networks—$950 million; and (2) Technology Equipment, Services and Management—$6 billion.

Public Buildings Service. The Public Buildings Service (PBS) provides workspace for 1.1 million Federal employees housed in over 8,000 owned and leased facilities nationwide. PBS is responsible for construction, repairs and alterations, lease acquisitions, buildings operations and real property disposal. In fiscal year 2002, PBS collected fees in excess of $7.6 billion from its customers and paid contractors over $6.8 billion to provide the goods, services and facilities needed to meet its customers' housing needs.

As one can see from the above descriptions, GSA is very much akin to a large commercial enterprise. Its $40 billion in business activity involving more than 15,000 commercial firms and their employees, all managed by 12,000 Federal employees, creates an environment that understandably has inherent risks to waste, fraud, and abuse. That fact is evidenced by data reported by our office in our Semiannual Reports to the Congress for fiscal year 2002 and the first half of 2003:

• Criminal indictments and information—63;
• New cases accepted for criminal prosecution—72;
• New cases accepted for civil action—23;
• Individuals/contractors suspended or debarred from competing for additional government contracts—72;
• Administrative actions taken against employees—55;
• Fines, settlements and restitutions—$10.3 million;
• Funds or property recovered—$2.2 million;
• Management decisions on audit recommendations that funds be put to better use, or questioned costs—$292 million.

[1] Under Public Law 107–252, The Help America Vote Act of 2002, GSA was designated responsibility for disbursing $650 million to the States, District of Columbia, and the Territories to implement various improvements to the Federal election process, including the replacement of voting equipment. As of July 7, 2003, GSA had disbursed $649.5 million. The Act establishes the Elections Assistance Commission to carry out other provisions under the act and make further disbursements.

We, along with GSA management, are committed to taking measures to continue to address waste, fraud, and abuse in agency operations and reduce the amount of dollars lost. I would like to highlight for the committee a few of the key efforts underway to address problem areas.

THE MANAGEMENT CHALLENGES

Each year, our office prepares for GSA management officials and the Congress an assessment of the major challenges facing the agency and what efforts have been taken to address them. Four of these challenges are especially relevant to this discussion:

Management controls. The establishment of sound internal controls. In recent years, the agency has moved to streamline procedures and controls. These new processes make it essential that the few broad controls in place are consistently followed. Failure to do so is costly. For example, employees in one program directed contractors to provide additional services to client agencies. The orders were verbal and unrecorded in either the administrative or financial records. The failure to complete the control documents resulted in GSA having to pay $1.9 million to the contractors with no means to obtain repayment from the customer agencies.

Procurement activities. With acquisition services being at the heart of GSA's business activities, weaknesses in procurement planning, negotiation or contract administration can have serious consequences; some brief examples from our work follow:

• A poorly crafted selection plan led to the selection of a marginally suitable contractor. Project delays occurred soon after, work became disorganized and costs started to rise because of delays and rework.

• Contracting officers creating contracts available for all agencies to use did not avail themselves of all the resources they could to establish the best prices, resulting in Federal customers paying for some items 5, 10 percent or more than their commercial peers.

• Personnel responsible for providing oversight of contractors' work did not require milestones or other means to assess project progress. Only months later it was learned that work was behind schedule and way over budget.

• A contractor hired as a construction project executive and another contractor engaged to provide quality assurance services for a GSA project were investigated and prosecuted for accepting over $80,000 in bribes from a prospective firm seeking a multimillion dollar subcontract related to a Federal construction project.

• A contract manager whose performance evaluation was heavily weighted toward developing new business, awarded work to existing contractors who did not have suitable experience to meet the new requirement. The projects incurred at least $3 million in excess costs.

Human capital issues. GSA, like other agencies, is losing its corporate knowledge base and most experienced personnel to retirement and at the same time has a shortage of personnel with skills necessary to function in the 21st century business environment. In several cases, personnel without the appropriate training or requisite skills have been given responsibilities well beyond their abilities to handle them. For example:

• A project manager placed a work order under the wrong type of contract causing the government to pay $288,000 for tasks that could have been obtained for less than $60,000 under a more suitable contract.

• An inexperienced contracting official agreed to a contractor's request for reimbursement of several administrative and general expenses associated with an existing contract. Subsequent evaluation found these costs were already considered in establishing the prices for the basic contract.

Aging Federal buildings. More than half of GSA's Government-owned buildings are over 50 years old, and it is estimated that it would take several billion dollars in renovations to bring the inventory up to building standards. Older buildings are energy inefficient and lack the physical infrastructure necessary to support modern business operations. Without necessary funds to modernize, these marginal spaces often are underutilized or vacant and, they are excessively costly to operate and produce little or no revenue.

OTHER MEASURES

In addition to our office's mission and programs aimed at eliminating waste, fraud, and abuse, GSA management works with us to enhance controls and exercise oversight to discourage wrongdoing and reduce errors. Our office, along with the agency's most senior leaders, comprise the Management Control and Oversight Council responsible for meeting the requirements of the Federal Managers' Financial Integrity Act and more recently used as a forum to discuss issues raised by the

Office of Inspector General, the General Accounting Office, our public accountant and other evaluators. The Council, more importantly, designs corrective action plans and oversees implementation plans to help the agency move forward.

I trust this presentation has been useful to the committee. We would be pleased to discuss more fully any of the issues raised or respond to any questions members of the committee may have. If I may be of personal service, please feel free to contact me.

PREPARED STATEMENT OF HON. GORDON S. HEDDELL, INSPECTOR GENERAL, U.S. DEPARTMENT OF LABOR

OFFICE OF INSPECTOR GENERAL, U.S. DEPARTMENT OF LABOR,
July 8, 2003.

DEAR MR. CHAIRMAN: Thank you for the opportunity to submit information for the hearing record on waste, fraud, and abuse in the Department of Labor's (DOL) mandatory programs. Enclosed is information that we believe will be useful to the committee as it reviews mandatory programs in the Federal Government. We formatted the information to respond to the questions contained in your invitation letter. We focus on three mandatory programs under the DOL's jurisdiction: 1) the Unemployment Insurance (Ul) Program; 2) the Black Lung Disability Trust Fund; and 3) H–1B Technical Skills Training Grants. Our work in all three programs over the years has found instances of fraud, waste, or abuse.

Of particular concern are the overpayments that are projected in the Ul Program due partly to claimants who failed to report earnings or other fraud-related schemes. In fiscal year 2002 alone, the Department of Labor projected that $3.4 billion in Ul benefits were overpaid. In addition, we have noted for the past 15 years that the Internal Revenue Service has overcharged the Unemployment Trust Fund, which funds the benefits paid to the unemployed, to administer the fund. An OIG audit estimated that the IRS overcharged the fund $174 million between fiscal years 1999–2002.

I appreciate your interest in the work of the DIG. If you or your staff have any questions on this or any other matter, please do not hesitate to contact me.

Sincerely,

GORDON S. HEDDELL,
Inspector General, U.S. Department of Labor.

UNEMPLOYMENT INSURANCE PROGRAM

The Unemployment Insurance (UI) Program is the Department of Labor's largest income maintenance program. This multibillion dollar program provides income maintenance to individuals who have lost their jobs through no fault of their own. While the framework of the program is determined by Federal law, the benefits for individuals are dependent on State law and are administered by State workforce agencies in 53 jurisdictions covering the 50 States, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands, under the oversight of the Department of Labor.

1. A current estimate of the magnitude (in dollars) of waste, fraud, and abuse within the Department's mandatory programs:

• In fiscal year 2001, the States identified and reported $699 million in actual UI overpayments. Of this amount, the largest single cause ($227 million or about 32 percent) of detected overpayments was unreported claimant earnings. Other causes for overpayments include a variety of eligibility reasons such as, failing to do a work search, being terminated by an employer for a reason that does not qualify for UI, and not qualifying for the benefit amount received because of insufficient base period wages. For fiscal year 2002, the States identified $908 million in overpayments.

• The Employment and Training Administration's (ETA's) Benefit Accuracy Measurement (BAM) system projected claimant overpayments at $2.45 billion in fiscal year 2001 and $3.4 billion in fiscal year 2002. Of the fiscal year 2001 projected amount, ETA estimated fraud related overpayments to be $580 million while non-fraud overpayments were estimated at $1.865 billion.

• For the 1 year period ending June 3, 2003, OIG investigations involving the UI Program have resulted in 68 indictments, 58, convictions, and $5.3 million in monetary results.

2. The general nature of these problems and how long they have persisted:

• According to ETA's projections, for fiscal year 2001, fraud made up about 25 percent of the projected overpayments. Fraud was perpetrated through fictitious employer schemes, internal embezzlement, and false claims established through identity theft.

• The balance of overpayments, about 75 percent, is considered non-fraud overpayments. Such overpayments can occur when a State establishes and pays a claim, only to later discover that the claimant was not eligible for other reasons. Non-fraud overpayments can also occur when a claimant's earnings for a claimed week of unemployment exceed State law minimum.

• ETA has projected unemployment benefit overpayments since 1987. Despite ETA's quality control program, including BAM, the UI overpayment rate has remained steady at between 8 and 9 percent for the past 12 years.

• From an investigative perspective, based on recent casework, the OIG is concerned about organized crime fraud activity in the UI Program. We have conducted several investigations that illustrate exploitation by organized crime groups of the UI Program through the use of theft.

3. Illustrative examples of these problems:

• In addition to instances of millions of dollars of overpayments resulting from unreported claimant earnings and a variety of eligibility issues, the OIG continues to investigate fraud within the UI Program. Some recent examples include:

• A Washington State man was sentenced and ordered to pay nearly $700,000 in restitution in connection with UI fictitious employer, private insurance, and credit card schemes he orchestrated for more than 10 years. The investigation revealed that he orchestrated these schemes using multiple identities and fraudulently obtained Social Security numbers. He set up multiple fictitious businesses in Washington State and submitted false quarterly wage reports, enabling him to draw more than $100,000 in UI benefits.

• A New Jersey man who used fictitious companies to file false UI applications was sentenced and ordered to pay back more than $320,000 he fraudulently obtained from the New Jersey UI Program.

• A California man filed more than 30 fraudulent UI claims totaling $130,000 using identities of Los Angeles City and County employees stolen from a credit union.

• Thirteen members of a Mexican non-traditional organized crime group were indicted on charges of conspiracy, mail fraud, identity theft, and money laundering in connection with more than $10 million in fraudulent UI claims. The investigation revealed that they defrauded the California, Washington, Nevada, and Arizona Unemployment Insurance Programs through the use of at least 3,000 stolen identities obtained from payroll servicing companies.

• Six members of a Mexican family living in California were indicted on charges of conspiracy, mail fraud, identity theft, and money laundering for defrauding the State of California UI Program. The investigation revealed that the family, which constituted a criminal group, opened approximately 100 mailboxes and established several business bank accounts to allegedly launder over $3 million dollars obtained from fraudulent UI checks.

4. What actions are being taken to eliminate or reduce these problems:

• In 1987, ETA implemented a quality control program to address Federal regulations (20 CFR 602.1) that directs the UI system to implement a quality control program. A key component of this program was the BAM system.

• ETA increased the priority of preventing and detecting UI overpayments by establishing a Government Performance and Results Act overpayment measure.

• As stated in question two, ETA has projected unemployment benefit overpayments since 1987. Despite ETA's quality control program, including BAM, the UI overpayment rate has remained steady at between 8 and 9 percent for the past 12 years.

• ETA issued an UI Program letter offering States grants to enhance their State's connectivity to the State directory of new hires. The new hire database with current employment information can detect "unreported earnings" overpayments by matching the paid claims list to the database. Such a cross match can detect unreported earnings far quicker than traditional cross match methods which rely on employer quarterly wage reports.

• Most recently, the Department announced on July 2, 2003, that it awarded $4.8 million in grants to help 41 State workforce agencies implement or enhance systems to prevent and detect fraudulent payments of unemployment insurance benefits. One of the systems will allow State agencies to cross-match UI benefit claims against the State new hire reports; the other system allows electronic data exchange between State UI agencies and the Social Security Administration to help prevent identity theft by individuals filing UI claims.

• The OIG currently is auditing BAM to determine how well it projects overpayments and whether it can be used to point the way to program improvements.

• The OIG periodically sponsors fraud awareness seminars for State UTF Program directors and staff to make them aware of fraud problems within the UTF.

5. What additional actions, either administrative or legislative in nature, are required:

• Past GAO and OIG audit reports have acknowledged the potential benefits of new hire data in UI overpayment detection. Most—but not all—States are using their respective State new hire directories. However, the State directories alone do not afford the States access to nationwide data. Moreover, legislative restrictions currently bar States' access to the national directory of new hires maintained by the Department of Health and Human Services. Through connectivity to the national directory, the States could establish cross match procedures that detect overpayments early, thus preventing future overpayments on the same claim and increasing the likelihood of recovery.

UNEMPLOYMENT TRUST FUND ADMINISTRATIVE COSTS

1. A current estimate of the magnitude (in dollars) of waste, fraud, and abuse within the Department's mandatory programs:

• Another cause of continuing waste affecting the Unemployment Trust Fund (UTF) is the overcharging of the trust fund for costs incurred by the Internal Revenue Service (IRS) in collecting and processing employers' unemployment taxes.

• The OIG's March 2003 report estimated that overcharges to the UTF amounted to $174 million for fiscal years 1999–2002. This occurred because IRS did not have a cost accounting system to equitably recover its costs.

2. The general nature of these problems and how long they have persisted:

• The OIG first reported this problem 15 years ago. In addition, in 1999, the OIG reported that the IRS did not have a cost accounting system to capture actual UTF-related costs and had overcharged the UTF in fiscal years 1996–98. While the IRS returned these overcharges to the UTF, ETA was unable to get the IRS to resolve the issues regarding its UTF charging process.

• The OIG recently completed a follow up audit of the IRS's process for identifying administrative costs charged to the UTF. We found that for fiscal years 1999–2002, the IRS did not have adequate support for these costs. In addition the Treasury Inspector General for Tax Administration (TIGTA) recently issued an audit report, which found that Treasury could not support the expenses charged to the UTF. The Treasury agreed with TIGTA's recommendations.

3. Illustrative examples of these problems:

• Using fiscal years 1999–2002 as an example of IRS overcharges to the UTF, our March 2003 audit report disclosed that the IRS had charged the trust fund almost $300 million without adequate support. Using an alternative methodology based on percent-of-revenue-received; we estimated the amount charged should have been $126 million.

4. What actions are being taken to eliminate or reduce these problems:

• The IRS recently proposed an alternative cost recovery methodology. We raised questions with one aspect of this methodology, and we recommended that ETA work with the IRS to address this issue and adopt an acceptable methodology. Using the IRS's proposed methodology, the IRS would have charged only $126 million rather than the nearly $300 million it actually charged.

5. What additional actions, either administrative or legislative in nature, are required:

• We continue to recommend ETA negotiate with the IRS to adopt an acceptable alternative methodology for charging the UTF for the allocable administrative costs, and enter into a Memorandum of Agreement to ensure consistent application of the agreed upon methodology.

IRS should also reimburse the UTF $118 million ($174 million minus $56 million already recovered) in overcharges. ETA and IRS are holding discussions to develop a mutually acceptable methodology.

BLACK LUNG DISABILITY TRUST FUND

The Black Lung Disability Trust Fund (BLDTF) provides benefit payments to eligible coal miners disabled by pneumoconiosis when no responsible mine operator can be assigned liability. These benefits, along with administrative and other costs, are chiefly financed by excise taxes from the sale of coal by mine operators.

1. A current estimate of the magnitude (in dollars) of waste, fraud, and abuse within the Department's mandatory programs:

• Outstanding advances to the BLDTF totaled $7.7 billion at the close of fiscal year 2002, up from $5 billion at the end of fiscal year 1996. Of the $7.7 billion in cumulative advances as of the end of fiscal year 2002, only $2 billion had been spent for benefit payments, with the remaining $5.7 billion used to pay interest on past

advances. The BLDTF continues to be unable to repay any principal on these advances, and it must borrow to pay the interest.

• For the 1-year period ending June 3, 2003, OIG investigations involving the Black Lung Program have resulted in 4 indictments, 3 convictions, and $7.1 million in monetary results.

2. The general nature of these problems and how long they have persisted:

• The OIG first reported on the chronic insufficiency of trust fund revenues in our March 1997 semiannual report.

• The Black Lung Benefits Revenue Act provides for repayable advances to the BLDTF from the U.S. Treasury when trust fund resources are inadequate to meet obligations, as continues to be the case. Currently, coal excise taxes are sufficient to pay benefits and administrative costs; however, the fund must continue to borrow from the Treasury to pay the interest due on past advances. The Omnibus Budget Reconciliation Act of 1987 significantly reduces coal excise taxes after the year 2013, exacerbating the deficit. The Department's projections through September 30, 2040, indicate that, when the payment of interest on advances is taken into account, the trust fund will experience a negative cash flow—necessitating more borrowing—in each of the next 38 years, culminating in a projected $49.3 billion deficit by the end of fiscal year 2040.

• From an investigative perspective, our investigations have shown that a problem exists with the fraudulent conversion of deceased claimants' black lung payments by family members and friends. Our investigations have also demonstrated that the Black Lung Program is susceptible to fraud by doctors and other medical providers.

3. Illustrative examples of these problems:

• In addition to the outstanding advances and mounting debt to the BLDTF, the following are examples of fraud against the program:

• A Virginia doctor, who was a provider to the Federal Black Lung Program, was sentenced to nearly 6 years in jail and fined $42,700 after being found guilty of 427 counts of dispensing narcotics, including Oxycontin, without a legitimate medical purpose. A joint investigation revealed that the doctor was unnecessarily dispensing prescription narcotics to Black Lung claimants. This investigation is part of a larger probe into medical provider fraud in rural Virginia.

• In another case, two physicians were sentenced for defrauding the Black Lung Program of over $1.5 million and were ordered to jointly pay $2 million in restitution. The investigation found that the doctors billed and received payment from the Black Lung Program for excessive office visits and unnecessary medical treatments and supplies.

4. What actions are being taken to eliminate or reduce these problems:

• The OIG continues to investigate fraud within the Black Lung Program. Our work has led to the Black Lung Program saving at least $4 million through our investigations of medical suppliers' inflated billing of an oxygen supplying device. Medicare paid only a fraction of the cost for the same devise. When the OIG brought this to the Black Lung Program's attention, the program immediately instituted a new purchasing policy, which resulted in the savings.

5. What additional actions, of either an administrative or legislative nature, are required:

• Restructuring the BLDTF debt could address the mounting debt caused by the large interest bearing repayable advances received from the U.S. Treasury. The Department's 2004 budget justification States that the administration will propose legislation to (1) authorize a restructuring of the BLDTF debt, (2) extend, at the current rate, BLDTF excise taxes set to expire in January 2014, and (3) provide a one-time $2.3 billion appropriation to compensate the General Fund of the Treasury for forgone interest payments.

H–1B TECHNICAL SKILLS TRAINING GRANTS

The American Competitiveness and Workforce Improvement Act of 1998 was passed to help employed and unemployed U.S. workers acquire technical skills for occupations that are in demand and being filled by H–1B visa holders. DOL awards competitive H–1B Skills Training grants for this purpose.

1. A current estimate of the magnitude (in dollars) of waste, fraud, and abuse within the Department's mandatory program:

• In fiscal year 2002, DOL awarded 38 H–1B grants totaling approximately $101 million. In fiscal year 2003, DOL's budget authority for Technical Skills Training grants is $97.6 million. In 2002, the OIG reported on audits of six of H–1B skills training grants totaling $15.4 million. We found that the value of the grants we audited in achieving the legislative purpose—training in H–1B demand occupations—

was questionable. None of the participants in two of the grants obtained employment or upgrades in occupations for which they were trained. Two other grantees did not track placements, and therefore employment outcomes were unknown. Further, just three of the six grantees demonstrated that their projects could continue to operate after the current grants ended, a requirement of the grants.

2. The general nature of these problems and how long they have persisted:

• Our last audit covered grants through calendar year 2000. In this audit, we found that training provided by the grants was not related to H–1B occupations and training either did not result in target employment or the employment outcomes were not measurable.

3. Illustrative examples of these problems:

• Training at one of the six grantees consisted of non-technical courses such as diversity and anti-harassment.

• Three of the six audited grantees were not achieving employment outcome goals. Participants were not placed directly into H–1B occupations and most did not have any type of placement or upgrade outcome.

• Employment outcomes for three of the six audited grantees were indeterminable because the grantees did not measure, achieve, and report the outcomes as specified in their grants.

4. What actions are being taken to eliminate or reduce these problems:

• In October 2002, DOL revised its guidelines on the availability of skills training grants to ensure grants are awarded to high-skilled training programs. Recent DOL solicitations for H–1B Grant applications have focused on addressing high skill technology shortages of American businesses.

5. What additional actions, either administrative or legislative in nature, are required:

• In our opinion, DOL should consider that grants be awarded only to entities that agree to provide the appropriate technical skills, and should consider monitoring grant performance to ensure the legislative intent and grant deliverables are met.

STATEMENT OF HON. KENNETH M. DONOHUE, INSPECTOR GENERAL, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Thank you for inviting me to submit a statement for the record on waste, fraud, and abuse in mandatory spending programs within the Department of Housing and Urban Development (HUD). For budgetary purposes, our insurance programs meet the definition of mandatory programs. Consequently, my remarks will only focus on our audit and investigative efforts involving the Department's insurance and guarantee programs, The Federal Housing Administration (FHA) and the Government National Mortgage Association, known as Ginnie Mae. While these government sponsored enterprises are considered mandatory programs, the monetary savings identified through our audits or investigations would generally not be returned to the U.S. Treasury. For example, the FHA insurance programs are self-sustaining. Income is generated through borrowers' mortgage insurance premiums and the costs for foreclosure losses are paid by the insurance fund. Mortgage insurance premiums are adjusted up or down to cover program needs. If there are excess premium revenues, the Assistant Secretary may authorize the payment of premium refunds.

Last month, we provided testimony for the House Committee on Financial Services on areas of potential savings from our discretionary programs. We identified several older programs with remaining obligated funds from expired contracts (i.e., HUD's Section 8 Program which provides rental assistance to low income households). We recommended that these obligations be recaptured and used to offset future budgetary needs. In response to our findings, the Department has taken action to offset fiscal year 2004 funding by $1.7 billion.

Program background. FHA was created as a U.S. Government corporation within HUD and administers active insurance programs designed to make mortgage financing available to the home buying public. FHA insures private lenders against loss on mortgages that finance single-family homes, multifamily projects, health care facilities' property improvements and manufactured loans. Ginnie Mae, through its Mortgage-Backed Securities Program, facilitates the financing of residential mortgages by guaranteeing the timely payment of principal and interest to investors. Ginnie Mae issuers pool FHA, VA and farmers' home mortgages into mortgage-backed securities. The Ginnie Mae guarantee gives lenders access to the capital markets to originate new loans.

FHA insures more than a million loans each year. FHA's outstanding insurance portfolio exceeds $600 billion. Last year, Ginnie Mae reached the $2 trillion mark in mortgage-backed securities issued since 1970. The outstanding portfolio of these

securities now exceeds $587 billion. FHA and Ginnie Mae, from a financial standpoint, are both fiscally sound organizations. FHA mortgage insurance premiums more than cover any losses incurred through the foreclosure and note sales processes. The FHA insurance fund is actuarially sound and it more than exceeds the 2 percent capital ratio requirement set by the Congress. Ginnie Mae fees charged to issuers currently earn Ginnie Mae between $700 and $800 million annually.

The magnitude of the problem. You requested an estimate of the magnitude of waste, fraud, and abuse in these programs. As you can see from the balance of my testimony, there are so many players in our programs that making such an estimate would be extremely difficult. HUD relies on thousands of approved FHA direct endorsement lenders for underwriting. These lenders accept applications, verify borrower income/assets/liabilities, and determine appraised property values. Any of these many processes in the origination of an FHA loan can be compromised. Much of our mortgage and lender targeting for OIG review is based on the small percentage of loans that may be in default or foreclosure at any time.

With more than a million FHA loans insured each year, the slightest percentage of fraud can equate to high-risk loans valued at hundreds of millions in dollars. HUD uses a detailed lender default monitoring system to identify lenders with a high incidence of defaulted loans. FHA's Quality Assurance Division and our office both use this default information to identify lenders for review. An early loan default is generally a good indicator of underwriting irregularities. However, not all failed loans are fraudulent—job loss, health issues, divorce, etc., may be the reason for default. A significant part of our audit and investigative resources are committed to FHA lender and Ginnie Mae issuer reviews. Last year, we opened numerous investigations on individuals potentially involved in FHA insurance fraud and our workload continues to drastically increase.

Single family mortgage fraud continues to be an investigative priority for the OIG. Our investigations of perpetrators of fraud include: title companies, loan officers, mortgage companies and brokers, real estate agents, closing attorneys and appraisers. These perpetrators, through a variety of schemes, submit fraudulent loan applications, appraisals, and other falsified loan documents and/or utilize straw buyers, and other conspirators, to effect the fraud.

Our Semiannual Report to the Congress for the period ending September 30, 2002 reflected investigative recoveries of $59 million. During the same period approximately 60 percent of our cases and 90 percent of our investigative recoveries were attributable to single family mortgage fraud cases. During the first 6 months of this fiscal year, investigative recoveries are approximately $65 million, a figure that already exceeds our recoveries for all of fiscal year 2002.

Recent statistical information gathered from our 10 investigation regional offices shows that investigative efforts expended on these single family cases involve approximately 1,400 subjects who have originated more than $1 billion in loans affecting nearly 36,000 FHA-insured properties. These investigations are worked in coordination with 148 assistant United States attorneys.

A recent focus of our audit and investigative work has been on single family property flipping. In certain parts of the country, especially in urban areas, investors have been purchasing distressed properties and reselling them to an FHA-insured purchaser at an inflated value. The purchase and resale was often done on the same day. In many cases, there was collusion between sellers, lenders and appraisers to inflate values. In our OIG reviews, we found a wide disparity between the original purchase price and the resale price of the property. The concentration of flipped properties in certain neighborhoods resulted in one inflated property value being used as the comparable (i.e. setting the value for another property). We have found, in particular, a concentration of problems in Los Angeles, New York City, Ft. Lauderdale and Baltimore. These involved hundreds of properties and millions of dollars in losses to the FHA insurance fund. An example of one of our flipping investigation involved Schmidbauer Realty, Inc. of Baltimore, MD.

The OIG identified a series of real estate "flip" transactions through a company owned by William Otto Schmidbauer. Schmidbauer bought and then resold numerous single family properties at prices well above their market value. He used straw buyers to complete the transactions and would use preselected lenders, loan officers and appraisers to facilitate the loans. The 58 real estate transactions identified to date involved approximately more than $5 million in fraudulent FHA loans. Eleven straw purchasers and one loan officer have entered guilty pleas in the district of Maryland.

Early this year, working with HUD program staff, a property flipping rule was put in place to stop immediate property sales or flips. By establishing zero-day waiting period between FHA sales, investors cannot quickly resell properties as they did

in the past. We anticipate this rule will deter a major part of fraudulent property flipping schemes.

Multifamily equity skimming is another major focus of our audit and investigative endeavors in FHA programs. Equity skimming is the illegal use of rents, assets, proceeds, income or other funds derived from an FHA insured multifamily property for purposes other than to meet actual or necessary expenses. When owners do not pay their mortgages, the living conditions in the developments can deteriorate because the funds intended to maintain the individual units and common areas are diverted for unauthorized uses.

A recent example of equity skimming involved a housing development in the Bronx, NY. The owner of the project was found guilty of equity skimming and ordered to pay restitution to HUD in the amount of $894,000. The owner took cash from the project for fraudulent expenses and stopped making mortgage payments. In another case, the project manager of four projects in West Virginia was found guilty of submitting false invoices for maintenance work not performed. As a result, the physical condition of the projects deteriorated. This case involved more than $800,000 of false invoices. The project manager was sentenced to 2 years in jail, 3 years probation and ordered to pay $250,000 in restitution.

HUD requires that insured projects receive a financial audit each year. In the course of these reviews, the auditors identify the source and use of funds at the project. These reports may provide information that funds are being removed from projects in a non-surplus cash position and thereby assist HUD–OIG investigators and auditors and the Department in its efforts to uncover such activity.

Ginnie Mae Issuers are responsible for pooling eligible mortgages into mortgage-backed securities and passing mortgage payments through to investors each month. Another recent OIG investigation involved First Beneficial Mortgage Corporation (FBMC) of North Carolina who was an approved FHA direct endorsement lender as well as an approved Ginnie Mae issuer. At the time the fraud was detected, this issuer had a Ginnie Mae mortgage-backed security portfolio worth $45 million. FMBC saw a window of opportunity to originate fraudulent FHA mortgages and then pool them into mortgage-backed securities. By using the investor proceeds from the sale of securities, the issuer was able to continue a "pyramid" scheme by appearing to pass through mortgage proceeds. Over 100 of the pooled mortgages in 11 Ginnie Mae pools were, in fact, fraudulent. FMBC systematically recruited straw buyers to sign fraudulent and fictitious mortgage notes for vacant parcels of land. FBMC would then submit these false notes to their registered document custodian as backing for their securities as required by Ginnie Mae.

FBMC was permitted to sell millions of dollars of Ginnie Mae securities without verification through, or by, FHA that these mortgages were appropriately insured. FBMC was continuing to issue pools using false documents. FHA and Ginnie Mae communications could have detected the fraud earlier. A simple verification by Ginnie Mae that the FHA pooled loans were, in fact, insured would have raised a red flag. Ginnie Mae has since started a process of verifying whether Ginnie Mae pooled mortgages are FHA insured. This control should help detect improper pools within a few weeks of their origination.

Corrective actions. As we identify possible systemic weaknesses in HUD's operations through our audits, we make recommendations that, in our opinion, will best correct the problem. These recommendations will assist in the correction of many internal control weaknesses by establishing sound checks and balances through handbook or regulatory changes. In addition to administrative recommendations, a legislative remedy may, in our estimation, be required in some instances. Over the years, we have submitted legislative proposals to the Congress in an effort to reform wasteful or ineffective features in HUD programs, increase accountability in the award of financial assistance, and improve program enforcement.

Our last submission a number of years ago included close to 40 proposals. Several of these proposals involved FHA activities. For example, we proposed the elimination of the Title 1 program under Section 2 of the Housing Act. This program provides insured loans for home improvements and for the purchase of mobile homes. We based our proposal on the small number of individuals served, the inability of HUD to effectively monitor this program and the availability of private sector financing. Another proposal was to eliminate investor participation in the Section 203(k) rehabilitation mortgage insurance program. We based our proposal on our findings in a comprehensive review of the 203(k) program where investors were using the program to obtain unjust enrichment. The Assistant Secretary for Housing voluntarily suspended the program for investors based on these findings. We have also made several other proposals to increase penalties for activities relating to mortgage fraud.

In closing, our audits and investigations continue to uncover fraud and abuse in HUD's programs. Abuses, such as those discussed above, have a tremendous economic impact on the lives of the citizens these programs are intended to serve. We are continuing to work jointly with Departmental officials to correct the many problems I have discussed. I recently hosted a forum in Philadelphia wherein senior managers from OIG and HUD programs met to discuss waste, fraud, and abuse. We characterized this meeting as a "fraud symposium" where the OIG worked together with program staff in collectively addressing prevention and detection of losses in the programs. This collegial effort has been successful and will continue into the future.

I've been the Inspector General at HUD for little more than a year. It has been a very productive time. I have a well trained and very dedicated staff. Our goal is to ensure that the billions of taxpayers' dollars appropriated by the Congress for HUD programs are used effectively to provide safe, decent, and sanitary housing for millions of Americans. I've tasked my staff and I have challenged program officials to work together to combat waste, fraud, and abuse. The structure of HUD programs and the diversity of programs make this a formidable task. But by working in coordination together with program staff and congressional staff, I think we can take positive steps to make HUD operate in an optimum manner.

PREPARED STATEMENT OF HON. EARL E. DEVANEY, INSPECTOR GENERAL, U.S. DEPARTMENT OF THE INTERIOR

U.S. DEPARTMENT OF THE INTERIOR, OFFICE OF INSPECTOR GENERAL,
September 23, 2003.

DEAR MR. CHAIRMAN: Thank you for the opportunity to provide the Committee with information regarding waste, fraud, and abuse in the mandatory spending programs within the Department of the Interior (Department or DOI).

Your letter of invitation asked for information concerning mandatory spending, or "entitlements," which are funds controlled by laws other than annual appropriations acts. We used the list prepared by the Congressional Budget Office, which identified DOI accounts with this sort of funding, to determine those mandatory spending areas in which the Office of Inspector General (OIG) has reviewed and addressed potential for waste, fraud and abuse. The major program area in which the OIG has conducted audits and/or investigations and determined that funds were either misspent or that improvements over the control of funds were warranted was in assistance to U.S. Territories and Freely Associated States.

The Department is appropriated over $300 million annually for distribution to U.S. Insular Area (IA or Insular Areas) governments. Most of these funds are given to the IA governments in the form of entitlement-type funding, over which the Department has little or no control.

In fiscal year 2002, following years of frustration over the lack of responsiveness to OIG audit findings in the Insular Areas, we undertook an historic review of the often-reported weaknesses plaguing the IA governments. Based on this review, we concluded that the state of financial affairs in the Insular Areas was disturbing and that legislation might be required to effectively remedy part of the problem.

In our April 2002 Semiannual Report to Congress, we called upon the Department and other Federal agencies that provide funding to the Insular Areas to take aggressive action to address these longstanding concerns. In that issue, we reported:

The state of financial affairs of the Insular Areas is, in a word, disturbing. In no fewer than 458 audits conducted in the Insular Areas dating back to 1982, repeated deficiencies have been detected, reported, and passed on to the various governing entities. While a majority of the recommendations were accepted, in the end, most have gone unimplemented. The Federal Government can no longer continue to accept silence and inaction from appointed or elected officials, legislative bodies, or other responsible Insular Area entities concerning these deficiencies.

The Insular Area governments (Guam, U.S. Virgin Islands, American Samoa, Commonwealth of the Northern Mariana Islands, Republic of the Marshall Islands, Federated States of Micronesia, and the Republic of Palau) face major management challenges that in most cases are not being addressed, yet program monies and grants continue to flow.

The tax dollars at stake are not insignificant. Those funds aggregate to approximately three-quarters of a billion dollars annually, when Department of the Interior funded programs (fiscal year 2002: $353 million) and other non-Interior Department funding such as from the Departments of Health and Human Services, Education, and Agriculture (which totaled $405 million in fiscal year 1999) are taken into account. The Department of the Interior does not have authority over any of the program grants funded by other Federal Departments or agencies.

We believe unrealized opportunities for improvement exist in the fundamental areas of:

- Financial management;
- Revenue enhancement;
- Expenditure control;
- Program operations.

Selected examples of the types of deficiencies uncovered during this reporting period include:

- Estimated lost potential tax revenues of $7.1 million in American Samoa in fiscal years 1997 through 1999 due to uncorrected long-standing deficiencies identified in five audit reports issued since 1986.
- The loss, or potential loss, of as much as $65.1 million by four semi-autonomous government agencies in Guam, brought about by not following financial advice available from the Guam Economic Authority.
- Failure to conduct required biennial fire safety inspections or collection of fire inspection fees of at least $1.1 million by the Virgin Islands Fire Service in fiscal years 1999 and 2000.
- The failure by the Virgin Islands Housing Finance Authority (Authority) to (1) establish competitive procurement procedures for selection of housing development contractors, and (2) ensure that program participants met eligibility requirements. This led to questionable payments of as much as $1.95 million to two preferential treatment to some clients as well as several interest-free loans to Authority employees.
- Inadequate controls over financial operations by the Authority also led to a debt of $809,500 for loans to two housing communities and the inability to use bond proceeds of $33.7 million to provide mortgages to eligible participants.

There are many other examples that can be drawn from several prior audits. The common denominator, though, is the lack of responsiveness in seeking to remove impediments to efficiency. Legislation might be required to effectively remedy part of the problem. The Insular Areas may also require resources and other assistance in order to overcome these obstacles.

Without implementation and enforcement of accepted business standards and improved accountability, waste and abuse in the Insular Areas will continue unabated. It is time for OIA and the other Federal grantor agencies to assign a degree of urgency in devising and implementing a realistic plan that will provide assistance and bring about results.

Although over a year has passed since we made this report, we have no information to suggest that the state of affairs in the Insular Areas has unproved. The OIG has proposed a task force effort with its counterparts in other Departments and agencies that provide funding to the Insular Areas, with very limited success. We believe, however, that if funding to the Insular Area governments were tied to their responsible management of those funds, we would see a marked improvement in their fiscal operations. As we noted in our April 2002 Semiannual Report, this may require legislation, in addition to resources and other assistance, to accomplish.

I hope this information will be helpful to you and the Committee. If you have additional questions, please feel free to contact me or my deputy, Diary Kendall Adler.

Sincerely,

EARL E. DEVANEY,
Inspector General.

PREPARED STATEMENT OF HON. GLENN A. FINE, INSPECTOR GENERAL, U.S. DEPARTMENT OF JUSTICE

Mr. Chairman, Congressman Spratt, and members of the Committee on the Budget:

I. INTRODUCTION

I appreciate the opportunity to submit this written statement in connection with the committee's hearing on waste, fraud, and abuse in mandatory spending programs. Unlike other Federal Government agencies, the Department of Justice (Department) has few programs in which funding levels are set by law. Nonetheless, we expend significant efforts at the Office of the Inspector General (OIG) identifying and preventing waste, fraud, and abuse in a wide variety of Department programs—efforts that are consistent with the committee's goal of holding government agencies accountable for how they spend taxpayer money.

In my statement today, I will describe the results of OIG audits, inspections, investigations, and special reviews that examined issues related to waste, fraud, and

abuse. These issues fall into three general categories, each of which we have identified as top management challenges in the Department:

- Procurement, including contracting for detention space;
- Grant management; and
- Information technology (IT) systems planning and implementation.

Before I turn to these OIG reviews, I want to describe for the committee an important initiative we have ongoing in our investigations division—our Fraud Detection Office (FDO). We formed this office in order to concentrate specialized investigative resources on detecting and investigating fraud in Department programs and expenditures. In addition, the FDO assists other OIG Investigations Division field offices by providing investigative and forensic audit support to their fraud investigations. Currently, the FDO consists of a Special Agent in Charge, Assistant Special Agent in Charge, five Special Agents, two Forensic Auditors, and a Fraud Analyst.

The FDO has investigated several cases involving false claims or false statements related to the Department's September 11th Victim Compensation Fund, Office of Justice Programs (OJP) grants, and Community Oriented Policing Service (COPS) grants. In addition to working criminal and administrative fraud cases, the FDO conducts proactive fraud briefings in procurement offices throughout the Department.

One of the FDO's major initiatives is to detect and deter fraud in Department credit card purchases. This initiative, which began in June 2003, will examine whether Department credit cards used for purchases, employee travel, government vehicles, and telephones are used in accordance with applicable laws, regulations, and policies. Reviews in other Federal agencies, such as the Department of Defense and the General Services Administration, have disclosed particular vulnerabilities to fraud through use of agency credit cards, most of which center around unauthorized purchases for personal items and outright theft or embezzlements. The FDO project includes compliance checks of Department policies and procedures; data mining of credit card transactions for indications of fraud; verification of documents, account statements, and purchase invoices; and site visits to the component headquarters and field office units.

II. Procurement

The Department spends over $4 billion annually on contracts for building construction; information technology; and professional, administrative, and management support services. In addition, in fiscal year 2002 the Department spent an additional $1 billion on intergovernmental agreements (IGAs) with State and local governments to house immigration detainees and individuals awaiting Federal criminal proceedings. Our audits of these IGAs have disclosed significant over-billing of the Department for detention services. For example:

- In June 2001, we issued an audit of an IGA for detention space with York County, PA. The audit revealed that in fiscal year 2000 York County overcharged the Department in excess of $6 million due to York County's understatement of its average daily population, a key figure used to determine reimbursement from the Immigration and Naturalization Service (INS). In addition, we found that the Department could realize annual savings of approximately $6.4 million if York County used the daily rate determined by our audit.
- Our audit of the IGA between the INS and the DeKalb County, GA, Sheriff's Office revealed that the county included $13.4 million of operating costs that were unallowable, unallocable, or unsupported; understated its average total inmate population by more than 29 percent; and over-billed the INS $5.7 million in fiscal year 2000.
- We examined an IGA involving the Government of Guam's detention of INS and U.S. Marshals Service (USMS) detainees and found that for fiscal year 1999–2000 the Department overpaid Guam more than $3.6 million based on the actual allowable costs and the average daily population. In addition, the OIG found that the Department could realize annual savings of $3.3 million by using the OIG's audited rate for future payments.

The OIG has conducted reviews in other Department components in which we have identified significant potential cost savings, including an audit of the Drug Enforcement Administration's (DEA) contracts for linguistic services in which we identified $2.8 million in questioned costs out of $9.4 million paid to contractors. Specifically, we found that the DEA contracting officer's technical representatives did not provide adequate oversight of the contracts, and that the DEA paid contractors for services not authorized by delivery orders, services performed outside the allowable performance period, hours not supported by time sheets or logs, overtime that was not properly approved, and unauthorized or unsupported travel costs.

Finally, the OIG continues to investigate individual allegations of fraud or misuse of government resources by Department employees and contractors. For example, a clerk in the U.S. Attorney's office in Los Angeles, CA, pleaded guilty to embezzling more than $400,000 using her government-issued procurement card. The OIG established that the clerk purchased computers, printers, copy machines, clothes, and vacation trips using the government credit card. The clerk was sentenced to 40 days' incarceration, 5 years' probation, and ordered to pay $432,000 in restitution.

In another case, the OIG found that an administrative officer for the U.S. Attorney's office in Portland, OR, misused her government-issued credit card by obtaining cash advances and draft checks amounting to more than $39,000. The investigation further determined that the employee created fictitious obligation accounts and used existing obligation accounts with forged signatures in order to obtain the money. The employee pled guilty and received 10 months incarceration, 3 years' of probation, and was ordered to pay $39,000 in restitution.

III. Grant Management

The number and amount of grants the Department awards have grown rapidly, increasing from $849 million in 1994 to nearly $5 billion in each of the past 5 years. Grants, which now account for almost 20 percent of the Department's total budget, are primarily awarded by the Department's Office of Justice Programs (OJP) and the Office of Community Oriented Policing Services (COPS).

Over the past decade, the Department has disbursed billions of dollars for, among other initiatives, community policing, drug treatment programs, reimbursement to States for incarcerating illegal aliens, and counterterrorism initiatives. Disbursement of such significant amounts of grant money has resulted in ongoing management challenges and our reviews, in addition to work performed by GAO, have identified problems with grant management in the Department.

For example, OIG reviews have found that many grantees did not submit required program monitoring and financial reports and that program officials' on-site monitoring reviews did not consistently address all grant conditions. Grant monitoring is an essential management tool to ensure that grantees are properly expending funds and that the objectives of the grant program are implemented. Generally, each grant manager is required to prepare a monitoring plan that includes on-site visits, review of financial and progress reports, telephonic contacts, and review of audit reports. In some cases, however, we found that monitoring activities were not being documented in grant files, reports for on-site visits were not prepared, on-site inspections did not include visits to project sites, financial and progress reports were not submitted or not submitted timely, and grant managers were not reviewing carefully the information they received. As a result, grant managers failed to catch inconsistent or incorrect information on project activities.

In April 1999, the OIG issued a report summarizing the findings from 149 audits of COPS grants conducted during fiscal years 1997 and 1998, the OIG's first 2 years of auditing COPS grant recipients. These 149 grants totaled $511 million, or about 10 percent of the $5 billion in grants COPS had obligated up to that time. Our individual audits focused on: 1) the allowability of grant expenditures; 2) whether local matching funds were previously budgeted for law enforcement; 3) the implementation or enhancement of community policing activities; 4) hiring efforts to fill vacant officer positions; 5) plans to retain officer positions at grant completion; 6) grantee reporting; and 7) analyses of supplanting issues.

Our audits identified weaknesses in each of these areas. For the 149 grant audits, we identified approximately $52 million in questioned costs and approximately $71 million in funds that could be better used.[1] Our dollar-related findings amounted to 24 percent of the total funds awarded to the 149 grantees.

In our judgment, based on our ongoing audit work, the Making Officer Redeployment Effective (MORE) Grant Program continues to be the COPS office's highest risk program. The MORE Grants have funded technology or the hiring of civilians to allow existing officers to be redeployed from administrative activities to community policing. More than $1 billion has been awarded under MORE Grant Programs since the first awards began in 1995. Although MORE grants are intended to last for 1 year, we found numerous instances where COPS extended grant periods several additional years. For example, when police departments buy computers or mobile data terminals and fail to install them in a timely manner, they may become obsolete by the time they are operational. Importantly, we rarely found that MORE grant recipients could demonstrate that they had redeployed the required number of officers to community policing as a result of the MORE grants. We believe the recent 2002 MORE grants add to the high-risk nature of the MORE Grant Program by not requiring tracking of officer redeployment.

Over the years, the OIG has audited a variety of OJP grant programs, several of which we describe below.

A. STATE CRIMINAL ALIEN ASSISTANCE GRANT PROGRAM (SCAAP)

Under the SCAAP Program, OJP provides grants to State and local governments to help defray the cost of incarcerating undocumented criminal aliens convicted of State or local felonies. In an audit report issued in May 2000, we found that OJP had overcompensated State applicants approximately $19.3 million for unallowable inmate costs and ineligible inmates who were included in grant applications. We found that OJP's methodology for compensating States was over-inclusive and needed improvement, because OJP overpaid States for many inmates whose immigration status was unknown.

B. SAFEFUTURES: PARTNERSHIPS TO REDUCE YOUTH VIOLENCE AND DELINQUENCY

Partnerships to Reduce Youth Violence and Delinquency (Safefutures) was a 5-year demonstration grant program administered by OJP to help six competitively selected communities reduce juvenile delinquency. OJP's Office of Juvenile Justice and Delinquency Prevention (OJJDP) administered the grants that helped communities implement a continuum of care consisting of prevention, intervention, treatment, and graduated sanctions programs for at-risk and delinquent youth. Each grantee could receive up to $1.4 million per year, for a total of about $7 million, to implement nine specific programs and help reform its existing service delivery system. Total program costs were expected to be about $42 million. Our audit report, issued in April 1999, found that OJJDP program managers were not adhering to the grant monitoring plans, and their monitoring efforts were neither consistent nor consistently documented. As a result, we found it difficult to determine the level of monitoring that actually occurred. We found that a lack of current policies and procedures, unclear expectations, and insufficient accountability contributed to the monitoring problems.

In addition, we found weak controls over fiscal monitoring of the program. Quarterly financial reports, which often were untimely and inaccurate, were not reviewed or corrected routinely. Additionally, we found that incomplete official grant files were a continuing problem. All of the files reviewed by the OIG in this audit were missing some of the required documents needed to record the activity of each grant.

C. RESIDENTIAL SUBSTANCE ABUSE TREATMENT FOR STATE PRISONERS FORMULA GRANT (RSAT) PROGRAM

The OIG reviewed RSAT Grants in six States from March 1999 through June 1999 and issued a summary report in September 2000. The purpose of the RSAT Grant Program is to develop or enhance residential drug and alcohol abuse treatment programs for adult and juvenile offenders in State and local correctional facilities. Funding for RSAT Grants from fiscal year 1996 through fiscal year 2002 has ranged from $27 million to $63 million. OIG site visits assessed the States' adherence to grant guidance and progress toward implementing residential substance abuse treatment programs.

In a September 2000 summary report, we concluded that OJP's monitoring and oversight of the grant program needed strengthening. States received grant funds through a formula grant and had responsibility for monitoring any sub awards and providing the required monitoring reports to OJP. We found that OJP was not diligent in ensuring that States provided the required reports (such as financial status reports, semiannual progress reports, and individual project reports) on the use of grant funds and the progress of projects. All six RSAT grantees failed to submit accurate or timely reports. These reports are an important tool to help managers and grant monitors determine if grantees are meeting program objectives and financial commitments. Even when States provided the reports, the quality of the CPO review was not consistent. Further, OJP failed to ensure that conflicting or missing information in a State's reports were clarified or obtained.

We found that OJP conducted limited site visits, citing insufficient staff resources. When visits were conducted, sub-grantees—the organizations that actually implement the projects or programs—were not targeted and visits were generally limited to the State office designated to receive grant awards. Therefore, OJP did not assess the actual programs for compliance with grant requirements. We also found that on-site monitoring reports were not completed or included in the official grant file. Finally, we found that overall record keeping needed improvement. Official grant files were missing applications, award documents, State reports, and site visit reports so that the life cycle of a State's grant compliance could not be tracked readily.

D. OIG INVESTIGATIONS IN DEPARTMENT GRANT PROGRAMS

In addition to OIG audits and inspections, the OIG's Investigations Division investigates allegations of waste, fraud, and abuse in Department grant programs. Examples of cases that we have substantiated include:

• An Oklahoma death row inmate pled guilty to charges of false statements in connection with a fraudulent claim he made to the September 11th Victim Compensation Fund. The OIG developed evidence that the inmate submitted false statements purporting that his wife had been killed at the World Trade Center on September 11, 2001.

• An individual pled guilty in the Western District of Arkansas to charges of mail fraud for submitting a fraudulent application for compensation from the September 11th Victim Compensation Fund. The individual claimed that her brother, a New York City firefighter, was killed in the terrorist attacks. In fact, the OIG determined that her brother did not die in the terrorist attacks.

• In September 2002, OJP sent a letter to the City of Portland, OR, demanding repayment in the amount of $114,514 for misuse of funds received between 1996 and 1998 under an OJP Local Law Enforcement Block Grant. An OIG investigation disclosed that police officers received overtime pay from the Block Grant on more than 100 occasions for work they did not perform.

• An OIG investigation led to the arrest and conviction of a former Missouri chief of police for false statements and theft. The OIG established that the former police chief in Novinger, MO, falsified COPS Universal Hiring Grant paperwork to claim he hired and paid one additional officer when, in fact, he used the grant to pay his own salary, including a $6,000 annual raise. When confronted by OIG special agents, the former police chief admitted falsifying grant applications. He was sentenced to 2 years' probation and ordered to pay $53,190 in restitution.

• A former acting chief of the Town of Navajo Department of Law Enforcement was convicted at trial in the District of New Mexico on charges of wire fraud. He was sentenced to 30 months incarceration and ordered to pay $102,877 in restitution. A joint investigation by the OIG and the Federal Bureau of Investigation (FBI) determined that the acting chief fraudulently applied for and received a COPS Problem-Solving Partnership Grant to establish a "Crime Busters" program targeting burglaries. The acting chief diverted more than $100,000 in grant funds to personal use by making illegal sub-awards to members of his immediate family who used some of the money to purchase a used pickup truck and other vehicles.

• Based on an investigation by the OIG and the North Carolina Governor's Crime Commission, Hoke County repaid the State of North Carolina $93,467 in Byrne Formula grant funds awarded by the Department. The county manager was alleged to have purposefully submitted false documentation relating to police vehicle purchases under the grant and then diverted the funds to other uses. Although no proof of intent to defraud was sustained, the supplanted funds were recovered and returned to the State.

IV. IT System Planning and Implementation

The Department currently spends about $2 billion annually on IT, approximately 6 to 8 percent of its total budget. The OIG monitors the Department's IT system planning and implementation through a combination of performance reviews, financial statement audits, and computer security audits. Examples of our performance audits include reviews of IT management practices at the INS and the FBI.[2]

For example, our December 2002 audit concluded that the FBI had not effectively managed its IT investments because it did not fully implement the management processes associated with successful IT investments. Consequently, the FBI continued to spend hundreds of millions of dollars on IT projects without adequate assurance that these projects would meet their intended goals. FBI managers recognized that the agency's past methods to manage IT projects were deficient and they have committed to changing those practices.

Nonetheless, we concluded that the FBI must take further actions to ensure that it can implement the fundamental processes necessary to build an IT investment foundation, as well as the more mature processes associated with highly effective IT investment management. These actions include: 1) fully developing and documenting its new IT investment management process; 2) requiring increased participation from IT program managers and users; and 3) further developing the FBI's project management and enterprise architecture functions.

Additionally, we issue annual reports that review the Department's financial statement as part of the Chief Financial Officers Act of 1990 and the Government Management Reform Act of 1994. For the last two fiscal years, the Department has received an unqualified opinion on its financial statements. An unqualified opinion

means that the financial statements present fairly, in all material respects, the financial position and results of operation for the Department of Justice. However, while Department components have made improvements in internal controls, material weaknesses remain in financial accounting and reporting procedures and in information systems. Many tasks had to be performed manually because the Department lacks automated systems to readily support ongoing accounting operations, financial statement preparation, and the audit process. Manual efforts compromise the ability of the Department to prepare financial statements timely and in accordance with generally accepted accounting principles, require expenditure of considerable monetary and human resources, and represent an inefficient use of these resources.

Further, the lack of integration between principal financial management systems and sub-systems requires Department components to maintain duplicate records and perform additional account reconciliation. The Department currently has at least six major financial management systems used by its components, including both systems developed in-house and numerous off-the-shelf systems. Millions of dollars have been wasted in the last 5 years on installing these systems throughout the Department with varying success and, in some cases, little improvement in the quality or timeliness of financial data. These issues, which have existed for decades, continue to cause difficulties in preparing consolidated financial statements and in providing consistent and timely financial information to Department managers.

V. Ongoing Work

While I have focused on the areas of procurement, grant management, and IT in this statement, the OIG reviews a variety of other Department programs as part of our ongoing efforts to identify and prevent waste, fraud, and abuse. Among our ongoing reviews:

- September 11th Victim Compensation Fund. The September 11th Victim Compensation Fund was established in September 2001 as part of the Air Transportation Safety and Stabilization Act to provide "compensation to any individual (or relatives of a deceased individual) who was physically injured or killed as a result of the terrorist-related aircraft crashes of September 11, 2001." We are currently reviewing the Victim Compensation Fund to determine the effectiveness of the fraud controls used to identify fraudulent claims for compensation.
- The Department's Counterterrorism Fund. The Department of Justice Counterterrorism Fund (fund) was established to assist Department components with the unanticipated costs of responding to and preventing acts of terrorism. The fund is used to pay for expenses beyond what a component's appropriation reasonably could be expected to fund, such as: reestablishing the operational capability of a facility damaged by a terrorist act; investigating or prosecuting acts of terrorism; and conducting a terrorism threat assessment of Federal agencies and their facilities. Congress has appropriated more than $360 million to the fund since its inception in 1995, of which about $290 million has been obligated for counterterrorism expenses, including the Oklahoma City bombing investigation and trial, the U.S. embassy bombings in Africa, and the September 11 World Trade Center and Pentagon bombings. We are currently reviewing the fund to determine whether fund expenditures were authorized, supported, and obligated in accordance with the intent of the law.
- Vendor payments and credit card usage in the U.S. Attorneys' Offices (USAO) and the Executive Office for U.S. Attorneys (EOUSA). We are currently reviewing vendor payments and credit card usage in the USAOs and the EOUSA to determine whether payments were made in accordance with relevant policies and authorities.
- USMS medical care. As part of this audit, we are assessing whether USMS medical costs are necessary and reasonable and will examine potential double-billings.

VI. Conclusion

The OIG has a long history of aggressively reviewing Department operations and programs in an effort to detect and deter waste, fraud, and abuse. As we look to the future, the OIG will continue to emphasize audits, inspections, and investigations while at the same time launching new initiatives such as the Fraud Detection Office in an effort to deter fraud and promote efficiency and effectiveness in Department activities.

ENDNOTES

1. "Questioned costs" are expenditures that do not comply with legal, regulatory, or contractual requirements, are not supported by adequate documentation at the time of the audit, or are unnecessary or unreasonable. Questioned costs may be remedied by offset, waiver, recovery of funds, or the provision of supporting documentation. "Funds to better use" are expenditures that would be better used if management acts on and implements our audit recommendations.

2. As of March 1, 2003, the INS transferred from the Department of Justice to the Department of Homeland Security (DHS). Since March 1, oversight of immigration-related programs and personnel is the responsibility of the DHS–OIG.

PREPARED STATEMENT OF HON. HUBERT T. BELL, INSPECTOR GENERAL, U.S. NUCLEAR REGULATORY COMMISSION

INTRODUCTION

I am pleased to have the opportunity to provide testimony with respect to fraud, waste, and abuse in the Nuclear Regulatory Commission's (NRC) spending programs. NRC is a fee-based regulatory agency and in fiscal year 2003 has a discretionary budget of approximately $578 million, of which about $331 million is for salaries and benefits (57 percent) and $247 million is for contractor support and travel costs (43 percent). The agency, in fiscal year 2003, is required to recover approximately 94 percent of its budget by collecting fees from agency licensees. NRC has no mandatory spending or entitlement programs.

As you know, the mission of the Office of the Inspector General (OIG) at the NRC is to assist the NRC by ensuring the integrity, efficiency and accountability in the agency's programs that regulate the civilian use of byproduct, source and special nuclear material in a manner that adequately protects public health and safety and the environment, while promoting the Nation's common defense and security. My office carries out this mission by independently and objectively conducting and supervising audits and investigations related to NRC's programs and operations; preventing and detecting, fraud, waste, and abuse; and promoting economy, efficiency, and effectiveness in NRC's program's and operations. The OIG also keeps the NRC chairman and Members of Congress fully and currently informed about problems, recommends corrective actions, and monitors NRC's progress in implementing those actions.

During the past year, my office reviewed agency programs and operations, conducted investigations and event inquiries, and reviewed legislative and regulatory proposals. In

Fiscal year 2002, my office issued 17 audits of NRC's programs and operations and 17 contract audits. We completed 56 investigations that focused on violations of law or misconduct by NRC employees and contractors and 3 event inquiries into allegations of irregularities concerning staff actions cited as contributing to the occurrence of an event that could adversely affect public health and safety.

To perform these activities, OIG employs auditors, management analysts, criminal investigators, investigative analysts, legal counsel and support personnel. The OIG also uses private-sector contractors to audit NRC's financial statements and for other audit, investigative and information technology support services. OIG audits and investigations make internal control recommendations to improve the agency's programs and safeguard its assets.

FRAUD, WASTE, AND ABUSE IN NRC'S PROGRAMS

Because NRC's has neither mandatory nor entitlement spending programs, the agency's vulnerability to fraud, waste, and abuse is significantly less than agencies with those programs. Furthermore, the high percentage of salaries and benefits (57 percent) to the total budget reduces NRC's exposure in this area. As a result, the greatest opportunities for fraud, waste, and abuse may exist in the contracts area, where estimated costs are approximately $150 million (25 percent) of the total agency budget. OIG has an active program to monitor contract expenditures and has identified internal control improvements needed to bolster the integrity of the agency's contracts program. For the year-ended September 30, 2002, OIG questioned $404,321 in costs and identified $3.6 million in unsupported contractor costs. The agency is in the process of completing corrective actions to remedy these issues.

During fiscal year 2002, OIG reviewed the NRC's purchase card program. OIG's review was based on both a statistical sample of transactions and a judgment sample of transactions that appeared suspicious. Although reviews in other agencies have reported significant abuse of purchase cards, our audit disclosed only one

minor improper use of a purchase card. We also continually monitor employees' use of travel cards. While we have observed and reported abuses, these instances are neither systemic nor financially material.

As you know, the Office of Management and Budget requires Federal agencies to report on improper payments in their Performance and Accountability Reports. The NRC reported in its fiscal year 2002 report the following:

Payment data for the period October 2000 to September 2002 was collected and analyzed to determine the number and dollar value of improper payments compared to total payments made. The results showed that there were 100 improper payments out of 103,724 total payments, or 0.1 percent. The dollar value of improper payments was $135,626 out of $409,728,369 total dollars or 0.03 percent. This data supports the NRC's initial assessment that improper payments are an area of low management control risk. The agency will continue to monitor improper payments.

On November 25, 2002, the NRC chairman advised Senator Joseph Lieberman that the approximately $135,000 in improper payments had been recovered.

SUMMARY

The NRC is a fee-based regulatory agency that does not participate in loan, grant or benefit programs, which the GAO has traditionally cited as the basis of many of the government's improper payments. Salaries and benefits alone for fiscal year 2003 account for about 57 percent of the agency's budget.

OIG's makes recommendations to improve agency programs and safeguard its assets, and agency management has historically agreed to take corrective action on nearly all OIG recommendations. While there have been instances of irregularities in the areas we have reviewed, to date, no widespread instances of fraud, waste, or abuse in agency programs has been disclosed.

Thank you for providing the opportunity to report on issues related to NRC's spending programs.

PREPARED STATEMENT OF HON. PATRICK E. MCFARLAND, INSPECTOR GENERAL, U.S. OFFICE OF PERSONNEL MANAGEMENT

Mr. Chairman, ranking member and members of the committee. Thank you for giving me the opportunity to testify on the extent of waste, fraud, and abuse in mandatory programs of my agency, the U.S. Office of Personnel Management (OPM). At a time in which there are so many competing demands on the Federal budget, we join every taxpayer in concerns over whether funds available for mandatory Federal programs are being utilized in the most efficient and effective manner. We are all concerned in identifying existing problem areas and the actions being taken to eliminate or reduce them. You have addressed your concerns to the government officials charged with responsibility to oversee their respective agency's programs and who address your questions on a daily basis—the inspectors general. I have been honored to serve successive presidents and directors of the OPM for over 13 years.

In its role administering benefits to government employees, annuitants, survivors and their dependents, OPM has three mandatory programs that are susceptible to waste, fraud, and abuse. They are the Federal Employees Health Benefits Program (FEHBP), the Retirement Programs (RP), including both the Civil Service Retirement System and the Federal Employee Retirement System and the Federal Employees Group Life Insurance Program (FEGLI). However, it should be noted, the Thrift Savings Plan is not administered by OPM. As of fiscal year 2002, the outlays for each of the programs were: FEHBP $24 billion; and RP $48 billion; and FEGLI $2 billion.

In understanding our role in dealing with waste, fraud, and abuse, it is important to understand how these programs work. Under the FEHBP, OPM contracts with different health maintenance organizations (HMOs), employee organizations, such as the National Postal Mail Handlers Union, and the Blue Cross Blue Shield Association (the "carriers") to provide benefits to eligible persons. Payments to health care providers and suppliers are not made directly by OPM but by these organizations. Under the RP, claims are adjudicated and paid by OPM. Under the FEGLI, claims are made to a contractor who administers the program for OPM. In order to better understand the magnitude of waste, fraud, and abuse in OPM's mandatory programs, each program needs to be examined separately.

THE FEDERAL EMPLOYEES HEALTH BENEFITS PROGRAM

My office has the responsibility under the FEHBP to audit the carriers for the purpose of identifying funds improperly paid to them under their contracts with

OPM. My office also has responsibility to investigate fraudulent claims submitted to carriers by health care providers and suppliers. Each demonstrates a different level and type of waste, fraud, and abuse and needs to be discussed separately.

In dealing at the insurance carrier level, I would classify these improper payments primarily as waste of government funds rather than as fraud or abuse.

At this level, OPM is justifiably proud of operating programs with relatively small amounts of waste. While improper payments amounting to about $160 million in fiscal year 2002 are not an insignificant figure, it amounts to less than 1 percent of FEHBP premiums paid.

EXAMPLES OF IMPROPER PAYMENTS MADE TO CARRIERS INCLUDE:

• Coordination of benefits (COB)—Carriers are not properly coordinating claim payments with Medicare as required by their contract with OPM. As a result, the FEHBP is paying as the primary insurer when Medicare is, in fact, the primary insurer.

• Duplicate payments—Carriers are improperly charging the program for duplicate payments, such as paying a provider twice for the same services. These payments are unnecessary and unallowable charges according to the contract.

• Amount paid is greater than the covered benefit charge—Carriers have paid more than the amount indicated in the carrier's contract with the provider.

Another area where we continue to experience waste, as well as fraud and abuse within the FEHBP is in the rate setting process for community rated health benefits carriers. Defective pricing occurs when the FEHBP is not offered the same discount that a carrier offers to other large groups similar in size to the FEHBP. Historically, defective pricing has been an ongoing audit and investigative issue within the FEHBP. Several cases have been referred by my office to the Department of Justice. In our September 30, 2002 semi-annual report to Congress, my office highlighted a major recovery of funds to the FEHBP in the amount of $63.9 million resulting from defective pricing which was derived from payments made over multiple years to multiple plans.

To address defective pricing issues, my office has and will continue to increase the number of audits performed on community rated contracts. By increasing our presence at a larger number of contractors, we believe the defective pricing issues can be reduced. The success of such an increased audit presence is demonstrated by an initiative we implemented in 1996 by conducting audits of premium rate calculations for the largest carriers on an annual basis. This process was known as rate reconciliation audits (RRA). In 1996, my office questioned $6.5 million for RRAs. During the first couple of years after the RRA process was implemented, we found that 60–70 percent of the carriers we audited under this process were not in compliance with OPM regulations. I am pleased to say that after 5 years of these annual audits, the noncompliance rate has dropped to approximately 40 percent of the carriers, and the dollar amounts in question have been reduced from $6.5 million to about $2.5 million.

The largest amount of FEHBP fraud and abuse occurs at the health care provider or supplier level. My criminal investigators work with other law enforcement agencies and the carriers to identify and pursue prosecution for payments fraudulently submitted to and paid by the carriers to dishonest health care providers and suppliers. By its very nature, this fraud and abuse is hidden and therefore, difficult to detect. Adding to our difficulty in estimating the extent of provider fraud is the indirect nature of OPM's contractual relationship with health care providers. They are not government contractors or subcontractors and only have such relationships with the carriers. Therefore, my criminal investigators respond to allegations of provider fraud or abuse or irregularities detected through our audits. I do not have authority to audit health care providers generally. OPM is seeking contractual changes to provide audit authority for the very largest providers, such as pharmacy benefit managers. Therefore, I currently lack adequate information to accurately estimate the amount the FEHBP loses each year to health care provider and supplier fraud, but I do believe losses are significant and substantial.

Examples of fraud against the FEHBP by providers and suppliers include submitting false claims for services not rendered, billing for medically unnecessary procedures, falsifying billing codes that lead to a higher rate of reimbursement, and placing FEHBP patients in harms way with their illegal activities. These types of waste, fraud, and abuse have been inherent in the FEHBP since the inception of the program. Despite their long-standing nature, we fight the waste, fraud, and abuse every day, using new and innovative techniques as they become available and assigning resources to new problem areas as soon as they are discovered.

For example, a new problem area is pharmacy benefit manager organizations (PBMs). We are working closely with the Department of Justice to pursue waste, fraud, and abuse by the PBM industry. We currently do not have statistics to quantify the magnitude of problems that may exist in the prescription drug program since our involvement in this area has just begun. But given the large amount of funds expended on prescription drugs and the increases expected, we will be focusing a significant portion of our resources on this area in the future and should have a better idea of the magnitude of fraud involving PBMs, an issue recently brought to light by fraud allegations against Merck-Medco.

Another example of action taken to reduce the waste, fraud, and abuse in the FEHBP at both the carrier level and the health care provider and supplier level is a new initiative to improve our benefit payment claims review capacity. The initiative combines the use of affordable computer technology with expert knowledge in the field of health benefit analysis. The goal is to develop a data warehouse, employ program-wide review strategies, and ultimately, implement sophisticated data mining techniques to thoroughly analyze FEHBP health benefit claims payments.

We have developed an implementing strategy that has had an immediate impact on our claims analysis capabilities, while offering future opportunities for our auditors to use their expertise to discover other types of improper claims payments. We envision that this data warehouse/data mining project will significantly increase our ability to highlight trends of potential health care fraud in the FEHBP. The project will also provide our criminal investigative staff with the ability to react quickly to investigative leads. For example, our criminal investigators will be able to determine the potential program risks associated with an identified provider or subscriber fraud allegation, and take appropriate action in a matter of hours versus days or weeks.

Our current data warehouse plan centers around health benefit claims data from the FEHBP contract with the BlueCross BlueShield Association (BCBS Association). In 2002, the BCBS Association paid $10.8 billion in FEHBP health benefit payments including $3 billion for prescription drug benefits. Our ultimate goal is to include claims data from all carriers who determine premium rates using the same methodology as FEHBP-participating Blue Cross and Blue Shield plans.

We have recently implemented a series of computer claims analysis applications that our auditors are using as part of our routine BCBS Association FEHBP audits. The first application is designed to assist the audit staff in selecting a claims sample in order to verify various controls that have been established within the carrier's claims processing system. Additional applications have been designed to assist the audit staff in identifying the following types of routine claim payment errors:

- Coordination of Benefits;
- Duplicate Payments;
- Amount Paid is Greater than the Covered Benefit Charge; and
- Debarred Providers.

Prior to the development of these applications, the auditors were required to work through a single computer specialist. While we were quite successful with this approach, it limited the number of audits that could be completed annually. Now, by applying these technical advancements in computer hardware and software with the skills of our staff (computer specialists, information systems audit staff and FEHBP Program auditors), we have realized two important auditing goals: First, we have made our claims analysis process more comprehensive; secondly, we have significantly increased the number of health care audits we are able to complete each year.

These user friendly, computer assisted audit techniques have standardized the audit process, while allowing our auditors the necessary flexibility to adjust the applications to the specific requirements of their assignments. By empowering our auditors to complete more routine computer analyses, our computer specialists, in turn, are free to concentrate on more complex issues. These specialists also have time to work on the development of our OIG data warehouse and, ultimately, our data mining applications. These computer applications can be run from remote locations throughout the country through a secure, virtual private network.

Another important new strategy in identifying potential program waste is to complete our claims analysis on a global rather than plan-by-plan basis. This approach offers us the opportunity to address significant issues one time only instead of multiple times per year and to recover overcharges to the program when appropriate. We are in the process of completing our first such global review. This first review targeted our on-going problems with improperly coordinated claims with Medicare. While we have not finalized this review, we anticipate questioning over $22.5 million in improperly coordinated claims. We have targeted other claim payment issues, such as duplicate payments, for global reviews.

One of the key components of this strategy is to work with OPM and the appropriate carriers to identify and resolve the root causes of these claim payment issues. The goal is to work cooperatively to resolve issues once and for all. With routine updates to the data warehouse, we will be able to monitor our joint efforts in resolving these global issues.

Finally, we plan to apply data mining techniques to our data warehouse to automate the process of discovering suspect trends and unusual payment patterns. Our first step has been to form a data mining team. This team, made up of a senior FEHBP Program auditor and a senior computer specialist, will have the unique challenge of employing data mining software to discover relationships and hidden patterns in claims data. Using their combined technical skills, the team will use these relationships and patterns to identify potential health benefit payment errors and possible fraudulent payments. The data mining team is also supported by additional auditors with claims audit experience, as well as our OIG information systems audit unit.

The key to our ongoing success is to provide the audit and criminal investigative staff—our experts—with powerful, yet easy-to-use, computer-assisted auditing tools to combat waste, fraud, and abuse in the FEHBP with increasing effectiveness and efficiency. This initiative mixes affordable computer technology with our human capital expertise to maintain and enhance our audit and criminal investigative capabilities in a rapidly changing technical environment.

We are also combating fraud by health care providers and suppliers through our enhanced administrative sanctions and civil monetary penalty program. Since May 1993, our office has debarred or suspended over 24,000 health care providers who have committed serious violations that disqualify them from participating in the FEHBP.

New regulations effective in February 2003 expand the range of actionable violations and substantially improved the operational efficiency of our sanctions activities. We anticipate that additional regulations will become effective later this year to enable OPM to impose, through administrative action, civil monetary penalties and financial assessments on health care providers who have knowingly committed claims-related violations resulting in incorrect payments of FEHBP funds. These financial sanctions will permit OPM to recover damages and costs resulting from provider misconduct and will carry a deterrent effect to such violations among providers participating in the FEHBP.

FEDERAL RETIREMENT PROGRAMS

While my office focuses primarily on waste, fraud, and abuse in the FEHBP, we also guard against it in the RP. The RP has an erroneous payment rate of less than one-half of 1 percent of payments made or about $100 million in fiscal year 2002. Most of the erroneous payments are computation errors identified and corrected by the agency itself. However, there is other waste, fraud, and abuse within the RP, notably the failure to notify OPM of the annuitant/survivor's death, resulting in improper continuation of RP payments. This failure may often be due to unfamiliarity with the RP requirements. Unfortunately, it is frequently the result of deliberate fraud.

OPM has tried to eliminate the erroneous payments by routinely performing computer matches using OPM's annuity rolls and the Social Security Administration's death records. We assist the agency by proactively reviewing RP annuity records for any type of irregularity, such as reaching 100 years of age. If we discover an irregularity, we conduct independent queries with other data bases to determine if annuitants are deceased. We will continue, as necessary and as our resources permit, to actually verify that annuitants are still alive by visiting them at their residences.

As an additional measure to review the RP rolls, when we hire new criminal investigators, we will be placing them in areas of the country where large clusters of current and former Federal employees reside, such as California and Florida. This provides us with additional resources for fraud referrals against the FEHBP and the RP where the criminal activity is most likely to originate.

FEDERAL EMPLOYEE GOVERNMENT LIFE INSURANCE PROGRAM

FEGLI is the third mandatory program which my office has a responsibility to audit and investigate for waste, fraud, and abuse. However, our regular audits of the program and the financial statement audits by outside auditors demonstrate that there is not a significant amount of waste, fraud, and abuse in the FEGLI. While there undoubtedly is some, I would estimate it to be less than one-tenth of 1 percent of FEGLI payments each year or less than $2 million a year.

At this time, we are unaware of any additional actions of an administrative or legislative nature needed to improve our ability to combat waste, fraud, and abuse in OPM mandatory programs. We are pleased with the support Congress has given us in recent years by providing effective administrative sanctions authority in the Federal Employees Health Protection Act of 1998 and providing statutory law enforcement authority for certain inspectors general offices through enactment of the Homeland Security Act. I will continue to keep you informed of our progress and future needs in our semi-annual reports and through such testimony as you may find helpful in the future. Thank you again for the opportunity to discuss the challenges, opportunities and progress that we have made at OPM in cooperation with the administration, Congress and other law enforcement agencies.

PREPARED STATEMENT OF HON. JAMES G. HUSE, JR., INSPECTOR GENERAL, U.S. SOCIAL SECURITY ADMINISTRATION

Good morning, Chairman Nussle, Ranking Member Spratt, and members of the Committee on Budget. I welcome the opportunity to testify with several of my colleagues of other key agencies on this important issue of fraud, waste, and abuse in mandatory spending programs. Since these issues are at the heart of the Office of the Inspector General's (OIG) mission, I appreciate your letting me tell you about our efforts to identify and prevent fraud, waste, and abuse in the Old-Age, Survivor's and Disability Insurance (OASDI) and Supplemental Security Income (SSI) Programs administered by the Social Security Administration (SSA).

We all know that prevention of program fraud, waste, and abuse is more cost effective and more meaningful if it can be detected before benefits are ever paid. To that end, our office has focused not only on identifying erroneous payments, but also preventing such payments from being issued in the first place.

I would reiterate two comments Comptroller General David Walker made during questioning at your June 18 hearing. He noted that the greatest potential for cost savings lies in making fundamental reassessments of government programs, policies, and activities based in "21st century reality," and that smaller savings were possible primarily from improving economy, efficiency, and effectiveness of Federal programs. The smallest savings, he said, can be found in the areas of vulnerability to waste, fraud, abuse, and mismanagement. The sort of fundamental reassessment Comptroller General Walker described is not quick work, and will entail prolonged public discussion of the manner of government we want in the next century.

Today's hearing pursues more modest, and hopefully more readily obtainable goals. Certainly there are still areas of waste, fraud, abuse, and mismanagement in government programs, though years of effort have reduced waste from every Federal agency. In finding those areas of fraud, waste, and abuse, we also devise the ways to improve economy, efficiency and effectiveness that the Comptroller General mentioned as a more productive source of savings.

Let me add to what the Comptroller General advocated. He urged Congress to adopt the recommendations of the various Offices of the Inspector General and to hold agencies accountable for not adopting OIG recommendations—especially those that have not been implemented over time and could save Federal funds.

For 25 years, Congress has tasked OIGs with reporting on the work we do. A great deal of our work product, as I will describe today, consists of the careful and thoughtful audit analyses we conduct. Twice each year we report to Congress—and specifically to the committees that oversee our parent agencies—on recommendations we have made to save money or to deliver agency services more effectively. Those reports are required by statute to advise you on what our agencies have done to put our recommendations into effect, and what they have left undone or done differently.

The savings we propose represent great sums of money that could be used better elsewhere, whether within or outside of Government. The OIGs exist not only to capture frauds and cheats, but equally to find those savings that may be realized through better management and less waste. Our ability to do all of this is limited only by our resources, and we return more in savings than we cost in outlays by a return-on-investment figure most corporations would envy. My colleagues and I appreciate the interest this hearing demonstrates in making greater use of the work we are paid to do. I believe we offer this committee and the other committees of Congress a great deal of help in oversight and decision-making.

Within SSA, to focus on my own agency, despite significant strides there is still room for improvement. In fiscal year 2002, for example, SSA issued $483 billion in OASDI and SSI benefit payments to 53.1 million people. Thus, considering the volume and amount of payments SSA makes each month, even a small percentage of fraud, waste, and abuse can result in millions of dollars in erroneous benefit pay-

ments. It can also harm SSA's reputation as a good steward of its programs and American's faith in Government overall.

For instance, in fiscal year 2002, SSA identified and reported $1.6 billion in overpayments in the OASDI Program and $2.0 billion in overpayments in the SSI Program—for a total of $3.6 billion in overpayments. The agency must now expend its scarce resources to recover and return those overpayments to either the OASDI Trust Fund or the General Fund. Although a portion of these could not be prevented under current legislative requirements or due to the current design of SSA's Programs, another portion can be attributed to fraud, and abuse.

According to SSA statistics, the agency collected about $1.9 billion in overpayments in fiscal year 2002 (for periods prior to and including fiscal year 2002). Further, $514 million in overpayments were waived and $506 million were deemed uncollectible in fiscal year 2002. (Charts attached to this testimony provide additional information.) There is also a portion of the debt that remains unresolved. Under 1631(7)(B)(ii) and 204(b) of the Social Security Act, SSA has the authority to waive an overpayment. If an overpayment is waived, the individual is no longer liable for the debt and SSA can not collect the overpayment amount at a later date. On the other hand, overpayments that are deemed uncollectible may be recovered at a later date if a person's circumstances change. If an overpayment is deemed uncollectible, SSA will stop collection activity; however, if the person comes back into pay status or other circumstances arise that indicate the person can repay the debt, then SSA can try to recover the funds. These statistics represent only identified instances of overpayments in SSA's Program. They do not represent overpayments from fraud, waste, and abuse that are undetected.

To quantify the magnitude of fraud, waste, and abuse, we plan to initiate a comprehensive study in fiscal year 2004 to estimate some of the unidentified overpayments in SSA's disability programs. Specifically, we plan to sample and analyze approximately 1,500 disabled beneficiary cases to determine whether the benefits have been properly paid or should be terminated because of fraud, waste, or abuse. This work will focus on the 4 disability diagnosis groups that our prior audit and investigative work have shown to be most problematic. Due to the comprehensive nature of our planned review and the resources needed to investigate this type of activity, we expect that the work necessary to analyze these cases will take between 12 and 15 months to complete.

We are focusing our work on SSA's disability programs, in part, because the General Accounting Office designated modernizing Federal disability programs—including SSA's disability program—as a high-risk area in January 2003; and also because of the higher likelihood of fraud, and abuse in this area. To illustrate, in fiscal year 1998, with assistance from SSA and the State Disability Determination Services (DDS), we analyzed 66 SSI cases of individuals from an extended Georgia family of 181 SSI recipients who received in excess of $1 million based on alleged physical and emotional disorders, hyperactivity, and attention deficit disorders. During the continuing disability review (CDR) process, SSA halted benefits to these individuals. It is believed that most of these claimants initially qualified for benefits because they malingered or feigned a disability.

In addition to our planned work to quantify the amount of unidentified improper payments due to fraud, waste, and abuse in SSA's disability program, our Cooperative Disability Investigations (CDI) teams—which first opened in fiscal year 1998—are at the forefront of our efforts to identify and prevent fraud. The CDI teams investigate suspicious disability claims under the DI and SSI Programs; and, generally, these teams consist of OIG special agents and personnel from SSA and the State DDS, as well as State and local law enforcement. These CDI teams have been identifying and investigating doctors, lawyers, and other third parties who facilitate disability fraud. Today, 17 CDI units have been opened in 16 States and we plan to add CDI units on a year-to-year basis, depending on availability of funds. In the first 6 months of this year, we reported that the CDI units had confirmed 733 fraud cases, recovered $879,235 in funds, and saved the Social Security Program over $43 million.

Our work has also identified fraud, waste, and abuse in the disability program. For example, we recently completed an audit on SSA's procedures to control duplicate SSI checks issued to the same recipient and recover overpayments resulting from double check negotiations. We found that SSA recorded over 226,000 double check negotiations totaling about $104.7 million during the 2-year period ended March 31, 2002. During the most recent year, we identified 8,375 individuals who negotiated both their initial and replacement checks from 3 to 12 times in the same year, resulting in overpayments of $16.7 million. This category includes 1,271 individuals who negotiated 6 or more SSI replacement and initial checks, resulting in average overpayments of about $3,500. Our investigators are also involved in a

project in Syracuse, NY—where 649 double check negotiations were processed—to seek prosecution of individuals who abused the replacement check process. As a result of our work, SSA has revised its procedures to improve its controls over double check negotiations and recovery of related overpayments.

We also recently identified fraud, waste, and abuse involving the issue of unreported marriage information to SSA. Based on our analysis of some State Bureau of Vital Statistics records, we estimated that if SSA had purchased State vital records to identify unreported marriages at the end of 1999, the agency could have detected about $11.9 million in OASDI overpayments on an annual basis at a projected cost of $1.7 million—resulting in net program savings of about $10.2 million. As a result of our work, we made several recommendations to SSA, including that the agency obtain marriage records from State Bureaus of Vital Statistics on a regular basis to identify beneficiaries who did not report their marriages. SSA did agree to continue its efforts to work with the National Center for Health Statistics and National Association for Public Health Statistics and Information Systems to promote the reengineering of State vital records processes. The initial phase of the effort deals with birth and death records. SSA plans to have 90 percent of the States participating in the initial phase by 2005 at the earliest. Implementation of a computer match with marriage records would occur as a later phase.

As you can see, we have made great strides in preventing fraud, waste, and abuse in SSA's Programs, as well as in identifying and recovering erroneous payments that result from it. We will continue to focus our resources on this critical area; and where necessary, we will work with SSA and Congress to make any needed administrative or legislative changes.

I would be happy to answer any questions the committee might have.

Thank you.

DISPOSITION OF OASDI DEBT

[In millions of dollars]

OASDI overpayments	Fiscal year 1998	Fiscal year 1999	Fiscal year 2000	Fiscal year 2001	Fiscal year 2002
Collected	$1,103.4	$1,191.3	$1,343.6	$1,121.1	$1,036.1
Waived	$159.5	$201.8	$233.5	$260.2	$278.0
Uncollectible	$128.7	$110.5	$120.7	$95.1	$150.7

The bar chart shown above—which was provided by SSA—illustrates the disposition of SSA's OASDI overpayment debt for the past 5 years in terms of what has been collected (the green bar), what has been waived (the yellow bar) and what has been terminated as uncollectible (the red bar).

As you can see, collections peaked in fiscal year 2000 at $1.34 billion. However, they decreased the last 2 years; and collections were only a little over $1 million dollars in fiscal year 2002.

This chart shows that if SSA were to collect just 10 percent of the OASDI funds it waived or wrote off as uncollectible for the last 5 years, the agency could save about $174 million. (Breakdown: If SSA collected 10 percent of the funds it waived, savings would be $113.3 million. If SSA collected 10 percent of the funds it deemed uncollectible, savings would be $60.6 million).

The chart also shows the savings if SSA collected 30 percent or 50 percent of the erroneous payments it waived or wrote off over the last 5 years (from 1998–2002).

SSI DEBT

[In millions of dollars]

	Fiscal year 1998	Fiscal year 1999	Fiscal year 2000	Fiscal year 2001	Fiscal year 2002
Collected	$539.2	$639.9	$701.6	$795.5	$4859.7
Waived	$91.1	$145.2	$194.4	$174.3	$196.7
Uncollectible	$215.2	$349.5	$301.2	$410.6	$326.6

As shown in the chart above (which was also provided by SSA), the agency's collection of SSI overpayments have been increasing slightly each year. For example, SSA collected of $795 million in fiscal year 2001 and then collections increased to $859 million in fiscal year 2002.

However, as you can also see from the chart, waivers and uncollectible debt make up a larger percentage of the SSI Program than the OASDI Program. This is not

unexpected since the SSI Program is a needs based program and it is difficult to collect overpaid funds from those who are financially needy in the first place. Also, the general limitation of only collecting 10 percent from current SSI benefits impacts the agency's ability to collect SSI overpayments.

This chart show that If SSA were to collect just 10 percent of the SSI funds it waived or wrote off as uncollectible for the last 5 years that the agency could save about $240 million—$80 million from waivers and $160 million form funds deemed uncollectible.

The chart also shows the savings if SSA collected 30 percent or 50 percent of the overpayments it waived or wrote off over the last 5 years (from 1998–2002)—$721 million in savings if 30 percent of waivers/uncollectible funds recovered and $1.2 billion in savings if 50 percent of waivers/uncollectible funds recovered.

PREPARED STATEMENT OF HON. ANNE M. SIGMUND, ACTING INSPECTOR GENERAL, U.S. DEPARTMENT OF STATE

Chairman Nussle and members of the committee:

Thank you for this opportunity to highlight recent work of the Office of Inspector General (OIG) directed toward working with the Department of State and the Broadcasting Board of Governors (BBG) to improve the efficiency and effectiveness of their respective programs and operations and to prevent fraud, waste, and mismanagement. Several of our reviews were initiated at the request of the Department and the BBG and designed to ensure that tax dollars were utilized prudently and focused where needed most.

INFORMATION TECHNOLOGY AND SECURITY

In the area of information technology, OIG has focused on the Department's vulnerabilities with respect to new technology and its efforts to develop new strategies for dealing with the communications challenges facing foreign affairs agencies. For example, we recently reviewed the Department's implementation of the Foreign Affairs System Integration (FASI) project. The Department was the lead agency in this global affairs initiative to acquire and test a standard system, featuring a web-based portal, applications, and tools for improved communications, information sharing, and knowledge management among U.S. foreign affairs agencies at overseas missions. In the past, each agency had its own information systems, which could not communicate easily with those of other organizations within a diplomatic mission, despite the need to share information on a variety of issues. OIG reviewed the FASI project, which was piloted at our embassy in Mexico City, and determined that the project was not meeting its objectives. Specifically, OIG found that FASI did not prioritize or obtain user input to requirements sufficiently to ensure that only the most essential needs were met with the interagency system. FASI did not adequately coordinate with or consider using existing systems as potentially less costly alternatives to eliminate duplication. Interagency commitment to the system also was uneven due to inadequate marketing to other organizations whose support also would be critical to supporting global system deployment. Further, OIG found that the overseas pilot test of the interagency system was at risk due to poor timing, inadequate communications and coordination, ineffective content management, and system and technical difficulties. Due to these concerns, OIG recommended that, after completing the pilot test, the project be streamlined and redirected. In keeping with OIG recommendations, the Department discontinued the FASI project, thereby avoiding the cost of $200 [million] to $235 million to deploy globally the interagency system. The Department has merged FASI objectives with those of a related messenging system replacement initiative, which will allow for reexamination of user requirements and consideration of alternative approaches for meeting the knowledge sharing requirements of the Department and the U.S. foreign affairs community.

OIG conducted information technology (IT) inspections at four missions—Lisbon, Madrid, Montevideo and Buenos Aires—within the last 6 months to assess how information was handled and protected. These reviews identified several opportunities for improving IT management controls, operational controls and technical controls. In terms of management controls, OIG recommended that these missions periodically assess their IT security vulnerabilities and risks; prepare and implement IT security plans to mitigate the identified vulnerabilities and risks; and routinely review and improve the established IT security controls. With respect to operational controls, OIG recommended that the Department address security awareness problems by conducting training and by ensuring that the administrators assigned to embassies overseas have in-depth knowledge of appropriate security. Finally, concerning technical controls, OIG recommended that the Department improve the

management of its access controls to prevent unauthorized access to systems; systems configuration, including compliance with the Department's baseline security settings; and audit trails to ensure individual or process accountability to enable the reconstruction of events, detect intrusions, and identify problems.

INTERNAL CONTROLS

OIG reviewed internal controls for several Department and BBG Programs to reduce vulnerabilities for fraud, waste, and mismanagement in the areas of real property systems as well as use of the government purchase cards and the domestic travel card program. In our review of the Department's domestic travel card program, we examined the policies and procedures that were in place for managing the program. We noted that the Department had recently instituted several steps to improve the oversight of 90-day and 120-day past due categories of delinquencies on cards held by employees. However, the Department had not addressed the 60-day past due category of delinquencies, which may cause the commercial credit card provider to reduce the volume-based refund it gives the Department and can lead to account suspension, which may hinder an employee's ability to travel on Department business. Moreover, OIG determined that the Department had not done enough to prevent and detect misuse of the cards. As a result, OIG recommended that the Department improve and centralize its travel card regulations and that program coordinators and cardholders receive better training. We also concluded that the Department's Bureau of Resource Management was working with the Bureau of Human Resources, the Bureau of Diplomatic Security, and OIG to develop an acceptable notification process when employees misuse the cards or become delinquent with repayment. OIG also determined that the Department did not have adequate internal controls for providing administrative oversight of the program. For example, the Department did not ensure that program coordinators were managing an appropriate number of accounts; that accounts were transferred or canceled as needed, when, for example, an employee transferred or left the Department; and that multiple accounts for an individual employee were identified and cancelled. We recommended that the Department develop guidelines to address travel card delinquencies in the 60-day past due category, provide program coordinators with clear written guidance on an Intranet site and through formal training, and improve the oversight of the travel card program by checking for multiple accounts and transferring or canceling travel cards when an employee leave a bureau within the Department.

Our review of the Department's purchase card program was designed to evaluate the effectiveness of domestic operations for the program and determine whether the Department was achieving cost savings. We reported in 2001 that the program had experienced rapid growth in the number of cardholders since its inception and that the Department's customers were receiving goods and services more quickly under the program. However, we also found that part of the rapid growth in cardholders was attributable to purchase card users who made infrequent or no transactions, and, therefore, may not actually need the cards. Moreover, about 12 percent of the domestic transactions review by OIG lacked required documentation for OIG to independently verify that purchases were made properly and reconciled in a timely manner. Further, responsible officials interviewed by OIG had not conducted required annual reviews of their offices' purchase card operations. OIG also found that the Department's method for determining cost savings—the reduction in the number of paper purchase orders processed—does not necessarily capture the actual administrative cost reductions that have occurred. Finally, OIG found inappropriate procurement practices that, if changed, could yield additional cost or time savings for the Department. Based on OIG's report recommendations and observations on the purchase card program, the Department has addressed the documentation and annual review issues. Additionally, the Department has taken steps to examine low purchase card use and withdraw unneeded cards, clarify reporting on cost savings from the program, and explore additional cost avoidance measures. Subsequent to the 2001 report, OIG advised the Department in their efforts to identify cardholders, who do not comply with program requirements and track corrective actions. Finally, OIG suggested and the Department agreed to identify cardholder best practices that can be used throughout the program for improving the economy and efficiency of operations. This fall, OIG will closely review ways for optimizing the overseas use of purchase cards and for preventing waste, fraud, and mismanagement.

In our review of the Broadcasting Board of Governors (BBG) Controls on Domestic Personal Property, OIG examined whether the International Broadcasting Bureau (IBB) had established effective policies for inventory controls at six of its property management units. OIG found that the IBB did not have fully functioning property

management policies and procedures to ensure that government property was properly used and safeguarded. Furthermore, there was no evidence that a complete property inventory had ever been conducted by the IBB. Therefore, OIG made several recommendations, including conducting an agency-wide inventory to provide an accurate property baseline, implementing a plan for bringing the agency into compliance with applicable accounting and reporting requirements, and establishing a single, centralized receiving operation for all international headquarters' offices to ensure better accountability. The IBB generally agreed with our report and is taking steps to implement our recommendations.

PREVENTING FRAUD

Central to OIG's portfolio for preventing fraud, waste, and mismanagement is our investigative work. We identified approximately $2.5 million that had been embezzled from Embassy Lusaka as a result of a Foreign Service National directing funds to bank accounts associated with bogus vendors. OIG identified an additional $850,000 that had been embezzled between May 1997 and June 2000 from the Miami Passport Agency for which two Department employees were indicted on a conspiracy charge and were ultimately sentenced for imprisonment. In a recent review of the Department's domestic passport operations, OIG found that a comprehensive set of internal control procedures for cashiering and blank passport book controls had been established. However, we also found that internal control procedures for cashiering had not been implemented consistently at five of the six passport agencies visited. In addition, OIG found that the Department's management internal control reviews were not conducted frequently enough to assess adequately their reliability. Finally, OIG concluded that the unannounced adjudication audit program is not achieving its primary objective of preventing and detecting malfeasance. The Department agreed with all of OIG's recommendations with the exception of requiring all passport agencies to perform daily reconciliations of the cash receipts and cash register summary reports.

Mr. Chairman, we have worked closely and collaboratively with Department and BBG senior managers to ensure accountability in programs and operations for these two agencies. We believe that this partnership has resulted in a more efficient and effective use of appropriated funds. Thank you.

PREPARED STATEMENT OF HON. PAMELA J. GARDINER, DEPUTY INSPECTOR GENERAL FOR AUDIT, U.S. TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before you today to discuss five important questions involving waste, fraud, and abuse in Internal Revenue Service (IRS) programs. Government agencies must always spend taxpayers' dollars wisely. However, during times of extremely tight budgets, it becomes even more important that steps are taken to eliminate waste, fraud, and abuse.

1. YOUR CURRENT ESTIMATE OF THE MAGNITUDE (IN DOLLARS) OF WASTE, FRAUD, AND ABUSE WITHIN YOUR AGENCY'S MANDATORY PROGRAMS

It is impossible to accurately estimate the magnitude of waste, fraud, and abuse in IRS programs, but there are a number of areas of concern. For example, statistics are frequently cited that the tax gap (i.e., the difference between the amount of tax owed and the amount of tax voluntarily paid) is $280 billion. The IRS estimated between $8.5 and $9.9 billion of the $31.3 billion in Earned Income Tax Credit (EIC) claims on tax year 1999 returns should not have been paid. Further, an estimated $40 to $70 billion in taxes are believed to be avoided by an estimated 1 to 2 million taxpayers using offshore bank accounts.

However, all of these figures are just estimates, some are outdated, and some can be misleading. For example, it is not always clear what constitutes waste, fraud, and abuse. With respect to the EIC, if divorced parents share custody of a child, and both claim the EIC because each believes he or she is entitled to receive it, is that waste, fraud, or abuse? The $8.5 to $9.9 billion range cited earlier is for noncompliance; the amount involving outright waste, fraud, or abuse is not known.

Nonetheless, there clearly is waste, fraud, and abuse in IRS programs. For example, during calendar year 2001, IRS Fraud Detection Centers, which are designed to detect fraudulent returns and prevent issuance of related false refunds, identified $338.3 million in 38,846 fraudulent claims involving 3,447 schemes. In addition, the advent of electronic filing of income tax returns has provided a new mechanism for unscrupulous preparers to commit fraud. IRS Criminal Investigation determined that fraudulent electronic filings through December 16, 2002, had increased 720 per-

cent since the end of 1999. As another example, the IRS Frivolous Return Unit is using a computer program my office developed to identify and stop reparations credit claims (i.e., false claims for a special tax credit to African-American taxpayers who may be descendants of slaves). In just a 2-day period in March 2002, the Frivolous Return Unit reported that it identified 19 such claims, most of which were for more than $40,000. I will be discussing more specific instances of waste, fraud, and abuse in my response to question 3.

2. THE GENERAL NATURE OF THESE PROBLEMS AND HOW LONG THEY HAVE PERSISTED

The IRS has been experiencing many significant problems that include declining enforcement actions, the lack of a current baseline measure of reporting compliance, a growing balance of uncollected accounts receivable, delays in modernizing its computer systems, weaknesses in its financial management controls, increasingly complex tax laws, and IRS employees' concerns over the mandatory termination provision in section 1203(b) of the IRS Restructuring and Reform Act of 1998 (RRA 98). Despite experiencing these problems, in recent years the IRS has processed a steadily increasing number of tax returns and revenue. From 1987–2001, the number of returns filed increased by 22 percent, from 140 million to 171 million. In approximately the same time frame, the amount of revenue received by the IRS increased from $935 billion to $2.1 trillion.

Declining enforcement actions: The examination rate has dropped significantly in recent years to a level that appears to have already been detrimental to the system. Specifically, the percentage of individual tax returns selected for examination has dropped from 1.67 percent in fiscal year 1996 to .57 percent in fiscal year 2002. Additionally, a survey conducted for the IRS Oversight Board identified an 11-point drop (from 87 percent in 1999 to 76 percent in 2001) in the percentage of Americans who believe it is inappropriate to cheat on their tax returns.

Enforcement actions against individuals and businesses that purposefully conceal tax liabilities or even refuse to submit tax returns have fallen dramatically, despite concerns that tax cheating remains at high levels. The following chart exhibits the fact that, since fiscal year 1996, the level of IRS enforcement activities has significantly declined.

TABLE 1.—ENFORCEMENT ACTIONS SINCE FISCAL YEAR 1996

Enforcement action	Overall decline (fiscal year 1996–2002)
Face-to-Face Audits	70%
Correspondence Audits	56%
Liens	34%
Levies	79%
Seizures	97%

The overall decline in enforcement actions has been primarily attributed to a long-term reduction in compliance staffing, the redirection of compliance resources to customer service functions during the filing season, a decline in direct examination time, and concerns over section 1203(b) of the RRA 98. Specifically, collection revenue officer staffing decreased from 5,537 in fiscal year 1996 to 3,495 in fiscal year 2002, while during the same time examination staffing decreased from 17,406 to 13,046. Further, the number of examination and collection staff years detailed to customer service increased from 165 in fiscal year 1996 to 974 in fiscal year 2000, although it has since declined to 217 for fiscal year 2002. Direct examination time decreased from 52 percent in fiscal year 1996 to 41 percent in fiscal year 2000, but has since rebounded to 51 percent in fiscal year 2002. Finally, as a result of the mandatory termination provision in section 1203(b) of the RRA 98, some IRS employees have been reluctant to take enforcement actions. This has been a deterrent to fair enforcement of the tax laws.

Lack of a current baseline measure of reporting compliance: The IRS has not conducted Taxpayer Compliance Measurement Program (TCMP) examinations since 1988. These examinations required an exhaustive review of the entire tax return for those taxpayers randomly selected. The results of the TCMP were used to improve the effectiveness of selecting for examination returns that would result in a change. Without the TCMP, the IRS has neither had a reliable method to measure voluntary compliance, nor been able to determine the effect that increased customer service and diversion of compliance resources are having on voluntary compliance.

Uncollected accounts receivable: The IRS is challenged by an increasing balance of accounts receivable (i.e., amounts owed to the IRS because of balance due, but unpaid, filings by taxpayers, and IRS enforcement actions). From fiscal year 1996 to 2002, this balance increased from $216 billion to $280 billion. The IRS has estimated that approximately $77 billion of the $280 billion is potentially collectible.

Need for modernized computer systems: The IRS' goal of providing efficient and responsive information services to its operating divisions is heavily dependent on modernizing its core computer systems while maintaining the existing systems. Since 2001, the Business Systems Modernization (BSM) Program has been deploying projects and learning valuable lessons that should help improve future projects. As of the end of fiscal year 2002, the 8 BSM projects that are currently being developed and deployed had experienced cost increases of 26 percent and delays averaging 13 months over initial estimates, most occurring during the planning and design phases of these projects. The BSM Office forecasts that future project costs and schedules will be much closer to the estimates.

One of these projects, the Customer Account Data Engine or CADE, will eventually replace the existing master file of taxpayer accounts. CADE will be the foundation for managing taxpayer accounts in the modernized IRS. CADE and related applications will improve customer service and compliance. Although the IRS and its contractor have made progress in delivering the CADE project, the Release 1 deployment date is now estimated to be August 2003, which is about 20 months behind its original planned delivery date. Since CADE is the foundation for other projects, its delay means that taxpayers are not receiving the benefits of faster processing, and other projects that will provide improved customer service and compliance activities will also be delayed.

Weaknesses in financial management controls: Although the General Accounting Office (GAO) gave the IRS an unqualified (clean) opinion on its fiscal year 2002 financial statements, GAO reported that the IRS' internal controls were not effective and its financial management systems lacked substantive compliance with the Federal Financial Management Improvement Act. Some control weaknesses affect the IRS' ability to properly manage unpaid assessments, resulting in both taxpayer burden and potentially billions of dollars in lost revenue. Other weaknesses in controls over tax refunds could result in the disbursement of billions of dollars of improper refunds. Also, weaknesses in computer security controls may allow unauthorized individuals to access, alter, or abuse proprietary programs and electronic data and taxpayer information.

Increasing complexity of the tax laws: This further complicates the IRS' efforts to administer the tax system and minimize waste, fraud, and abuse. For several years, the Taxpayer Advocate has identified tax law complexity as a major concern. For example, according to the fiscal year 2000 Taxpayer Advocate's Annual Report to Congress, tax law complexity was the highest-ranking problem individual and business taxpayers had with the IRS. In the 2002 report, the Taxpayer Advocate stated that the scope and complexity of the tax code make it virtually certain that taxpayers will face procedural, technical and bureaucratic obstacles in meeting their tax obligations. Small businesses are particularly affected by the complexity of tax law and IRS' related processes. For example, each year an estimated 46,000 small businesses are not successful in filing their U.S. Income Tax Return for an S-corporation (Form 1120's) because the IRS does not have valid elections on file to allow their returns to be processed. Consequently, these taxpayers spend an estimated 2.3 million hours each year preparing returns that cannot be successfully processed.

3. ILLUSTRATIVE EXAMPLES OF THESE PROBLEMS

On June 20, 2003, TIGTA provided a letter to the chairman and this committee containing examples of audits and investigations that identified waste, fraud, and abuse involving the IRS in fiscal years 2002 and 2003. Our letter was in response to an effort initiated in May 2003 to scrutinize certain mandatory programs and identify examples of waste, fraud, and abuse sufficient to reduce outlays in those programs by 1 percent.

The following three sections provide brief synopses of (1) audit reports resulting in cost savings,[1] (2) significant audits/investigations that identified internal and external fraud, and (3) audit reports that identified revenue protection[2] or trends in compliance and systems modernization. The first two sections were included in our June 20 letter; the third section, while not directly related to cost savings in appropriated funds, is nonetheless important since this audit work shows the importance of protecting tax revenue and other important trends. For each audit report, we have included a link to our web site to provide access to the entire report.

REPORTS THAT IDENTIFIED COST SAVINGS AT THE INTERNAL REVENUE SERVICE

OPPORTUNITIES EXIST TO EXPAND THE TELEFILE PROGRAM

http://www.treas.gov/tigta/2003reports/200340092fr.pdf

Opportunities exist for the IRS to expand its TeleFile Program to provide more taxpayers with the option of filing via telephone. The number of taxpayers who use the TeleFile system each year decreased from the 1998–2002 filing seasons. Since the expansion of the TeleFile Program in 1997, the IRS has not identified any additional opportunities to expand taxpayer TeleFile Program eligibility. The IRS' reluctance to expand the TeleFile Program is based primarily on management's incorrect perception that the processing costs for TeleFile tax returns significantly exceed the processing costs for paper filed and other electronically filed tax returns. Management also believes that the use of a telephone to file tax returns is considered obsolete because of the widespread use of computers and the Internet. To provide measurable benefits to both the taxpayer and the IRS, and to enable the IRS to continue to move toward its goal of having 80 percent of all tax returns e-filed by 2007, we recommended that IRS management develop a strategy outlining steps to be taken to offer the TeleFile Program to those taxpayers who file a Form 1040EZ and are currently ineligible to use the TeleFile system. We estimated that our audit would result in $31.86 million in funds put to better use.

THE IRS CONTINUES TO OWE MILLIONS OF DOLLARS IN INTEREST TO TAXPAYERS WITH FROZEN REFUNDS

http://www.treas.gov/tigta/2002reports/200230062fr.pdf

The IRS was experiencing problems in releasing large dollar refunds because of the automatic freeze placed on accounts containing a credit balance of $1 million or more. In a prior report, we indicated that controls did not ensure that frozen refunds were timely released and additional interest of approximately $17.5 million was paid to taxpayers with frozen accounts. The IRS did not implement our recommendations as agreed, and our current review found that the IRS continues to pay millions of dollars in interest to taxpayers with frozen refunds. In 51 percent of the frozen accounts we reviewed, the improperly frozen accounts resulted in issuing approximately $185.8 million in refunds and paying taxpayers an additional $15.4 million in interest. As a result of our recommendation, we identified $12.9 million in funds put to better use.

IMPROVED OVERSIGHT OF THE GUARD SERVICES CONTRACT IS NEEDED TO ENSURE COMPLIANCE WITH CONTRACT TERMS AND CONDITIONS

http://www.treas.gov/tigta/2003reports/200310076fr.pdf

Increased oversight of the guard services contract is needed to ensure the contractor's compliance with all contract terms and conditions, particularly those concerning licensing. Although validations completed through October 2002 did not identify any issues related to the current employment of security guards with criminal convictions or immigration violations, the IRS paid $4.7 million in costs during the time when the contractor was in violation of the contract, all of which we classified as questioned costs.

THE IRS COULD REDUCE THE NUMBER OF UNNECESSARY NOTICES SENT TO TAXPAYERS REGARDING UNREPORTED INCOME FROM SCHEDULES K–1

http://www.treas.gov/tigta/2003reports/200330071fr.pdf

In an effort to increase tax reporting compliance and because of a mandate from the Senate Committee on Finance, the IRS began matching information reported to taxpayers on Schedules K–1 to the taxpayers' individual income tax returns. The IRS must ensure notices issued to taxpayers as a result of this matching are appropriate; otherwise, the IRS' compliance efforts will be compromised. Recently, the IRS suspended issuing notices resulting from underreported Schedule K–1 income and committed to evaluate the program to make enhancements. The IRS implemented several procedures to try and ensure notices were not issued to taxpayers unnecessarily. Despite these steps, the rate of assessments made on Underreporter Program cases related to Schedule K–1 income is significantly lower than the rate of assessments made for other Underreporter Program case income types. We recommended that the IRS make changes to the Form 1040 Schedule E to account for the original amount of Schedule K–1 income and to show offsets to this income. We further recommended that the IRS reevaluate the costs and benefits of key verifying data (entering data twice) or evaluate other ways to improve the accuracy of Schedule K–

1 information in the IRS' database. Our audit identified $3 million in funds put to better use that could be used to improve the accuracy of IRS processing of paper Schedules K–1.

ADDITIONAL COST SAVINGS AND INCREASED PRODUCTIVITY IN THE PRINT OPERATION AND COMPUTER SUPPORT FUNCTION CAN BE ACHIEVED AT THE CAMPUS LOCATIONS

http://www.treas.gov/tigta/2003reports/200320035fr.pdf

IRS management has frequently evaluated and modified the organizational structure of its Information Systems Division to accomplish program objectives. However, management could further increase the electronic dissemination of internal reports and improve performance measures. IRS management should require users to discontinue printing reports that are currently available in both printed and electronic format, convert additional reports to electronic format, and establish a process for migrating identified efficient report distribution processes to all campuses. Performance measures should also be established to assess the efficiency of the print operation and computer support function. Finally, performance management reports for the print operation and computer support function should be created to ensure that results are compared against performance measure goals and actions are taken to improve operational efficiency. As a result of our recommendations, we identified $2.24 million in funds put to better use.

THE MANAGEMENT OF INFORMATION SYSTEMS MAINTENANCE CONTRACTS CAN BE IMPROVED

http://www.treas.gov/tigta/2002reports/200220100fr.pdf

The IRS is unnecessarily paying for maintenance on some computer assets. Maintenance contracts costing an estimated $451,400 per year cover 5,236 computer monitors, 108 printers, and 206 fax machines. We estimated 10 percent of these items would fail and require repairs each year. Canceling the maintenance contracts and allocating approximately $57,500 for replacements would save approximately $393,900 per year ($1,141,500 over 3 years).[3] In addition, cabinets and racks typically do not require periodic maintenance and, therefore, should not be included in maintenance contract coverage. Canceling these maintenance contracts would save approximately $13,600 per year ($39,400 over 3 years).[3] In total, our recommendations resulted in $1.18 million in funds put to better use.

PRICING DISCREPANCIES ON THE LONG TERM MAINTENANCE COMPUTING CENTER CONTRACT

http://www.treas.gov/tigta/2002reports/200210008fr.pdf

The contractually agreed upon price for specific contract line items was incorrectly priced by the contractor and/or its subcontractor. Specifically, the IRS was billed monthly for the yearly costs of maintenance coverage for nine contract line items. Additionally, the IRS paid for a higher priced software upgrade than that provided by the contractor. Approximately $580,000 was associated with these billing discrepancies, all of which we classified as questioned costs.

AUDITS AND INVESTIGATIONS THAT IDENTIFIED INTERNAL AND EXTERNAL FRAUD

SIGNIFICANT EFFORTS HAVE BEEN MADE TO COMBAT ABUSIVE TRUSTS, BUT ADDITIONAL IMPROVEMENTS ARE NEEDED TO ENSURE FAIRNESS AND COMPLIANCE OBJECTIVES ARE ACHIEVED

http://www.treas.gov/tigta/2002reports/200230050fr.pdf

Since 1997, the IRS has made significant efforts to combat abusive trusts. However, our review of abusive trust related returns examined and closed during the first quarter of fiscal year 2001 showed that the IRS may not be consistently asserting the accuracy related penalty. There is a risk that not penalizing taxpayers involved with abusive trusts could result in further noncompliance. We recommended that IRS management develop new penalty tables to monitor the application of the accuracy related penalty and develop a system to capture examination data. We estimate that this could result in $138.2 million in increased tax revenue over a 2-year period.

COMPUTER PROGRAMMING CAN BE USED TO MORE EFFECTIVELY STOP REFUNDS ON ILLEGAL CLAIMS FOR REPARATIONS CREDITS

http://www.treas.gov/tigta/2002reports/200230071fr.pdf

Since the early 1990s, thousands of false claims have been filed with the IRS for reparations credits. Promoters use a variety of techniques to market the promise of a special tax credit to African-American taxpayers, who may be descendents of slaves. Because the manual screening of tax returns by IRS employees is subject to human error and some employees may knowingly allow these illegal claims to be processed, some claims for reparations credits are processed and refunds sent to taxpayers. IRS computer controls that identify and stop reparations claims processing could be significantly improved by using a TIGTA-developed computer program. It is estimated that by using this program, IRS employees could identify 91 percent more of these returns than they could using the existing processes and stop an additional $90.7 million in refunds (revenue protection) from claims for reparations credits over a 5-year period.

MANAGEMENT ADVISORY REPORT: SIGNIFICANTLY MORE INDIVIDUAL TAXPAYERS INAPPROPRIATELY RECEIVED DISABLED ACCESS CREDITS FOR TAX YEAR 2000 THAN FOR 1999

http://www.treas.gov/tigta/2002reports/200230048fr.pdf

We reported that individual taxpayers were inappropriately receiving tax credits on their tax year 1999 U.S. Individual Income Tax Returns (Form 1040). These taxpayers received the Disabled Access Credit even though their tax returns indicated no business reasons for taking the credits. The number of taxpayers involved was limited but the issue was significant in that many of the taxpayers were elderly Americans who were possible victims of promoters recommending unwise investments in pay telephones and automated teller machines and promising bogus tax credits. From tax years 1999–2000, the number of tax returns for which this credit was inappropriately allowed had increased by 28 percent. The amount of credit allowed on these returns totaled over $1.25 million.

IDENTITY THEFT RING NETS $7 MILLION IN FRAUDULENT TAX REFUNDS

A criminal complaint charged 19 individuals with conspiracy to file false claims against the United States. The investigation began when bank officials notified the TIGTA that tax refund checks were deposited in a tax preparer's bank account. TIGTA agents subsequently arrested the tax preparer for the theft and negotiation of stolen IRS income tax refund checks. The tax preparer, with co-conspirators, engaged in the filing of numerous fraudulent income tax returns using stolen Social Security numbers, resulting in millions of dollars in IRS refunds. The tax preparer pled guilty to conspiracy to file false claims against the United States.

In April 2003, the eighteen co-conspirators were indicted by grand jury on 29 counts including conspiracy to file false claims.

TWO IRS EMPLOYEES DESTROY RECORDS

Two IRS employees were indicted for their role in the attempted destruction of IRS records. A citizen contacted the IRS to advise that numerous tax returns and other confidential documents were strewn on a city street. TIGTA agents secured several trash bags filled with current tax returns and taxpayer correspondence that had been removed from an IRS processing center by one of the employees. The other employee placed the bags filled with the documents on the curb to be collected as trash. Both employees were terminated from employment and pled guilty to unauthorized disposal of government documents. The IRS reviewed over 300 taxpayer accounts and determined the total impact to the applicable taxpayers and the agency was approximately $1.2 million.

IRS EMPLOYEE PLED GUILTY TO STEALING OVER $191,000 IN REMITTANCES

An IRS submission processing site employee altered the payee named on tax remittance checks and attempted to convert the money for personal use by depositing the checks into a personal bank account. The employee pled guilty and was sentenced to 5 years probation for stealing checks and a money order totaling $191,871. TIGTA recovered the stolen money and the taxpayers' accounts were properly credited.

IRS EMPLOYEE ARRESTED BY TIGTA SPECIAL AGENTS FOR SOLICITATION OF $200,000 BRIBE

An attorney representing a corporation reported that during a routine IRS examination, an IRS employee solicited a cash bribe of $200,000 from the company's attorney to reduce the company's tax liability. In January 2002, with assistance from TIGTA, an electronically recorded meeting took place between the attorney and the employee. After receiving the $200,000 bribe, the IRS employee provided the attorney with a fraudulent Revenue Agent Report. TIGTA special agents arrested the IRS employee before the employee left the meeting. The former IRS employee was sentenced to 24 months in prison followed by 3 years of supervised probation.

FORMER IRS EMPLOYEE PLED GUILTY TO MISUSE OF IRS COMPUTER SYSTEM AND IMPROPER RELATIONSHIPS WITH TAXPAYERS

A former IRS revenue officer was charged with allegedly accepting gifts from different taxpayers, including approximately $1,000 in cash, a television set, free health club privileges, free auto repairs, and free garage door repairs, for a payment plan of taxes and abatement of penalties owed by the taxpayers totaling $158,741. The former employee was also charged with allegedly accessing an IRS computer without authorization and obtaining information from the IRS and with allegedly failing to deposit money of the United States under his control. The former IRS employee pled guilty and in March 2002, was sentenced to 4 months imprisonment and ordered to pay restitution of $11,648.

BUSINESS OWNER INDICTED FOR BRIBERY

A business owner owed the IRS approximately $410,829 in assessed taxes, penalties, and interest arising from an examination. The owner gave an IRS revenue officer checks totaling $18,665 in return for delaying the collection of the owner's tax liability. In June 2002, the owner was charged with bribing an IRS employee.

REPORTS THAT IDENTIFIED REVENUE PROTECTION OR TRENDS IN COMPLIANCE AND SYSTEMS MODERNIZATION

MANAGEMENT ADVISORY REPORT: IMPROVEMENTS ARE NEEDED TO ASSESS THE USE AND IMPACT OF THE EARNED INCOME CREDIT APPROPRIATION

http://www.treas.gov/tigta/2001reports/200140064fr.pdf

In 1997, the Congress provided the IRS with a special 5-year, $716 million appropriation for the improved application of the EIC. The IRS does not adequately validate EIC results information, causing the inaccurate reporting of the use of the EIC appropriation funds to the Congress. Also, although establishment of some compliance initiatives and a process to track the spending of funds have improved the application of the credit, the IRS has been unable to measure improvements in the EIC compliance for the approximately $297 million spent on improving the application of the EIC. We recommended the IRS: establish a process to ensure the workload results reported in the IRS Tracking Earned Income Tax Credit Appropriation report to the Congress are complete, accurate, and reliable; and effectively measure the impact of the EIC initiatives on improving EIC compliance. Based on audit tests, we determined 1 function overstated the number of EIC cases by approximately 29 percent (1,015 cases) and a second function overstated the number of notices sent to taxpayers by approximately 23 percent (155,000 notices).

BETTER CONTROLS ARE NEEDED TO ENSURE APPROPRIATED FUNDS ARE USED TO IMPROVE THE APPLICATION OF THE EARNED INCOME CREDIT

http://www.treas.gov/tigta/2002reports/200240020fr.pdf

The Congress has been concerned with the IRS' ability to administer the EIC. The IRS established the EIC Program Office to administer the EIC appropriation and oversee the EIC-related activities of IRS functions involved in efforts to ensure the efficient application of the law; to increase participation of eligible taxpayers; and to reduce waste, fraud, and abuse. However, the IRS does not have an effective process in place to ensure that the expenditure of the EIC appropriation is only for EIC issues, programs, and projects. We recommended the IRS establish procedures to ensure that funds appropriated by the Congress for the improved application of the EIC are used for that purpose. These procedures should include providing guidance to the appropriate functions on using the EIC-related funds for expenditures, maintaining reliable data, and conducting periodic reviews of the expenditures to ensure they are being used for EIC-related items. Our analysis of the total labor expenses

for 2 IRS functions and a judgmental sample of the IRS' equipment purchases for fiscal year 2000 and the first quarter of fiscal year 2001 identified approximately $28 million in questionable expenses.

THERE ARE SIGNIFICANT WEAKNESSES IN THE INTERNAL REVENUE SERVICE'S EFFORTS TO MEASURE EARNED INCOME CREDIT COMPLIANCE

http://www.treas.gov/tigta/2002reports/200240021fr.pdf

From tax years 1997–99, the IRS made some improvements in its methodology to measure EIC compliance. However, that methodology still has some significant weaknesses. Specifically, some of the examinations in the tax years 1997 and 1999 EIC compliance studies lacked the necessary information to support the IRS' results, the IRS was inconsistent in its study methodology, the IRS' emphasis on EIC taxpayers with business income during the tax year 1999 EIC compliance study increased the time spent on the examinations but has not produced any apparent benefits, and poor planning by the IRS has caused taxpayers to be needlessly examined as part of the tax year 1998 EIC compliance study. We recommended the IRS coordinate among functions to: ensure the quality review process occurs immediately after the examinations are completed (before they are closed), ensure IRS auditors are effectively trained on EIC issues and reminded of the importance of the studies, ensure the examination results from the EIC compliance studies are accurately credited or charged to taxpayer accounts, develop an acceptable methodology concerning where and how examinations are to be conducted on all future EIC compliance studies, develop a standardized sampling methodology that will measure EIC compliance rates at the lowest cost with the least amount of burden to the taxpayers, and capture and maintain detailed costing figures to monitor each study's return on investment. Based on our audit tests, we believe approximately 308 examinations used for compliance measurement are questionable.

SIGNIFICANT TAX REVENUE MAY BE LOST DUE TO INACCURATE REPORTING OF TAXPAYER IDENTIFICATION NUMBERS FOR INDEPENDENT CONTRACTORS

http://www.treas.gov/tigta/2001reports/200130132fr.pdf

The IRS' ability to encourage the filing of accurate information returns for nonemployee compensation, through its administration of the existing back-up withholding and penalty provisions, is extremely limited and largely ineffective. Between tax years 1995 and 1998, the number of Miscellaneous Income documents (Forms 1099–MISC) reporting nonemployee compensation, received by the IRS with missing or incorrect Taxpayer Identification Numbers (TIN), increased by 36 percent. We recommended the IRS propose to the Department of the Treasury changes to several tax laws, explore opportunities to supplement its future Internet-based TIN confirmation program, and modify some administrative guidelines. Because the IRS was unable to match the documents with tax returns, we estimated that our audit would result in $2.2 billion in income taxes collected per year through back-up withholding on nonemployee compensation payments to independent contractors that fail to furnish a TIN.

THE INTERNAL REVENUE SERVICE HAS MADE SOME PROGRESS, BUT SIGNIFICANT IMPROVEMENTS ARE STILL NEEDED TO REDUCE ERRORS IN MANUAL INTEREST CALCULATIONS

http://www.treas.gov/tigta/2002reports/200230042fr.pdf

In 1993, the IRS Inspection Service (now the TIGTA) reported that 40 percent of the tax accounts it reviewed either contained errors in interest amounts computed by IRS employees or were unnecessarily restricted from automated computations. In 1994, in accordance with the Federal Managers' Financial Integrity Act, the IRS reported this issue as a material weakness in its internal control system. As a result, the IRS established a goal to reduce its high number of erroneous restricted interest assessments. While the IRS has achieved some success in increasing the automation of interest calculations, overall, its actions taken to address the material weakness in its controls over the calculation of restricted interest have not been effective. We recommended the IRS: limit the calculation of restricted interest to centralized staffs within the various functions and locations of the IRS, establish a national quality review process that includes all restricted interest cases, establish training that must be completed before an employee can work restricted interest cases, authorize a standard interest computation tool that would be used by all employees working restricted interest cases, and explore all available options to provide the technology and programming necessary to allow more interest calculations to be per-

formed by computer. We estimate that, over a 5-year period, the IRS could undercharge some taxpayers over $145 million.

TRENDS IN COMPLIANCE ACTIVITIES THROUGH FISCAL YEAR 2002

http://www.treas.gov/tigta/2003reports/200330078fr.pdf

The IRS' overall fiscal year 2002 compliance efforts and results were mixed but showed some continuing positive changes that started in fiscal year 2001. Specifically, the level of compliance activities and the results obtained in many collection areas in fiscal year 2002 showed a continuing increase, although some measurements decreased slightly in fiscal year 2002 after increasing in fiscal year 2001. Enforcement actions were higher or about the same in fiscal year 2002 compared to the numbers in fiscal year 2001. While enforcement revenue collected increased in fiscal year 2002, the inventory of delinquent accounts and the total amount of uncollected liabilities have continued to grow. For example, from fiscal year 1996 to fiscal year 2002, enforcement revenue collected decreased from a yearly total of $37.96 billion to $34.09 billion, while gross accounts receivable increased from $216 billion to $280 billion. The number of examinations of tax returns increased in fiscal year 2002, but the overall percentage of tax returns examined stayed about the same due to increases in the number of tax returns filed. The numbers and percentages of examinations of corporate and other business returns (except partnerships and very large corporations) continued to decrease or stay at about the same level. There were also slight increases in the numbers of examinations of fiduciary income, employment, and excise tax returns. We made no recommendations in this report.

ANALYSIS OF BUSINESS SYSTEMS MODERNIZATION COST, SCHEDULE, AND FUNCTIONALITY PERFORMANCE

http://www.treas.gov/tigta/2003reports/200320007fr.pdf

Beginning in 2001, the BSM Program delivered business results by deploying projects and learning valuable lessons that should help improve future projects. Deployed projects have increased the capacity of the IRS telephone system; improved the ability to receive, route, and respond to taxpayer telephone calls; and provided refund information via the Internet. However, as reported in previous TIGTA and GAO reports, the BSM Program has been experiencing difficulties meeting the original cost, schedule, and functionality estimates included in the BSM Spending Plans submitted to the Congress. Since the purpose of this review was to identify and analyze the cost, schedule, and functionality performance compared to the original project estimates, we did not make any recommendations in this report.

4. WHAT ACTIONS ARE BEING TAKEN TO ELIMINATE OR REDUCE THESE PROBLEMS

Given the volume of returns and revenue processed by the IRS, it would be a difficult task to fully eliminate all the problems that lead to waste, fraud, and abuse. However, the IRS has taken or plans actions to at least partially address some of the more significant problems I have described.

Compliance and enforcement: In recent years, the IRS has reversed the trend toward devoting significant compliance resources to customer service. This action has helped to stabilize some compliance results, and customer service activities have received staffing increases to provide services.

For example, while the decline in many categories of enforcement actions and results since fiscal year 1996 has been dramatic, there are recent indications that in some categories this trend has stabilized or even shown improvement. Overall, the IRS' fiscal year 2002 compliance efforts and results were mixed, but showed some continuing positive changes that started in fiscal year 2001. Specifically, the level of compliance activities and the results obtained in many, but not all, collection areas in fiscal year 2002 showed an increase. In addition, for fiscal year 2002, the number of criminal investigation cases initiated and in ending inventory was the highest since fiscal year 1998. However, the number of cases referred to the Department of Justice and case convictions remained lower in fiscal year 2002 than in fiscal year 1998, yet higher than in fiscal years 2000 and 2001.

The IRS also increased the focus of its examination resources on six high-risk areas of non-compliance with the tax laws. These six strategic priority areas are: offshore credit card users; high-risk, high-income taxpayers; abusive schemes and promoter investigations; high-income non-filers; unreported income; and the National Research Program (NRP), which is discussed in more detail below.

National Research Program: To address the void created from the discontinuation of the TCMP, the IRS NRP office was established in April 2000 as a component of the Research, Analysis, and Statistics Division. NRP is a comprehensive effort,

using a statistically valid sample, to measure reporting, filing, and payment compliance for different types of taxes and various sets of taxpayers. The NRP will be used to update IRS' examination selection systems. After the IRS' workload selection formulas are updated with NRP data, the number of no change examinations is expected to significantly decrease. As of February 14, 2003, a total of 33,738 NRP sample cases had been shipped to the field, which represented about 72 percent of the total 2002 NRP sample of 46,860. Of this total, related information has been assembled on 22,256 cases, and they are ready to be assigned to an examiner.

The NRP is scheduled to allow for the updating of the examination workload selection formulas by 2005. To accomplish this objective, examination of the NRP sample cases is scheduled to be completed by April 2004.

GAO issued a report in June 2002 on the IRS' NRP planning efforts. GAO concluded that the NRP design is likely to yield the type of information the IRS needs. In addition, GAO concluded that the NRP meets one of the IRS' key goals to minimize the burden that the NRP poses to taxpayers. GAO has assessed the IRS' efforts to gather trend data regarding the overall burden imposed by the 2002 NRP and will issue a report in this area soon.

TIGTA believes that the NRP is a much needed first step for providing the information necessary to gauge compliance levels and direct IRS compliance resources toward areas where attention is most needed. TIGTA is currently conducting audit work to provide an early assessment of the implementation of the 2002 NRP at the field office level. To accomplish this objective, TIGTA is performing on-site interviews and analyzing actions to date on a sample of NRP cases at selected IRS field offices. TIGTA has met with the GAO NRP team several times to coordinate the audit approach to avoid overlap.

Planned use of collection agencies: The IRS' proposal to contract out the collection of delinquent accounts to private collection companies has the potential to recover a significant amount of IRS accounts receivable. In 1996, the IRS piloted the use of collection agencies, and after a detailed internal evaluation, concluded that their use was not economically viable. The IRS' current approach, however, differs significantly from the prior methodology. Most importantly, in 1996 the collection companies were compensated with monies from the IRS' appropriated funds. In contrast, as part of its 2004 budget submission, the IRS has requested authority to fund the use of collection companies directly from the revenues collected by those companies.

The IRS plans to eventually place 2.6 million cases annually with collection companies. Treasury projects that this initiative will produce revenue of as much as $1 billion through 2013. While this amount is significant, it represents a small portion of the $280 billion in accounts receivable that were due at the end of fiscal year 2002.

EIC initiatives: IRS efforts to improve the administration of the EIC Program are ongoing. The IRS has implemented a number of initiatives targeting outreach, education, and compliance efforts. Also, it participated with Treasury in a task force to study EIC overclaims. This resulted in the IRS initiating significant changes to the way it will address EIC noncompliance, for example, by requiring some EIC applicants to provide additional information to the IRS to validate eligibility before payment (pre-certification).

The President's fiscal year 2004 budget proposal includes an increase of $105 million in EIC funding. This increase includes $100 million to implement the pre-certification initiative. The IRS is also supposed to use compliance and other available data to determine whether specific groups of claimants can be eliminated from the pre-certification process because they pose less risk of claiming more EIC than that for which they are eligible. The Treasury's EIC taskforce estimated that the pre-certification process would potentially reduce EIC overclaims by $2.3 billion.

In addition, the IRS recently reorganized the EIC Program Office to capitalize on the strategic planning and research resources in the Wage and Investment Division's Office of Strategy and Finance, and created an Executive Advisory Council made up of IRS executives involved in the administration of the EIC Program to help provide better oversight and coordination of the program. The Program Office has also drafted new annual performance measures for the EIC Program for fiscal years 2003 and 2004.

Offshore tax shelters: In fiscal year 2001, the IRS established the Offshore Credit Card Project. Underpinning the project are two "John Doe" summonses[4] served on MasterCard International and Visa for the records of foreign bank accounts in more than 30 countries. This data, supplemented with merchant summons[5] data, is to be used to develop cases for referral to the Compliance field function. TIGTA recently issued a draft report on its audit of the program, describing concerns with the IRS inconsistently using the accuracy-related penalty, potentially examining returns beyond the statute expiration date (which, except for special circumstances, would bar

any tax assessments), and not having an adequate management information system to provide key information and trends for decision making.

In addition, in January 2003, the IRS initiated the Offshore Voluntary Compliance Initiative to help taxpayers become compliant if they are involved in abusive arrangements. The program ended in April 2003.

BSM progress: During 2002, the IRS and its PRIME contractor identified and aggressively focused on improving 12 key processes to better ensure future success. Deployed projects have increased the capacity of the IRS' telephone system; improved the ability to receive, route, and respond to taxpayer telephone calls; and provided refund information via the Internet. There will be many challenges ahead, and the IRS and PRIME contractor need to effectively implement planned improvements in key management processes; commit the resources necessary to enable success; manage the increasing complexity and risks of the BSM Program; and maintain the continuity of strategic direction with experienced leadership.

Scheduled corrective actions for financial management weaknesses: As shown in the attachment, the Department of the Treasury lists nine internal control and financial management weaknesses at the IRS, including such things as the EIC, the growing inventory of accounts receivable, and the need for detailed transactions data to support custodial financial reporting of revenue. Some of these weaknesses have existed for many years, for example, property management and accounts receivable have both been listed since the 1980s.

Automated system for tracking tax law changes: In September 2002, TIGTA reported that the IRS had recognized the importance and sensitivity of tax law complexity, elevated the concerns to the highest levels within the IRS, and invested significant resources throughout the organization to address the problems. In addition, TIGTA concluded that the IRS' Legislative Implementation Tracking System will be an effective control to monitor the implementation of new tax legislation. The system is designed to provide timely, useful information to management and quickly elevate any delays in implementing new tax laws to a level of management high enough to address the problem.

5. WHAT ADDITIONAL ACTIONS, OF EITHER AN ADMINISTRATIVE OR LEGISLATIVE NATURE, ARE REQUIRED

Addressing the issue of tax law complexity would require legislative actions. In fact, the National Taxpayer Advocate's Fiscal Year 2001 Annual Report to Congress outlined proposals to simplify or clarify six areas of tax law—family status issues, joint and several liability, alternative minimum tax for individuals, penalty and interest issues, home-based service workers, and IRS collection procedures. Also in 2001, the staff of the Joint Committee on Taxation issued a comprehensive study of tax law complexity, which included numerous specific recommendations.

Legislation will have to be passed to authorize the Secretary of the Treasury to use private collection agencies and to allow the IRS to use a portion of taxes collected to fund the project. TIGTA has concerns whether IRS resources will be sufficient to provide adequate project management, contract oversight, and quality review; whether taxpayer rights and privacy will be adequately protected; and that the detailed design for the collection project has not been developed, including the system that will be responsible for selecting, controlling, and updating cases assigned to private collection companies.

Tax law changes are needed to effect significant improvement in information reporting and to protect the substantial tax revenues that are potentially being lost each year. The IRS agreed to consider the feasibility of proposing some new legislation to require mandatory withholding of income taxes on nonemployee

compensation payments, and changing the criteria for asserting the Incorrect Information Penalty. However, TIGTA is concerned that the IRS does not plan to enforce accurate TIN reporting once a TIN verification program is made available to payors. If the IRS does not require accurate TIN information from payors, compliance is not likely to improve.

Tax professionals and others expressed concerns about the difficulty in matching information from Schedules K–1 to individual income tax returns. The IRS must ensure notices issued to taxpayers as a result of this matching are appropriate; otherwise, the IRS' compliance efforts would be compromised. The IRS should carefully consider the benefits of the program, the cost of the program to the Federal Government and to taxpayers, and the enhancements that can be made to the program in the near term as a result of its own analyses, before proceeding with a program to match all data from Schedules K–1 again in 2003.

With regard to the BSM Program, we have recommended that the IRS issue more performance-based contracts to the PRIME contractor, tie incentives and disincen-

tives to performance, and require the use of firm fixed-price task orders whenever possible and appropriate. We also recommended that the IRS reduce the number of BSM projects being developed in order to better control and manage the program, and to improve its management and governance capabilities and processes. Finally, we recommended that the IRS ensure that project development teams follow the established systems development life cycle methodology and processes to increase the likelihood of success. We will be issuing audit reports this year with additional recommendations to improve the effectiveness and results of the program.

The IRS needs to establish long-term goals and measures for the EIC Program that reflect the program's anticipated outcomes over time, and establish a consistent method to measure progress toward these long-term goals. Only through consistent measurement will the IRS be able to demonstrate its progress over time and show how it has reduced erroneous payments or increased participation.

Finally, the IRS and other important stakeholders, such as the IRS Oversight Board, believe the agency needs more resources to accomplish its mission and goals. For fiscal year 2004, the IRS requested funding of $10.4 billion and 100,043 full time equivalents. This is an increase of $521 million (5.3 percent) over the President's fiscal year 2003 request. The largest portion of this increase will go toward strengthening compliance and customer service. The IRS emphasized that since

71 percent of its budget consists of salaries and benefits, any negative changes in the agency's financial situation could result in a negative impact on staffing levels. We believe that the IRS should consider expanding its workforce planning process from 3 to 5 years. This would increase the IRS' ability to identify risks and provide necessary data to key stakeholders.

Mr. Chairman and members of the committee, I appreciate the opportunity to share significant problems and challenges that confront the new Commissioner and IRS senior management. TIGTA will continue its efforts to provide reliable and objective reviews and assessments of IRS programs and operations. It is our intent to not only identify waste, fraud, and abuse in IRS programs, but also to propose solutions to IRS management that address the underlying causes of the problems.

ENDNOTES

1. Cost savings include funds put to better use and questioned costs. Funds put to better use are defined as funds that could be used more efficiently if management took actions to implement and complete a recommendation. Questioned costs are costs that are questioned because of an alleged violation of a provision of a law, regulation, contract, or other requirement governing the expenditure of funds; or a finding that, at the time of the audit, such cost was not supported by adequate documentation.

2. Revenue protection involves the proper denial of claims for refund, including recommendations that prevent erroneous refunds or efforts to defraud the tax system.

3. This calculation was based on the estimated savings for 1 year and the current Federal Funds Rate of 1.75 percent.

4. A John Doe summons is any summons that does not identify the person with respect to whose liability the summons is issued. A John Doe summons can only be issued after the approval by a Federal court.

5. A merchant summons is a summons served on the merchants involved in transactions with the credit cards identified via the John Doe summons.

STATEMENT OF HON. EVERETT L. MOSLEY, INSPECTOR GENERAL, U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Mr. Chairman, other committee members, and committee staff, thank you for the opportunity to provide my written testimony for the record.

This testimony is provided in response to your June 23, 2003, letter of invitation to me to testify before the committee or provide written testimony for the record. My testimony addresses the following:

1) My current estimate of the magnitude of waste, fraud, and abuse within the USAID's mandatory programs.

2) The general nature of these problems and how long they have persisted.

3) Illustrative examples of these problems.

4) What actions are being taken to eliminate or reduce these problems.

5) What additional actions, of either an administrative or legislative nature, are required.

USAID has two mandatory spending programs. They are 1) the Foreign Service retirement and disability fund, and (2) the credit subsidy under USAID's development credit authority.

The Department of State manages the Foreign Service Retirement System. As a consequence, the Department of State's Office of Inspector General is responsible for audits of the Foreign Service Retirement and Disability Fund. However, USAID's contributions to the fund are included in USAID's financial statements, which we audit as required under the Government Management and Reform Act of 1994 (GMRA). No issues have been noted regarding USAID's contributions to the fund during our audit of USAID's financial statements.

The credit subsidy under USAID's development credit authority is also included in USAID's financial statements, which are subject to an annual audit under the requirements of the GMRA. No issues have been reported regarding the subsidy during our audit of USAID's financial statements.

While there are no issues to report regarding USAID's mandatory programs, as verbally requested, I would like to provide some information on some of USAID's management challenges and the results of one of our more recent significant audits. A full discussion of USAID's management challenges can be found in our most recent semiannual report to the congress. Our semiannual reports and our audit reports can be found on our website at http://www.USAID.gov/oig/.

MANAGEMENT CHALLENGES

USAID still faces a number of major management challenges—which parallel the president's management agenda. These major management challenges are:

- financial management;
- information resource management;
- managing for results;
- procurement management;
- human capital management;

FINANCIAL MANAGEMENT

Although USAID has made considerable progress toward resolving the challenges with its financial management system in the past year, USAID still faces challenges in reconciling financial data, calculating and reporting accounts payable, recording and classifying advances and related expenses, and recognizing and reporting accounts receivable.

INFORMATION RESOURCE MANAGEMENT

OIG audits have identified significant weaknesses in USAID's management of information technology. The OIG reported that USAID processes for procuring and managing information resource technology have not followed the guidelines established by the Clinger-Cohen Act. Also, OIG audits have confirmed that, although USAID has taken steps to improve computer security, more work is needed to ensure sensitive data are not exposed to unacceptable risks of loss or destruction. In response to OIG audits, USAID has made substantial computer security improvements. The OIG will continue to monitor USAID's progress in improving computer security.

MANAGING FOR RESULTS

Federal laws, such as the government performance and results act of 1993 require Federal agencies to develop performance measurement and reporting systems that establish strategic and annual plans, set annual targets, track progress, and measure results. A significant element of USAID's performance management system is the annual reports prepared by each of USAID's operating units.

For fiscal year 2002, the OIG reported that the performance information included in the management discussion and analysis section of USAID's consolidated financial statements actually represented accomplishments from fiscal year 2001 instead of fiscal year 2002. The OIG has reported this system's deficiency many times in prior audit reports. Further, OIG audits conducted at selected audit units over the past few years have consistently identified deficiencies in the performance measurement systems of USAID operating units, deficiencies which call into question the reliability of performance data included in the units' annual reports.

PROCUREMENT MANAGEMENT

USAID's office of procurement has been the focus of various initiatives for defining ways to improve the effectiveness of USAID's acquisition and assistance process. These activities are in direct response to the long-standing challenges that the office of procurement has faced in the areas of procurement staffing, activity planning, and acquisition and assistance award administration.

HUMAN CAPITAL MANAGEMENT

The ability of USAID to carry out its mission in the 21st century will depend, in part, on how well it manages all segments of its diverse and widespread workforce. USAID has made efforts to improve its human capital management. However, OMB has expressed concerns about current and future critical skill gaps, slow progress in redirecting staff from supervisory positions to the hands-on activities, and staffing decisions made without programmatic justifications.

In the OIG's audit of human capital data, the OIG noted that the human capital data collected and maintained by USAID was neither complete nor totally accurate. The OIG made several recommendations to help improve the quality and completeness of the human capital data collected by USAID.

AUDIT OF CARGO PREFERENCE REIMBURSEMENTS UNDER SECTION 901D OF THE MERCHANT MARINE ACT OF 1936

The OIG's strategy is to help USAID address its major management challenges explained above. Some OIG audits directed toward USAID's major management challenges lead to recommendations with a significant financial impact. One such audit was the OIG's audit of cargo preference reimbursements under section 901d of the Merchant Marine Act of 1936.

During the cargo preference audit, the OIG found that in accordance with established laws, policies, and procedures governing administration of cargo preference reimbursements from the department of transportation to the department of agriculture, USDA could be entitled to as much as $289 million in additional reimbursements. Of that amount, up to $175 million could be made available to the two food aid programs administered by USAID. Furthermore, the OIG found that at least $7.2 million in USAID cargo preference reimbursements had been misallocated to a USDA program.

The OIG recommended that USAID seek $175 million in unclaimed reimbursements for excess ocean freight costs dating back to 1994, and further request correction of a $7.2 million misallocation of a 1995 cargo preference reimbursement from USDA to USAID. USAID management agreed with the recommendations and are working with OMB and other Federal agencies to recover the funds.

Thank you for this opportunity to submit written testimony concerning USAID's mandatory spending programs and management challenges. I will be happy to respond to any questions you may have.

PREPARED STATEMENT OF HON. RICHARD J. GRIFFIN, INSPECTOR GENERAL, U.S. DEPARTMENT OF VETERANS AFFAIRS

INTRODUCTION

Mr. Chairman and members of the committee, I am pleased to address the Office of Inspector General's (OIG's) efforts to identify and eliminate waste, fraud, and abuse in mandatory programs administered by the Department of Veterans Affairs (VA). We provide oversight that addresses mission-critical activities and programs in health care delivery, benefits processing, financial management systems, procurement practices, and information management. Our work is accomplished consistent with our strategic goals and aligned with the strategic goals of the Department.

I will present my observations, identify current efforts that are helping to raise fraud awareness in VA, and summarize some of our most significant work. I will also highlight management areas where I believe improvement can be made to reduce waste, prevent fraud, and improve administration of VA programs.

To provide continuing oversight of VA's operation, I established a Combined Assessment Program, (CAP), as part of my office's effort to ensure that high quality health care and timely benefits are provided to our Nation's veterans. CAP reviews combine the knowledge and skills of the OIG Offices of Audit, Investigations, and Healthcare Inspections to provide collaborative assessments of VA medical facilities and regional offices on a cyclic basis. The CAP assessments provide management independent and objective evaluations of key facility programs, activities, and controls.

During CAPs, we conduct fraud, and integrity awareness briefings to raise employee awareness of fraudulent activities that can occur in VA programs. CAPs continue to identify investigative leads, systemic weaknesses, and vulnerabilities in program areas and conditions that require management attention.

In March 1999, we issued our first CAP assessment and since that time we have completed almost 100 CAP reviews at VA healthcare systems, medical centers, and regional office facilities.

We also provide oversight by performing national program audits, preaward and postaward contract reviews, hotline reviews, healthcare inspections, and investigations. The results help identify where the Department needs to address major program challenges and improve the economy and effectiveness of its operations.

From fiscal year 1998 through March 31, 2003 we issued 872 reports, processed 2,008 hotline cases, and performed 7,073 investigations. We have made recommendations having the potential to save the Department approximately $1.5 billion by preventing waste, fraud, and other abuses in mandatory programs. My staff has detected major frauds impacting the delivery of benefits to veterans and their beneficiaries and investigated criminal activities perpetrated by employees and others that resulted in significant losses.

I will highlight the most significant of this work and address management areas where I believe further improvement is needed.

BENEFITS PROCESSING

I am pleased to note the success of the Department's ongoing efforts to reduce the pending claims backlog that once peaked at about 601,000. Today, the backlog of rating cases pending has been reduced to about 283,000. Over the last 5 years, we have made recommendations to VBA addressing many potential improvements and identified potential monetary savings in excess of $1.5 billion. In addition, investigations have led to the assessments of fines, restitution payments, and other recoveries through civil judgments totaling about $150 million.

Overall, I appreciate the responsiveness the Secretary and Under Secretary have shown to ensure the Department addresses OIG concerns. However, while VBA is making progress, there are still many opportunities for improvement to ensure the timely delivery of benefits and services to veterans.

OIG audits and investigations continue to find that improper benefit payments are a significant problem in the Department. Improper payments have been attributed to poor oversight, monitoring, and inadequate internal controls. Improper payments have also occurred because of payments to ineligible veteran beneficiaries, fraud, and other abuses. I believe the risk of improper payments is high considering the significant volume of transactions processed through VA systems, the complex criteria often used to compute veterans' benefits payments, and the numerous instances of improper and erroneous payments previously identified.

As a result of our work, I have seen improvement in the Department's efforts to ensure benefits are terminated or reduced upon incarceration of veterans.

INCARCERATED VETERANS

In July 1986, our office reported that veterans who were imprisoned in State and Federal penitentiaries were improperly receiving disability compensation benefits or needs based pension. This occurred because controls were not adequate to ensure benefits were terminated or reduced upon incarceration, as required by Public Law 96–385. As a result of our audit, Department managers agreed to implement certain measures to identify incarcerated veterans and reduce or terminate benefits as appropriate.

We conducted a follow-up evaluation in 1999 to determine if disability benefit payments to incarcerated veterans were appropriately adjusted, and other procedures agreed to in 1986 had been implemented. We found that Department officials had not implemented the agreed to control procedures and improper payments to prisoners had continued.

During the follow-up evaluation, we reviewed a sample of veterans incarcerated in State and Federal prisons and found that 72 percent of the cases were not adjusted as required. Based upon the number of beneficiaries that were incarcerated, we estimated that nationwide, about 13,700 incarcerated veterans had been, or would be overpaid by about $100 million. Additionally, overpayments to newly incarcerated veterans totaling about $70 million would occur over the next 4 years, if VBA did not establish appropriate controls.

Subsequently, VBA initiated positive actions to enter into agreements with the Federal Bureau of Prisons to identify claimants in Federal prisons and with the Social Security Administration (SSA) that allows VBA to use the State Verification and Exchange System to identify claimants incarcerated in State and local facilities. As a result of their actions, the Department is in a much better position today to reduce erroneous payments paid to incarcerated veterans and realize the projected savings.

I would also appreciate the opportunity to address our current work and provide some examples of where our work has identified large numbers and amounts of im-

proper payments and to address where we have identified fraud in the administration of VA benefit programs.

FUGITIVE FELON PROGRAM

In compliance with a recent law, I have established a fugitive felon program to identify VA benefits recipients and VA employees who are fugitives from justice. The program consists of conducting computerized matches between fugitive felon files of law enforcement organizations and VA benefit and personnel records. Once a veteran or employee is identified as a fugitive, information on the individual is provided to the law enforcement organization responsible for serving the warrant to assist in apprehension. Fugitive information is then provided to VA so that benefits may be suspended and to initiate recovery action for any overpayments. Based on our pilot study and matches conducted to date, I anticipate that between 1 and 2 percent of all fugitive felony warrants submitted will involve VA beneficiaries. Savings related to the identification of improper and erroneous payments are projected to exceed $209 million.

To date, a Memorandum of Understanding has been completed with the U.S. Marshals Service, the States of California and New York, and most recently, the National Crime Information Center. While we are still in the initial phases of setting up the program, our data matching efforts have identified more than 11,000 matches of potential fugitive beneficiaries and employees. Details of recent investigations of such fugitives follow.

• My agents along with State investigators arrested a fugitive beneficiary wanted on a parole violation warrant for aggravated kidnapping. Photographs were circulated and a briefing was given to the VA Regional Office (VARO) on the fugitive status of the veteran. We provided intelligence and assisted in field operations that resulted in terminating the fugitive's VA benefit. Several months later, the fugitive attempted to enter the VARO to inquire about the status of his benefits checks, however he was turned away by security due to the fact that he had a knife on his person. A member of the VARO recognized the fugitive from the pictures we had provided and immediately alerted my staff. OIG agents were able to take the fugitive into custody and subsequently turned him over to the State investigative agents.

• In another case, a fugitive sought by the FBI was arrested at his residence based on a Federal arrest warrant issued for unlawful flight to avoid prosecution. The veteran was wanted on a State warrant for manslaughter, assault, and reckless driving and had fled to avoid prosecution of the State case. Allegedly, the veteran killed a 10-year-old girl and injured her aunt because of his reckless driving. The Seattle VA Regional Office had previously suspended the veteran's benefits under the provisions of the fugitive felon project.

• In yet another instance, following due process, VA benefit payments going to a veteran wanted for armed robbery of a bank in Red Wing, MN, were suspended and later terminated. This action resulted in a $44,448 cost savings. In addition, during February 2003, the bank to which the veteran's funds were deposited was requested to return any available funds effective from the date the veteran became a fugitive felon. Accordingly, the veteran's bank sent VA a check for $8,975.90, the total amount of funds available in his account.

This program contributes to Homeland Security by apprehending fugitive felons, including some who are wanted for violent offenses in their communities.

DEATH MATCH PROJECT

In addition to the fugitive felon program, we are also conducting an ongoing proactive death match project. The OIG Death Match initiative is a continuous program that involves quarterly matching of the VA Compensation and Pension database with the SSA's records of death file. The purpose is to identify veterans who died, where VA is still erroneously paying benefits. Since we began this proactive initiative in fiscal year 2000, our data matching efforts have identified 8,754 possible cases. To date, we have closed 3,180 cases because the veteran was still alive or VA previously took corrective action. Of the 463 investigations completed to date, 76 individuals were arrested and $15.3 million is in the process of being recovered. Based on the results of the completed investigations, we project the remaining 5,111 cases may produce 855 arrests and $172 million in monetary benefits.

PHILIPPINES BENEFIT REVIEW

During 2002, the OIG and VA Regional Office Manila staff worked together on an international review to identify and eliminate erroneous benefit payments to payees supposedly residing in the Philippines. Over 1,100 interviews were conducted,

approximately 2,600 files were reviewed, nine criminal cases were initiated and one search warrant was obtained and executed. As of May 2002, awards of 594 beneficiaries were identified for suspension or termination. The overpayments for these 594 beneficiaries totaled approximately $2.5 million with a projected 5-year cost avoidance of over $21 million. Criminal investigations initiated during the Philippines review were turned over to the Philippines National Police. We also referred 94 beneficiaries to the VARO for review regarding a possible increase in benefits; appointment of a fiduciary; change of address; Prisoner of War Medal status; and various other benefits changes. From this review effort, several criminal investigations have been developed that will continue to be pursued during the next fiscal year. VA officials from the Manila Regional Office and VA's Financial Systems Quality Assurance Service were instrumental to the success of this review.

We are now looking at other areas outside the continental United States where large numbers of veterans or their dependents receive benefits. Presently, over 78,000 payees, outside the continental United States, receive approximately $49 million a month in benefit payments. For example, benefit payments of approximately $2.9 million are paid to approximately 5,100 veterans and their beneficiaries in Germany on a monthly basis. In addition, benefits valued at approximately $28 million are paid monthly to about 42,000 payees in Puerto Rico.

VA Regional Office Fraud Cases

ATLANTA VA REGIONAL OFFICE

An OIG investigation uncovered $11.2 million that had been fraudulently paid to a 30-year VA employee and her 11 co-conspirators representing the largest known embezzlement by a VA employee. Based on a phone call from an alert Naval Federal Credit Union employee, the OIG team's investigation determined that an employee of VA's Atlanta Regional Office devised a scheme whereby she used her position of trust and the VA computer system to resurrect the claims files of deceased veterans who had no known dependents. Once the files were reestablished, the employee generated large retroactive benefit payments and, in some cases, recurring monthly payments, to her co-conspirators. After the payments were deposited in private bank accounts, the co-conspirators shared the proceeds with the VA employee by giving her what amounted to approximately one-third of the money they had received.

The scheme started in July 1996, when the employee channeled funds to a retired career VA employee and a former VA employee. Between 1996 and August 2001, the trio stole over $6 million. As a result, the OIG team and the U.S. Attorney's Office decided to review all claims files touched by these individuals. We discovered a second conspiracy that showed the same VA employee, starting in 1993, embezzled approximately $5 million while working with close friends and eight co-conspirators. This scheme was devised whereby large lump sum payments and recurring monthly benefit payments were made to these individuals. Like the 1996 scheme, the VA employee received a share of the benefits when the checks were cashed. Over 100 bank accounts were analyzed to determine the disposition of the stolen money. The investigation generated 73 seizure warrants and 30 forfeiture recoveries.

The 12 co-conspirators pled guilty to various charges including theft of Government funds, conspiracy, and conspiracy to commit money laundering. The VA employee's guilty plea came after being indicted on 1,000 counts from the two conspiracies. In addition to defrauding VA, three of the co-conspirators also pled guilty to defrauding the SSA. The 12 defendants were sentenced to a total of 37.5 years' imprisonment, 35 years' probation, and judicially ordered to make restitution totaling over $34 million.

Property with an appraised value of almost $2.8 million was seized or forfeited. This included houses, airplanes, and such oddities as a mini submarine. In addition, numerous bank accounts, insurance policies, cash, jewelry, valuable collections (including a $40,000 Barbie doll collection), antiques, cars, boats, and motor homes were recovered from the individuals involved.

HOUSTON VA REGIONAL OFFICE

We also investigated a matter involving a Houston VA Regional Office employee who was found to have created a false veteran payee within VA data systems and, with the assistance of another VA employee, caused benefit payments to be disbursed to an address they controlled. In total, during a 3-year period, they stole over $229,700 from VA. Both employees were prosecuted and received prison sentences, 3 years' probation and were directed to make restitution totaling $459,572.

NASHVILLE VA REGIONAL OFFICE

In another instance, a VA Regional Office employee, assigned to the Nashville Regional Office as a veteran services representative, was prosecuted because of a scheme he devised wherein he obtained the medical information of another veteran from VA's computerized Automated Medical Information Exchange. He then altered the patient information to show it was referring to his medical condition, and forwarded the fraudulent documents to the VA Regional Office in Cleveland for inclusion in his own claims folder.

This action caused the VARO managing his records to re-evaluate the claim and upgrade his rating to a 100 percent disability. During the investigation, it was also determined that compensation granted the employee in 1988, based on his claim for suffering a gunshot wound, was based on fictitious information. The employee later resigned and prior to his prosecution, made restitution to VA amounting to $42,976. After pleading guilty to a Criminal Information charging him with aiding and abetting and wire fraud, the employee was sentenced to 6 months monitored home confinement and 24 months probation.

In another Nashville case, a veteran was prosecuted on charges of wire fraud relating to falsified records submitted to VA. The records included his DD Form 214, Certificate of Release or Discharge from Active Duty. The veteran essentially misrepresented himself to VA as a wounded prisoner of war. He further fabricated his military service by claiming to have received the Distinguished Service Cross, and Silver Star; and, a battlefield commission. During a major news network interview, the veteran claimed to be a surviving member of an Army group and claimed he was ordered to fire on Korean civilians at No Gun Ri during the Korean War.

Investigators proved he was not present and his account, therefore, was false. The veteran's false claims enabled him to wrongfully receive the Purple Heart and collect disability compensation and medical care benefits from VA for 16 years. The veteran was sentenced to 21 months imprisonment, 36 months supervised release and ordered to pay restitution to VA totaling $412,839.

In other benefit fraud cases, two VBA claims examination employees, at separate VBA Regional Offices, each embezzled over $600,000 in unrelated schemes.

NEW YORK VA REGIONAL OFFICE

In the first instance, a man was arrested in New Jersey on drug possession charges in April 1998. The arresting officers found a fictitious identification card on his person and records relating to a savings account in the name shown on the identification card. Our joint investigation led to the discovery that fraudulent VA disability compensation benefits were paid into the savings account monthly since August 1986. At the time the fraud was discovered, the payments were made at the rate of $5,011 monthly, the maximum VA compensation rate at that time.

The arrested man turned out to be a former VA employee who had worked as a disability rating specialist at VA's New York Regional Office from January 1986 to May 1987. The former employee was ultimately convicted of having fraudulently received VA compensation benefits to which he was not entitled. The scheme was perpetrated using another person's Social Security Number (SSN). The name and date of birth used were not those of the person whose SSN was used. The monthly fraudulent payments continued to be processed for 12 years, totaling over $620,000.

ST. PETERSBURG VA REGIONAL OFFICE

In this case, a supervisor at VA Regional Office St. Petersburg, FL, stole $615,451 by creating a fraudulent disability compensation award in the name of her fiance, a veteran who had served in the Persian Gulf War. The fraud began in March 1997 and continued until the employee's arrest in January 1999. The perpetrator used VBA's computer system on 10 occasions between March and October 1997, to retroactively increase the fraudulent payments she was sending to their bank account. These actions generated a series of one-time payments totaling about $520,000, and incrementally increased the recurring benefit payments to $5,011 monthly. At the time of her arrest, the perpetrator was a Veterans service center section chief, a mid-level managerial position.

After learning of these thefts, the Under Secretary for benefits requested that my office review internal controls in the compensation and pension (C&P) program to determine what vulnerabilities existed that might have facilitated these crimes. I provided a vulnerability assessment, reporting on 18 observed vulnerabilities in six general internal control categories. We also began our CAP review initiative to assess the scope and breadth of current vulnerabilities at VA's regional offices.

DEPARTMENT WIDE REVIEW OF LARGE ONE-TIME PAYMENTS

In order to ensure the integrity of the benefits delivery system, the Secretary of Veterans Affairs requested the OIG conduct a department-wide review of large C&P one-time payments. We began a project examining all one-time payments of $25,000 or more made by the VBA, as well as a review of active awards that were considered vulnerable to fraud. One additional case of employee fraud was found in our review of 58,129 one-time payments. The OIG team was able to conclude that payments were valid for 99.8 percent of the cases reviewed, with the balance of cases being associated with the Atlanta Regional Office matter.

Although the benefits delivery system and claims processing in general were free of any similar one-time pay fraud situations, we did find unacceptably high rates of non-compliance with internal control requirements related to the processing of one-time payment claims. As a result, VBA began requiring that regional office management review all large one-time payments to ensure that they were appropriate and that required reviews were performed. In addition, we recommended that security deficiencies discovered in the claims processing system be corrected, and that regional office managers certify annually that their claims processing security is in compliance with required controls.

INCOME VERIFICATION MATCH

One of most significant and successful data matching initiatives was our November 2000 audit of VBA's Income Verification Match. We identified opportunities for VBA to:

- Significantly increase the efficiency, effectiveness, and amount of potential overpayments that are recovered.
- Better ensure program integrity and identification of program fraud.
- Improve delivery of services to beneficiaries.

We found that VA's beneficiary income verification process with the Internal Revenue Service resulted in a large number of unresolved cases. We estimated the monetary impact of these potentially erroneous payments totaled $806 million. Of this amount, we estimated potential overpayments of $773 million were associated with benefit claims that contained fraud indicators such as fictitious Social Security numbers or other inaccurate key data elements. The remaining $33 million was related to inappropriate waiver decisions, failure to establish accounts receivable, and other process inefficiencies. We also estimated that $300 million in beneficiary overpayments involving potential fraud had not been referred to the OIG for investigation. While VA addressed most of the recommendations in our report, the recommendation to complete necessary data validation of beneficiary identifier information contained in compensation and pension master records to reduce the number of unmatched records with the SSA remains unimplemented.

While the Department did not agree with our monetary impact, they did agree to report the Income Verification Match Program as an internal high priority weakness. We did not accept the Department's rationale for reducing the monetary impact, since our estimate was based on a statistical sampling methodology that reflected a conservative estimate of the dollar impact of overpayments that have occurred.

WORKER'S COMPENSATION BENEFITS

We also audited VA's Federal Employee Compensation Act Program in July 1998 and concluded the program was not effectively managed and that by returning current claimants to work who are no longer disabled, VA could reduce future payments by $247 million. The audit found that the lack of effective case management practices placed the Department at risk for program abuse, fraud, and unnecessary costs.

In April 1999, in response to requests for assistance by the Department, we provided the Department with a handbook for VA Facility Workers Compensation Program Case Management and Fraud Detection. As a result, Office of Workers Compensation Program costs had decreased by 1.6 percent to about $130 million by the end of fiscal year 1999. However, since that time costs have increased to approximately $151 million in 2002. We are currently performing a follow-up audit to our 1998 audit. Our preliminary results indicate VA continues to be at risk for program abuse, fraud, and unnecessary costs because prior OIG program recommendations have not been fully implemented.

FINANCIAL MANAGEMENT SYSTEMS

Over the last 5 years, OIG has made recommendations addressing improvements needed in Financial Management activities and identified the potential for monetary savings totaling about $600 million. Since fiscal year 1999, VA has achieved unqualified Consolidated Financial Statement (CFS) audit opinions. However, continuing material weaknesses, such as information technology security controls and noncompliance with Federal financial management system requirements have been identified. Corrective action needed to address noncompliance with financial system requirements is expected to take several years to complete.

The material weakness concerning the Department's financial management systems underscores the importance of acquiring and implementing a replacement integrated core financial management system. Achieving the success of an unqualified CFS opinion currently requires a number of manual compilations and extraneous processes that the financial management system should perform. These processes require extraordinary administrative efforts by the program, financial management, and audit staffs. As a result, the risk of materially misstating financial information is high. Efforts are needed to ensure adequate accountability, and reliable, useful, and timely information needs to be available to help Department officials make well informed decisions and judgments.

I will now highlight some additional concerns focusing on debt management activities in the Department.

DEBT MANAGEMENT ISSUES

As of December 2002, debts owed to VA totaled over $3 billion, of which active vendee loans comprise about 52 percent. Debts owed to VA result from the payment of home loan guaranties; direct home loans; life insurance loans; medical care cost fund receivables; and compensation, pension, and educational benefits overpayments. Over the last 4 years, my office has issued reports addressing many facets of the Department's debt management activities. We reported that the Department should: (i) be more aggressive in collecting debts; (ii) improve debt avoidance practices; (iii) streamline and enhance credit management and debt establishment procedures; and (iv) improve the quality and uniformity of debt waiver decisions. While VA has addressed many of the concerns we reported over the last few years, our most recent audits continue to identify areas where debt management activities could be improved and OIG report recommendations have not been adequately addressed.

MEDICAL CARE COLLECTION FUND

During fiscal year 2002, we conducted an audit of VA's Medical Care Collection Fund (MCCF) activities that resulted in identifying opportunities to maximize the recovery of funds due VA for the provision of health care services. We reported there were potential opportunities for VA to enhance its collection efforts. Recovered funds are used to supplement the Department medical care budget and from fiscal years 1997 through 2001 MCCF collections have total $3 billion.

As of September 2001, VA reported a $1 billion backlog of unbilled care. We estimated that eliminating this backlog could result in additional collections of about $368 million.

Our audits continue to identify additional opportunities for improvements that can ensure the accuracy of medical record documentation and coding and more aggressively pursue accounts receivable collections. We also reported that insurance companies were not always billed in patient discharges sampled because the attending physician's participation was not documented in the patient medical record. Missed billing opportunities were estimated to total $13.1 million nationwide. Improvements can result in additional collections of about $4.6 million, based on projections that 35 percent of these billings are paid.

In our MCCF audit, we also noted that VA's average number of days to bill for these services took about 95 days. Private sector hospitals generally bill within 10 days of care. VA continues to be at risk of losing revenues by under billing and not ensuring more timely billing efforts for services.

Our 2002 Healthcare Inspections review found incorrect Current Procedural Terminology codes in 50 percent of the outpatient records sampled. Thus, we are continuing to evaluate the accuracy of medical record documentation and coding during our CAP reviews with emphasis on reviewing the quality of documentation and aspects of residency supervision to ensure the proper coding of services performed.

I strongly support follow-up of unpaid bills and appeal of denied insurance claims to increase future collection results in the Department. We have recommended that

the Department continue to aggressively pursue improvements in these activities. Promoting results oriented accountability over the MCCF Program will improve debt management in the Department.

ADDITIONAL BENEFITS OF COMPUTER MATCHING EFFORTS CAN BE ACHIEVED WITH LEGISLATIVE REFORM

Data sharing has been an important and successful tool for identifying improper payments, as well as fraud, waste, and abuse. Verifying that the right person is getting the right benefit at the right time is a priority management objective. Computer data matching gives us the ability to verify program participant information and thereby detect improper payments sooner or perhaps even prevent them before they start. We find computer matching initiatives cost effective because this type of work saves a significant amount of labor.

Unfortunately, under current regulations, we are not realizing the timesaving features that computers offer. There is a huge untapped potential for saving the Federal Government a significant amount of erroneous and improper payments in a timely manner through data matching. However, current regulations are overly cumbersome and time consuming.

Currently, under the Privacy Act, an initial computer matching agreement between two agencies may remain in effect for 18 months. Extensions must be negotiated for an additional 12 months. After this 12-month extension, agencies must then renegotiate a whole new agreement. Renegotiations are time consuming and unnecessarily increase workload demands on the agency. Furthermore, renegotiations do not always add any additional value to data sharing between agencies. For example, VA matches with the Social Security Administration wage data is an integral part of our efforts to review veterans eligibility for pension benefits. This match should be accomplished annually.

There are other restrictions that keep us from realizing the full benefits of computer matching to identify fraud, waste, and abuse. For example, the cumbersome and time consuming process under the Computer Matching and Privacy Protection Act of 1988 (P. L. 100–503), does not apply when matching records from the Department's system of records. However, P.L. 100–503 prevents the matching of Federal personnel records when there is the possibility that the match results will subject the Federal employee to adverse financial, personnel, disciplinary or other adverse actions. In other words, the law prevents us from timely stopping Federal employees from defrauding the Federal Government.

Here are some changes I believe would be beneficial:

- Lengthen the time periods that computer matching agreements can remain in effect.
- Amend the Computer Matching and Privacy Protection Act of 1988's exclusionary clause to include Federal personnel records when making internal matches using only records from the Department's system of records.
- Develop a process to streamline the development and implementation of a computer matching program. Actions can include consolidating notice requirements and reevaluating the need to submit approved matches to Congress as well as OMB. Currently, we must provide record subjects with prior notice by direct notice, constructive notice, and a periodic notice.

OTHER LEGISLATIVE REFORM OPPORTUNITIES

Acquiring routine access to Social Security wage and employment data is also critical to ensuring effective oversight and administration of VA benefits such as eligibility for monthly compensation and pension payments, verification of income for home loan guarantees, eligibility for medical care (without copayment) and matching efforts to VA's payroll files for protection against employee fraud. We need to initiate actions that will improve VA's ability to review applicants' eligibility for benefits and enhance our efforts to detect and prevent fraud.

For example, gaining timely access to Social Security wage data would be indispensable to efficient oversight of the Workers' Compensation Program. Investigation of workers compensation cases is very timely and resource intensive, frequently requiring lengthy surveillance to develop a fraud case. Access to the employment and earnings information held by IRS would also improve the effectiveness of our audits and investigations and ultimately free up audit and investigative resources for other high priority matters.

Many overpayments are caused by the inability of VA Regional Offices to act on information provided by VA employees or other Government entities. All entities other than the beneficiary or fiduciary are considered third party for purposes of verified information. As a result, while it is important to protect the interests of

beneficiaries, the designation of benefit delivering Government entities as third parties creates backlogs in VA's claims processing activities and benefit overpayments. VA policy should be revised to include all VA entities in the definition of first party. This would expedite the due process notification requirement; and reduce overpayments and other unnecessary claims processing work.

This completes my written testimony on waste, fraud, and abuse in mandatory programs of the Department of Veterans Affairs. I would be pleased to provide information on other activities and findings and to answer any questions the committee may have.

STATEMENTS OF HON. PHYLLIS K. FONG, INSPECTOR GENERAL, DEPARTMENT OF AGRICULTURE; HON. JOHN P. HIGGINS, JR., INSPECTOR GENERAL, DEPARTMENT OF EDUCATION; DARA CORRIGAN, ACTING PRINCIPAL DEPUTY INSPECTOR GENERAL, DEPARTMENT OF HEALTH AND HUMAN SERVICES; AND HON. KENNETH M. MEAD, INSPECTOR GENERAL, DEPARTMENT OF TRANSPORTATION

Chairman NUSSLE. First I would like to turn to Phyllis Fong, from the Department of Agriculture. Welcome. And we invite you to begin your testimony, and your written testimony will be made part of the record at this point.

STATEMENT OF PHYLLIS K. FONG

Ms. FONG. Thank you, Mr. Chairman and members of the committee. I am pleased to be here today to testify about USDA's mandatory spending programs. I will focus on those programs that comprise a significant portion of USDA's program levels and that contain identified management challenges for the Department.

As you know, mandatory programs within the Department comprise about $67 billion of the over $70 billion portfolio. The programs I will focus on today include the major food assistance programs—food stamps, school lunch and school breakfast—the farm programs, and the crop insurance programs.

Over the past 7 years, IG audits and investigations in these areas have identified over $751 million in questioned costs, $466 million in potential program savings, and $497 million in investigative results. So we have done quite a bit of work in these areas.

First of all, I would like to turn to the Food Stamp Program. As you know, that program is the Nation's principal nutrition assistance program, which FNS, the Food and Nutrition Service, administers in cooperation with State agencies. Food stamp benefits are provided via paper coupons and EBT cards which can be redeemed at authorized retailers.

In the area of retailer abuse, we have found that fraud in the program generally occurs when individuals sell their benefits for cash, in violation of the intent of the program as well as the law. This practice, which is known as trafficking, diverts food stamps away from their intended purpose. Curbing the incidence of trafficking by retailers and individuals remains an area of significant concern. The FNS has issued an estimate in fiscal year 2000, that disclosed that stores trafficked over $650 million each year for a 3-year period from 1996–98. This amounts to approximately 3½ cents of every food stamp dollar that has been issued.

The advent of EBT has not prevented fraud in the program. Rather, what we have seen is that fraud continues to exist, but the method of trafficking has moved from the streets to the stores. As

a result, our investigations are now focusing almost solely on the retailers, because they are the only ones who can redeem food benefits for cash from the government, using coupons or the EBT cards.

We have made a number of recommendations to the Department on this, and FNS has increased its onsite monitoring of retailers. And our belief is, they appear to be identifying and addressing problem retailers through that process.

Another area of concern for us is the area of improper payments. Eligibility for the Food Stamp Program is generally based on an applicant's household income and other resources, and certain deductions are allowed from a household's gross income similar to a tax computation.

FNS has undertaken to measure the accuracy of its payments using a statistical sampling system. And what they have found is that between fiscal years 1993–2001, the national error rates have fluctuated between 10.81 percent and 8.66 percent. These rates include both underpayments and overpayments to individuals. For fiscal year 2001, which is the most recent data, total erroneous payments were about $1.3 billion out of a total of $15.5 billion in issuances.

Recently Congress has taken some action to address this. The Food Stamp Reauthorization Act of 2002 contains provisions to simplify the definitions of income, deductions, allowances and other kinds of costs. Those provisions became effective in October of 2002, and FNS plans to issue implementing regulations soon.

While one would expect those provisions to result in fewer certification errors and therefore fewer improper payments, the determining factor will be how well FNS and the States actually implement the provisions of the new act and then make any adjustments based on their quality control process. We anticipate that we should be able to evaluate the results of that in the 2004–05 time frame.

Next I will to the national school lunch and school breakfast programs. Under these programs, FNS can reimburse schools for all meals served that meet program requirements, and meals that are served free or at a reduced price receive an additional reimbursement from the Federal Government. Eligibility for these meals is based on household income, and school food authorities are required to sample applications to verify the reported income of recipients.

The Department has acknowledged that eligibility determination and verification in those programs is a significant management challenge that must be addressed. The recent U.S. Census shows 27 percent more students are certified for free or reduced price meals than the census data itself would suggest are eligible. We have done a number of audits in this area, sampling specific jurisdictions, and we have also found that there are significant error rates, ranging from 19 percent in Illinois to about 69.5 percent in New York City.

As a result of this, FNS is exploring several options, and they have several pilot programs in place to address this problem.

I would now like to turn to the crop insurance and farm programs of the Department. These programs are closely related and

they use the same basic data to compute program benefits. Such data include acreage, crop location, production and shares, all of which are generally self-certified by program participants.

Insurance companies for the crop insurance program and FSA for the farm programs, however, collect this data separately. They collect it from producers and they collect it in different formats. Because there are fundamental differences in how these two different entities collect data and in the definitions of their data, there is sometimes the appearance that there are significant discrepancies in the data.

Congress took action with the Agricultural Risk Protection Act of 2000 to require these two entities within USDA to annually reconcile their data, and to address apparent discrepancies. The reason why this is significant is that if there are discrepancies in the data, it permits erroneous payments or improper payments to be made.

The act also requires RMA to use data warehousing and data mining technologies to identify anomalies in these programs and the potential for fraud. We have reviewed the 2001 crop year data reconciliation process. We found that FSA was able to resolve about half of the data records that were not matched between the two entities. We believe significant action remains to be done. And until this happens, it is our belief that neither entity within USDA will be able to reduce its improper payment rate.

In sum, in each of those mandatory programs that I have discussed, much has been done by USDA and the Congress to address some of the inherent weaknesses within USDA's programs. Overall I see the key to future improvement in this area as lying in the Department's response to implementing the 2002 Improper Payments Information Act which Congress enacted last year. This will be a critical action item for the Department.

In many of our programs, the Department has not yet done a full analysis as to the extent of improper, erroneous payments, and so it is very difficult for us to get a handle on it and to take appropriate corrective action.

There must be management commitment, inter- and intra-agency coordination, adequate information systems, and quality control processes and effective enforcement action for the Department to continue to move forward in these areas. We in the IG's office are committed to working with the Department and the Congress to address these areas, and we would be happy to address any questions that you may have.

Chairman NUSSLE. Thank you very much for your testimony.

[The prepared statement of Ms. Fong follows:]

PREPARED STATEMENT OF HON. PHYLLIS K. FONG, INSPECTOR GENERAL, U.S. DEPARTMENT OF AGRICULTURE

Thank you, Mr. Chairman and members of the committee. I am pleased to be here to provide testimony about the Office of Inspector General's (OIG) perspective on fraud, waste, and abuse in mandatory programs administered by the U.S. Department of Agriculture (USDA).

BACKGROUND

USDA's Office of Inspector General has over 40 years of service within the Department and as such has a long history of identifying fraud, waste, and abuse in

USDA's programs. Although our tools and techniques have changed over the years, our purpose remains the same: to perform audits and investigations of the Department's more than 300 programs and operations, recommend policies and actions to promote economy and efficiency, and prevent and detect fraud, waste, and abuse in these programs and operations. We have been actively involved in auditing and investigating the major USDA mandatory programs: food assistance programs and farm programs (including conservation) and crop insurance programs. We take as our motto and our purpose, "Ensuring the integrity of American Agriculture." In 40 years, we have seen many changes in the Department's programs, just as we have seen many changes in the nature of the schemes and devices we encounter, and the program abuse and mismanagement we find.

IMPROPER PAYMENTS

Allow me to say from the outset that while OIG has a long history in identifying fraud, waste, and abuse in USDA programs, quantifying the extent of these offenses is extremely difficult. In the case of fraud in particular, people do not commit it with the idea that it will be discovered. Consequently, a reliable estimate is difficult to obtain. Both Congress and the administration recognize the importance of reducing waste in Government programs. As you know, one of the initiatives of the President's Management Agenda is to reduce erroneous (improper) payments. An erroneous payment is any payment that should not have been made, or that was made in an incorrect amount, to an ineligible recipient, or for an ineligible service. The 2002 Improper Payments Information Act now requires agencies to identify programs vulnerable to improper payments, estimate the extent of these erroneous payments, and develop a plan to prevent such errors. This new requirement will be a significant management challenge to Federal agencies, including USDA. Successful implementation will require a strong internal control structure, to include management commitment and the necessary resources, quality control processes, and information systems to prevent, detect, and measure the extent of erroneous payments. Ultimately, the goal will be to design internal control systems to detect and prevent improper payments before they "go out the door."

Within USDA, the only agency that currently has a statistically based quality control program in place to measure the extent of improper payments is the Food and Nutrition Service (FNS). This program measures both over- and under-payments of Food Stamp Program benefits by State administering agencies, albeit "after the fact." A key component of FNS' program is to provide a system of incentives and penalties to encourage State administering agencies to lower their error rates and ensure that eligible individuals receive the proper amount of program benefits. OIG recognizes the importance of preventing improper payments and has recently initiated a review to assess the progress of select agencies in implementing this new mandated requirement.

Over the past several years, OIG has been requested to identify the top management challenges facing the Department. Among other things, we considered OIG's experience in finding fraud, waste, and abuse in the program and the nature of the program that might make it vulnerable to fraud, waste or abuse. USDA has about 70 mandatory spending programs (see Exhibit A). For fiscal year 2003, these mandatory programs amounted to approximately $67.8 billion, or 64 percent of the USDA's total estimated program dollar level. Today, we will focus our testimony on those programs that comprise a significant portion of USDA's program levels, in both dollars and participants, and that contain OIG-identified management challenges for USDA. The programs I will address are the major food assistance programs (Food Stamp and National School Lunch and Breakfast Programs); farm programs (including conservation); and crop insurance programs. Between fiscal years 1996 and 2002, OIG conducted 509 audits and 3,492 investigations in these programs; our audits identified about $751 million in questioned costs and $466 million in potential program savings in these programs, and our investigations resulted in over $497 million in monetary results.

FOOD ASSISTANCE PROGRAMS

FNS administers the food assistance programs of USDA. These programs include the Food Stamp Program, the National School Lunch and School Breakfast Programs, among others. The program goals are to provide access to a more nutritious diet for people with low incomes, to encourage better eating habits among the Nation's children, and to stabilize farm prices by distributing surplus foods.

FOOD STAMP PROGRAM

The Food Stamp Program is the Nation's principal nutrition assistance program. FNS administers the program in cooperation with State agencies. Households apply for benefits at State or local welfare offices. Those offices certify the households' eligibility to participate and issue the benefits. Eligibility is generally based on the household's level of income and other resources of the applicant, including bank accounts and real estate. In fiscal year 2002 just over $18 billion in food stamps was issued to an average 8.2 million households. FNS funds the entire cost of program benefits and shares in the State agencies' administrative costs. The program provides monthly program allotments to households in the form of paper coupons or in the form of electronic benefits transfer (EBT) systems cards, which function much like bank debit cards. Food stamp benefits provided via coupons and EBT cards can be redeemed at authorized retailers. FNS began pilot implementation of EBT to provide food stamp benefits in 1984. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (welfare reform) mandated all States to implement EBT for food stamps by October 2002. As of July 2003, FNS reported 52 of 53 State Agencies have operational systems with 48 being operational State- or district-wide. FNS now estimates that about 91 percent of participating households receive food stamp benefits through EBT systems, which is about 91 percent of the total issuances.

Retailers apply to FNS for authorization to accept food stamps at their establishments, including supermarkets, corner grocery stores, convenience stores, and farmers' markets. To qualify for authorization, a retailer must stock an ample variety of staple foods including breads, dairy products, fruits and vegetables, and meats.

RETAILER ABUSES

Fraud and abuse in the Food Stamp Program generally occurs when individuals sell their benefits for cash in violation of the intent of the program as well as the law. This practice, known as trafficking, diverts food stamps away from their purpose. Curbing the incidence of trafficking by retailers and individuals remains an area of significant mutual concern for FNS and OIG. FNS' latest estimate for trafficking was published in March 2000 (FNS is planning to issue a revised estimate this summer). The report used data from FNS investigations of authorized retailers and disclosed that stores trafficked over $650 million each year during the period 1996–98. This amounted to 3½ cents of every food stamp dollar issued. The advent of EBT has not prevented fraud from occurring; the scheme of trafficking has not changed yet the method has. Specifically, trafficking of food stamp benefits has moved from the street to the stores. Our investigations now focus almost solely on the retailers because they are the only ones who can redeem food benefits for cash from the government using paper coupons or households' EBT cards. EBT systems do, however, provide an electronic record of transactions and make it easier to identify stores that may be trafficking. The systems also identify the households whose benefits were trafficked, something that was not possible under the coupon system.

Since the FNS-authorized retailer is the key to redemption of program benefits, OIG has been concerned about the legitimacy and eligibility of these authorized retailers. We have testified in the past about our work in this area and the need for agency on-site reviews to determine if a retailer should be authorized or remain eligible for reauthorization. In 1995, we performed a review of retailer eligibility entitled "Food Stamp Program, Store Eligibility Task Force." At that time, we visited over 5,000 authorized retailers and identified over 850 stores that were obviously not eligible to participate and another 450 stores whose eligibility was questionable. These stores had minimal or no staple foods, were out of business, or did not exist. FNS had not routinely conducted onsite preauthorization visits and had accepted the information provided on the store's application without verification. While FNS could require stores to be periodically reauthorized, site visits were not a requirement of the reauthorization process. We recommended that routine onsite visits be incorporated into both the application and reauthorization processes. In response to OIG's concerns, FNS contracted with outside vendors to make the visits and provide FNS with specific information to be used in the authorization and reauthorization process. The contractors were required to complete a checklist of food inventory and take representative photographs of each retailer's operation. We have reviewed this system and concluded that it is working. At the time of our initial review of retailer eligibility in 1995, there were about 208,000 authorized retailers. At the end of fiscal year 2002, with increased onsite monitoring resulting in better information and more critical assessments, that number has now been reduced to 146,000. This being said, our ongoing investigations indicate FNS must remain vigilant in identifying and addressing problem retailers.

As previously mentioned, EBT systems provide an electronic record of individual transactions. Because FNS has a reliable quality control system in place to detect erroneous payments due to errors in determining recipient eligibility, OIG audits over the past 5 years have been directed to evaluating State and EBT processor controls to ensure that EBT systems can accurately and reliably issue, account for, and report Food Stamp Program data. Our audits have shown that these EBT systems are working. Analyses of EBT data have proven invaluable in targeting retailers whose activities are questionable. With the majority of food stamp benefits now being issued through EBT systems, the focus needs to remain on using this data to better target problem retailers and refining analyses as problem retailers change their techniques to avoid detection.

In fact, we focus our investigative efforts on retailer trafficking in an attempt to stem both the retailer's illegal gains and the recipient's illegal use of food stamp benefits. For the period fiscal years 1996–2002, we have conducted 2,540 food stamp related investigations. Of the investigations, 2,238 were retailer related, and of those, 491 involved trafficking with EBT benefits. Our food stamp related investigations for the past 7 years have resulted in 2,969 indictments, 2,740 convictions, and over $264 million in monetary results.

One example of our investigative work involved a joint investigation with the Internal Revenue Service of four food stores owned by family members in the Fort Worth, TX area. We found that from the period December 1996 through April 1999, the defendants' efforts in a food stamp trafficking scheme resulted in government losses exceeding $1.3 million. Part of the scheme involved trafficking food stamps through one authorized retail store via manual transaction over the telephone of another store. The owner of one store would call the owner of a second store and provide him with an EBT card number and associated PIN. The owner at the second location would enter the information into the point of sale (POS) device to complete the transaction. POS devices are terminals used to transact EBT benefits. Through our efforts five family members and several other store employees were convicted and received sentences ranging from 8 to 46 months in prison. They were charged with violations of food stamp EBT trafficking and conspiracy. These individuals were also ordered to pay over $1.3 million in restitution for the Government's losses.

We have recently identified a fraudulent scheme that while rare, appears to be growing in the Food Stamp Program. We noticed that authorized retailers are moving their POS devices to an unauthorized location, such as an unauthorized store or apartment, for trafficking purposes. We learned through investigation that unauthorized stores take possession of EBT POS devices, which are then used to conduct fraudulent transactions. Additionally, we found that stores work in concert with other unauthorized stores to further the scheme. We have met with FNS on this issue, and are working together to consider ways to prevent this activity from occurring. Factors such as cost, however, have been identified as potential impediments to some solutions.

The nature of the Food Stamp Program and the large amount of money that it provides to recipients creates the potential for laundered monies to be transferred overseas, where it is not always possible to track how the funds are used. We have noticed trends in our food stamp trafficking investigations where such activity occurs. In fact, the elements of money laundering and overseas transfers led to our participation in the Federal Joint Terrorism Task Force (JTTF) and Operation Green Quest, which is a national project to target money transfer businesses sending funds overseas to terrorist groups.

In one such investigation we uncovered a network of grocery stores, a wholesale distributing company and a video store, all owned by the same individuals that purchased food stamps and other program benefits for cash. The primary source of the trafficking occurred at the video store, which was located a few storefronts away from a food stamp issuance center. The video store would receive cash from one of the grocery stores, owned by the defendants, and use it to purchase food stamps and other program benefits. The video store would then provide the illegally obtained food stamps and other program benefits to the grocery store, which in turn redeemed the stamps or provided them to another authorized grocery store for redemption. Due to the large volume of food stamps and other program benefits, which needed to be redeemed, many authorized grocery stores were involved in the network, so that the fraud would go undetected. Through this investigation we discovered that approximately $1 million was transferred overseas. Two of the owners who pled guilty to food stamp fraud have fled the country and remain in a fugitive status. Additionally, the courts have entered a judgment against the store owners in an amount exceeding $71 million.

We currently have active investigations with most of the 44 local JTTFs, and have an OIG representative serving on the National JTTF.

FNS has the ability to take administrative action against authorized retailers using its own analysis of EBT data. FNS may also conduct retailer compliance investigations and take administrative action against retailers who violate the food stamp regulations. Such administrative actions include temporarily or permanently disqualifying retailers and their owners from participating in the program. In those instances when an FNS compliance investigation uncovers a retailer trafficking in food stamps, FNS promptly notifies OIG concerning the potential for a criminal investigation. Since fiscal year 1996, OIG has opened 1,159 food stamp trafficking investigations based on FNS referrals.

An excellent example of an OIG investigation based on an FNS Compliance referral involves a matter in Philadelphia. Through a joint investigation with FNS Compliance and the U.S. Secret Service, we found that over an 18-month period, the two owners of an authorized store fraudulently redeemed $1.3 million in food stamp EBT benefits. Both owners were convicted of fraud. One was sentenced to 9 months incarceration, 3 years probation, and ordered to pay $1.3 million in restitution. The other was sentenced to 6 months home detention, 5 years probation, and ordered to pay $1.3 million in restitution. Additionally, one of the owners agreed to cooperate and testify against the food stamp recipients who sold him their food stamp benefits. Thus far, the owner has identified about 3,000 recipients; over 2,000 of them have been notified that they will be removed from the food stamp rolls. The State of Pennsylvania has also indicted over 120 recipients in this matter.

IMPROPER PAYMENTS

Eligibility for the Food Stamp Program is generally based on household income and other resources of the applicant, including bank accounts and real estate. Certain deductions are allowed from a household's gross income including dependent care, shelter, medical, and child support payments. Applicants must provide proof of income to become eligible to participate. Since 1974, FNS has measured payment accuracy using a statistical sampling system called the Quality Control (QC) system. Each State conducts monthly reviews of a statistical sample of households to measure payment accuracy (overpayments and underpayments) and the correctness of decisions to deny benefits. Between fiscal years 1993 and 2001, the national annual error rates have fluctuated between 10.81 percent and 8.66 percent, which include both over- and underpayments. For fiscal year 2001, the total erroneous payments were about $1.3 billion, with about $1 billion in over-issuances and about $340 million in underissuances. Total issuances for fiscal year 2001 were about $15.5 billion. OIG considers the significance of these errors to be material to the Food Stamp Program.

FNS' analyses of the error rates for fiscal year 2000 (the latest year published) shows that 54 percent of the dollar errors were attributed to the certifying agency, while about 46 percent were attributed to the households. The single biggest factor is determining or reporting income, which makes up almost 52 percent of the errors. This is followed by deductions from the household's gross income, which makes up about 28 percent of the errors.

Our investigations have found that some recipients deliberately misrepresent their financial status, household income and composition, to obtain program benefits. Through this misreporting of information, individuals are certified as qualifying for food stamp benefits when, in fact, they do not. In a recent investigation worked jointly with the FBI, Immigration and Naturalization Service, Secret Service, Bureau of Alcohol, Tobacco, and Firearms, and two other Federal OIG offices, we found that an individual's personal finances and assets were inconsistent with those claimed on his food stamp and welfare applications. The investigation revealed that the individual provided false information in order to obtain credit cards, Social Security numbers, and alien registration documents. The individual was found guilty on several counts, including unlawful acquisition of food stamp benefits. He was sentenced to 30 months in prison and ordered to pay restitution in the amount of $41,805.

We note that the Food Stamp Reauthorization Act of 2002 contains provisions to simplify the definitions of income, utility allowances, housing costs, resources, and determining deductions. These provisions of the act became effective October 1, 2002 and FNS plans to publish regulations to implement the act as soon as possible. While one would expect these provisions to result in fewer certification errors, the determining factor will be how well FNS and the States implement the provisions and then make any adjustments based on QC results. The QC results will not be available until fiscal year 2004 data are tested.

At the time of OIG's audit in 1997, entitled "Reinvestment of Food Stamp Penalties," it was thought that the high error rates were attributable to large increases

in participation without a corresponding increase in State certification personnel. However, between 1995 and 2001 there was a significant decline in the number of participating households and a 34 percent decrease in program outlays. Yet the error rate for the same period only declined by 11 percent, which indicates that error rates are not directly linked to participation levels.

Reducing the error rate, and thus the corresponding program losses, needs to remain an area of focus for FNS. This emphasis is supported by the Under Secretary for Food, Nutrition and Consumer Services, who noted in his fiscal year 2003 budget hearings that the Department's focus will be to deal with States with the most serious problems and consistently high error rates. In line with the Under Secretary's statement, the Department has recently fined California, Michigan, and Wisconsin, the three States with the highest error rates for 2002.

The current law imposes QC liabilities each year a State's payment error rate is above the national average. Recent legislation (farm bill) made substantial changes to FNS' quality control system. Effective for fiscal year 2003, the reforms raise this threshold so that States are not penalized unless there is a 95 percent probability that their error rate exceeds 105 percent of the national average for two consecutive years. The law also contains various provisions for waiving penalties and provides bonuses for high performance. The impact of these changes on the payment accuracy rates and FNS' ability to encourage corrective actions by State administering agencies may not be known until fiscal year 2005. We plan to monitor the implementation of these program changes.

FUGITIVE FELONS MADE INELIGIBLE TO RECEIVE FOOD STAMP PROGRAM BENEFITS

In 1996, Congress passed the Personal Responsibility and Work Opportunity Reconciliation Act of 1996, generally known as the Welfare Reform Act. In the act, Congress recognized that certain people are not eligible for food stamps. The Act made felony fugitives ineligible to receive food stamp benefits. Additionally, this law allows the matching of law enforcement felony fugitive files with social service agencies' food stamp recipient records. To implement the law, OIG created "Operation Talon." This initiative capitalized on the provision of the act that declared individuals ineligible to receive Food Stamp Program benefits who are "* * * fleeing to avoid prosecution, custody, or confinement after conviction." The provision also authorized State agencies to provide the addresses of food stamp recipients to any Federal, State, or local law enforcement officer for official purposes. Operation Talon was commenced in conjunction with other law enforcement agencies across the United States to locate and apprehend fugitives who may be illegally receiving food stamp benefits. It was designed to carry out the intent of Congress by:

- removing ineligible fugitive felons from Food Stamp Progam rolls, thereby reducing program outlays;
- removing fugitive felons from the streets in order to make our communities safer; and
- demonstrating to States how to carry out the statutory provisions on a continuing basis.

Since its inception in early 1997, Operation Talon has resulted in 8,793 arrests. Serious crimes perpetrated by those arrested include homicide related offenses, such as murder attempted murder, and manslaughter; sex offenses, such as child molestation, rape, and attempted rape; kidnapping/abduction; assault; robbery; and drugs/narcotics violations. An example of an Operation Talon arrest involved an individual wanted for murder in southern New Jersey. The individual and two others were alleged to have executed a victim as part of a cocaine distribution conspiracy. OIG agents and detectives from the New Jersey State Police, the New York State Police, and the New York City Police Department, apprehended the individual in the Bronx, which was at the address he reported in his food stamp application.

As successful as this initiative is, I unfortunately cannot provide the cost savings brought about by these operations. Since the States determine eligibility, they are the ones who are best positioned to make such determinations. For example, New Jersey has developed a formula for estimating costs avoided. To date, New Jersey estimates cost avoidance (program benefits now available for eligible recipients) of $1.9 million since the inception of Talon in 1996. It is difficult, however, for most States to determine cost savings because even though fugitives are removed from the food stamp eligibility roles, they may be only one member in an entire household that continues to be eligible.

NATIONAL SCHOOL LUNCH AND SCHOOL BREAKFAST PROGRAMS

The National School Lunch and School Breakfast Programs are administered by FNS through State educational agencies. The programs are designed to provide chil-

dren with access to nutritious meals away from home and to improve their diets. Schools are eligible for reimbursement from FNS for all meals served that meet program requirements, with meals served free or at a reduced price receiving additional reimbursement. For fiscal year 2003, FNS estimates that National School Lunch Program outlays will be about $5.8 billion with the School Breakfast Program approaching $1.7 billion. Both programs share common eligibility requirements for free and reduced price meals. In fiscal year 2002, almost 58 percent of the National School Lunch meals were served free or at a reduced price, with the School Breakfast Program serving almost 83 percent of its meals as free or reduced price. Eligibility for free and reduced price meals is based on household income with households submitting applications at the beginning of the school year to their local school food authority. To test whether households correctly report their income, school food authorities are required to sample applications to verify the reported income.

In August 1997, OIG issued a report entitled "National School Lunch Program Verification of Applications in Illinois." We reported that while school food authorities generally followed regulations in conducting income verifications, they did not expand their sampling when high error rates were found. Overall, Illinois had a 19 percent error rate comprised of households underreporting income (about 9 percent) or failing to respond to verification requests (about 10 percent). This meant that $31.2 million, of the $165.1 million Illinois received in 1 year for free and reduced price meals, was potentially paid out for households that were not eligible. As part of the verification process, school food authorities are required to reduce or terminate benefits when the verification does not confirm the accuracy of the child's eligibility. OIG recommended that FNS establish a threshold for the maximum percentage of errors allowable during the verification process and require additional sampling when that percentage is exceeded. OIG further recommended that States be required to monitor school food authority verification efforts and follow-up to assure additional testing was undertaken where needed. FNS did not initially agree to make regulatory changes based only on our findings in Illinois, but subsequently revised this position when information it gathered on additional States showed an average error rate of 26 percent.

OIG's review, "National School Lunch Program Operations in New York City," issued in September 2002, further confirmed the severity of the problem. For school year 1998/1999, in which New York City received $204 million in FNS reimbursement, the school food authority's testing of households' applications showed about 55 percent of those sampled underreported income (about 23 percent) or did not respond to verification requests (about 32 percent), with the error rate climbing to 59.5 percent in school year 1999/2000, 65.1 percent in school year 2000/2001, and 69.5 percent in 2001/2002. Furthermore, the New York City school food authority did not always adjust its claims for reimbursement based on the verification results, as required.

The Department has acknowledged that eligibility determinations and verification in the National School Lunch and School Breakfast Programs is an issue that needs to be addressed for program integrity. The Under Secretary for Food, Nutrition and Consumer Services noted in his testimony before the House Appropriations Subcommittee on Agriculture, Rural Development, Food and Drug, and Related Agencies in March 2002, that the recent U.S. Census shows 27 percent more students are certified for free or reduced price meals than the Census data itself would suggest are eligible. Since National School Lunch and School Breakfast Program reimbursements are estimated to reach $7.5 billion during fiscal year 2003, in response to these concerns, FNS has published a proposed rule requiring schools to report on the results of their verification reviews to the State agency. In turn, State agencies would consolidate the data and report to FNS. FNS also currently has pilot projects underway in 22 school food authorities in 16 States to assess three different options to address the verification process and the current high error rate. The first option requires households that are not eligible for free meals, by virtue of being eligible for Food Stamp Program or Temporary Assistance for Needy Family benefits, to provide upfront documentation of household income with their application. The second option requires school food authorities to expand verification sampling if the initial tests showed an error rate exceeding 25 percent. The third option requires school food authorities to verify direct certifications, namely those who reported receiving Food Stamp Program or Temporary Assistance for Needy Families benefits. The pilots are to be completed at the end of school year 2002/2003.

FNS and OIG both agree that the eligibility determination and verification process is a management challenge that must be addressed to reduce fraud, waste, and abuse in FNS programs. The Under Secretary for Food, Nutrition and Consumer Services noted in his testimony before the Senate Committee on Agriculture, Nutri-

tion and Forestry in April 2003 that problems with school meals certification have worsened over time and that the Department has been working to develop and test policy changes that improve accuracy but do not deter eligible children from participation in the programs. Options being pursued by the Department include requiring direct certification for free meals through the Food Stamp Program, enhancing verification of applications by drawing samples early in the school year and expanding the verification sample, requiring a robust effort to follow up with those who do not respond to verification requests, streamlining the process by requiring a single application, and initiating a series of projects to test alternatives for certifying and verifying applicant information (including computer matching of wage data).

Another area in the National School Lunch and Breakfast Programs prone to fraud, waste, or abuse involves local school food authority contracts with food service providers. OIG is working with FNS to address cost reductions in the form of contract discounts, rebates, and allowances. Federal cost principals require that such benefits accrue to the program. However, the Office of Management and Budget has recently determined that Federal cost principles do not apply to local contracts with food service management companies. FNS is pursuing regulatory action to address this problem. Our investigations have also identified schemes by food service providers to inflate expense claims. One large food service provider agreed to pay $325,000, in order to settle a lawsuit brought in regards to inflated National School Lunch Program claims. In its billings to several school districts, this firm inflated flat rate labor costs for employee related expenses and claimed for insurance expenses that had not been incurred.

CROP INSURANCE AND FARM PROGRAMS

We believe the Department confronts the same challenges in administering these two program areas, since they are closely related, interdependent, and prone to the same types of abuse. When Congress enacted the Agricultural Risk Protection Act of 2000 (ARPA), it mandated the Risk Management Agency (RMA) and Farm Service Agency (FSA) to work together to strengthen their programs and to better serve American farmers and ranchers.

Federal crop insurance programs are delivered through private insurance companies under the oversight of the Federal Crop Insurance Corporation and RMA. Today's crop insurance programs help farmers survive depressed market prices and major crop losses through market-based risk management solutions. At the same time, the farm programs administered by FSA serve to stabilize farm income, help farmers conserve land and water resources, provide credit to new or disadvantaged farmers and ranchers, and help farm operations recover from the effects of disaster. For the five fiscal years 1998–2002, the average value of all financial assistance provided to the public by RMA, FSA, and NRCS (actual program levels) were $2.432 billion, $32.073 billion, and $1.426 billion respectively. Over those 5 years, RMA's, FSA's, and NRCS' combined program levels ranged from 28 to 45 percent of USDA's annual budget.

While OIG has observed the general nature of fraud, waste, and abuse in crop insurance and farm programs, the overall magnitude of these problems is unknown. Fraud is commonly perpetrated through false certification of one or more of the basic data elements essential for determining program eligibility and amounts of benefits. In RMA cases, the scheme typically involves a conspiracy between an insurance company representative and a producer. For example, in one investigation it was determined that a producer who was also employed as an insurance agent paid employees of his insurance company to assist him in setting up sham farming operations. These sham operations enabled the individual to receive over $5.9 million in ineligible payments from FSA and RMA. The individual was also able to use the sham operations to offset his sizable insurance profits and file false income tax returns. This individual was convicted on money laundering, conspiracy, false statements, aiding and abetting, false tax returns, mail fraud, and wire fraud. The individual was sentenced to 60 months incarceration, 3 years supervised release, $1,800 special assessment, $13,800 toward cost of prosecution, and forfeiture of $5.8 million.

Abuse is more subjective and occurs when a participant's actions defeat the intent of the program although no law, regulation, or contract provision is actually violated. Waste, on the other hand, occurs when there are flaws in the program design. These program design flaws or weaknesses inevitably invite abuse by the program participants—what we refer to as "moral hazards." For example, our September 2002 audit report, "RMA Viability of Fall Watermelons in Texas and Their Inclusion in the 1999 Watermelon Insurance Pilot Program," showed RMA's internal policy approval process was not adequate to preclude the issuance of a crop insurance pol-

icy on crops that were not viable. Specifically, RMA offered a policy covering fall watermelon crops in south Texas although such crops ran a high risk of failure. This pilot program presented producers with a significant opportunity for monetary gain since the crop insurance indemnities substantially exceeded the producers' input costs. In response to the policy offering, producers significantly increased their acreage devoted to fall watermelons. In south Texas alone, annual fall watermelon acreage jumped from its pre-1999 level of about 1,000 acres to nearly 27,000 acres for 1999. The fall watermelon pilot program in Texas culminated in the expenditure of $21.2 million in insurance indemnities (44 percent of all watermelon claims nationwide in 1999). RMA discontinued the program effective for the 2000 crop year, and we observed a corresponding decrease in fall watermelon acreage for that year. In this case, we found that RMA had adequate procedures in place for reviewing and approving pilot programs, however, these procedures were not closely followed. We recommended that the RMA consider holding the responsible officials accountable for their actions. We are still waiting for a response from RMA.

ACTIONS TAKEN TO ELIMINATE OR REDUCE PROBLEMS

The crop insurance and farm programs use the same basic data to compute program benefits. Such data include acreage, crop, location, production, and shares, all of which are generally self-certified by the program participants. The insurance companies and FSA, however, separately collect the data from producers in different formats. OIG believes common data should be shared between the agencies and programs, as well as the responsibility to ensure the integrity of the data.

AGRICULTURAL RISK PROTECTION ACT OF 2000 (ARPA)

Fundamental differences in FSA and RMA definitions and program procedures sometimes give the appearance there are discrepancies in the data. For example, RMA and FSA have different definitions for common pieces of land: RMA identifies land by "units," while FSA "farms" are composed of "tracts" which may further be broken into individual "fields." RMA units cannot be directly equated to FSA farms, tracts, or fields.

ARPA requires RMA and FSA to annually reconcile information received from producers and to identify and address any apparent discrepancies. To further improve program compliance and integrity, ARPA requires FSA to assist RMA in ongoing monitoring of crop insurance programs and requires RMA to consult with State FSA committees on policies and plans for insurance offered in the State. In addition, ARPA requires RMA to make full use of data warehousing and data mining technologies to identify anomalies in the crop insurance programs.

OIG reviewed the 2001 crop year data reconciliation process and found that FSA was able to resolve about 250,000 (52 percent) of the 480,000 data records unmatched between RMA and FSA. We believe significant additional action is still needed by RMA to resolve the remaining discrepancies. Most of the discrepancies can be attributed to differences in RMA's and FSA's definitions of the basic data necessary to compute benefits and in how they collect and record such data. Until these differences are resolved, we believe neither of these agencies will be able to effectively and efficiently implement the data reconciliation process and, therefore, meet its intended goal of reducing improper payments. We plan to issue our audit report, "USDA Implementation of the Agricultural Risk Protection Act of 2000," in September 2003. In fiscal year 2004, we plan to continue monitoring the agencies' implementation of ARPA. Our planned work includes emphasis on RMA's use of information provided through data mining.

During the past 7 fiscal years, we conducted 655 investigations related to FSA mandatory programs, involving unauthorized disposition of property mortgaged to the government, fraud by warehouse operators, false statements by commodities producers and exporters, and false statements by borrowers in order to obtain more or greater dollar value loans or debt write-downs to those which they are actually entitled. These investigations have resulted in 310 indictments, 306 convictions and $116.1 million in monetary results. For this same period we conducted 154 investigations related to RMA mandatory programs, which have resulted in 49 indictments, 43 convictions, and $22 million in monetary results. We believe a more effective data reconciliation and data mining process could detect potentially fraudulent actions and/or abuse by program participants and, thereby, mutually benefit both RMA and FSA.

EXISTING QUALITY CONTROL SYSTEMS

Because the crop insurance and farm programs fundamentally rely upon producers' self-certifications to determine eligibility for benefits, the agencies have in

place a number of differing internal control systems to evaluate participant compliance with program provisions. For example, there exists within each FSA program specific compliance or spot check requirements. FSA regards such compliance reviews as collateral duties to be performed by FSA county office employees. FSA also has in place a County Operations Review Program (CORP). CORP was implemented in 1986, based upon an OIG audit that determined existing internal control processes did not meet the requirements of the Federal Managers' Financial Integrity Act (FMFIA) or the internal control guidelines established by the Office of Management and Budget (OMB). For fiscal year 2002, there were 74 county operations reviewers (COR) positions approved nationwide for FSA. The COR position is a full-time position used exclusively for county office internal control functions.

The current internal review systems were developed independently of each other in response to known problems and without consideration of whether the reviews would be cost effective or the extent of the problems measurable. In addition, there has been no concerted effort to coordinate the conduct of the multiple reviews or to communicate the results to officials responsible for other programs that may be affected.

To evaluate overall program integrity and compliance, RMA uses a system that consists largely of insurance company internal reviews and periodic RMA verifications. Given its resources, RMA must continue to rely on this approach in partnership with the insurance companies. In our March 2002 audit report, "Risk Management Agency Monitoring of RMA's Implementation of Manual 14 Reviews/Quality Control Review System," we reported RMA continues to struggle to develop and implement a reliable QC system capable of evaluating private sector delivery of Federal crop insurance programs. RMA's stated commitment to QC has not answered basic policy questions, including what constitutes an error, the amount of improper payments made, and whether program delivery should be assessed at the national or at the insurance company level. We continue to monitor RMA's actions to implement our recommendations.

In general, RMA's and FSA's QC systems rely on judgmental sampling and are not designed to estimate the magnitude of fraud, waste, and abuse in the programs. Statistical sampling is the only reasonable way to review large populations in an objective and unbiased manner. Statistical sampling is objective and defensible; it provides the means to estimate the sample size and sample error; it saves time and money; it has a proven scientific basis; and it generally yields results that have high visibility and impact. We are aware of only one RMA internal review designed to use a statistical sample. We believe the agencies must move toward standardized statistical sampling in order to estimate annual amounts of improper payments as required by the Improper Payments Information Act of 2002.

The Department's conservation programs fall under the jurisdiction of FSA or the Natural Resources Conservation Service (NRCS). In some of these programs, such as the Conservation Reserve Program, FSA administers the program and NRCS provides technical assistance to the farmers. In other programs, such as the Wetlands Reserve Program, NRCS both administers the program and provides the technical assistance. For most programs, NRCS is responsible for monitoring the farmers' implementation of the conservation practices they agreed to. Farmers need to comply with the conservation provisions of their agreements with FSA or NRCS to remain eligible for farm program benefits. NRCS monitors this compliance through status reviews. The tracts it selects for these reviews are taken partly from a random sample and partly from referrals it gets from FSA, its own field offices, public complainants, or other sources. If NRCS finds that a farmer did not comply with the appropriate agreements, it may waive the noncompliance, recommend penalties, or ask FSA to withhold farm program benefits. In the past, NRCS has reported generally around a 98-percent rate of farmers' compliance with the conservation provisions.

We recently evaluated the performance of the status reviews (that is, compliance reviews) in one State in response to a whistleblower complaint. In our September 2002 report, "NRCS—Compliance With Highly Erodible Land Provisions," we pointed out a number of ways NRCS could strengthen its status reviews: clarify its handbook procedures, seek better coordination with FSA, perform more timely status review field visits, and require better reporting by the field offices of the results of the status reviews. The General Accounting Office's recently issued report, "USDA Needs to Better Ensure Protection of Highly Erodible Cropland and Wetlands," raised similar concerns. It pointed out that in the process of selecting sample tracts for review, NRCS disproportionately emphasizes tracts (e.g., permanent rangelands) where the conservation compliance provisions may not be applicable. Since these tracts provide little potential for noncompliance, the status reviews that include them result in inflated compliance rates. GAO reported that for crop years 2000 and 2001, only 5 percent of all tracts selected for compliance review resulted in waivers

or violations. And of those tracts with violations, over 60 percent of these cases from 1993 through 2001 were waived when the farmers appealed their cases to FSA. For fiscal year 2004, we plan to evaluate NRCS' compliance rates by verifying, through a statistical sample of tracts, that conservation provisions have been properly implemented.

RMA DATA ACCEPTANCE SYSTEM

Crop insurance program benefits are based on information provided by the producers to the insurance companies. The insurance companies enter the data into their information technology (IT) systems and then download it to RMA, where the data purportedly first undergo a series of IT edit checks or validations to ensure the data are complete and accurate. Once the data are cleared through this electronic information processing application, known as the Data Acceptance System (DAS), RMA's crop insurance database is updated.

For the 2001 crop year, we found RMA did not have documentation to describe all current DAS edits, users, and reports. We were unable to determine the internal controls in place to evaluate the quality of data downloaded to RMA from the insurance companies. Further, we discovered any updated or changed data overwrites and completely replaces any corresponding pre-existing data in RMA's crop insurance database. Thus, the audit trail or history of changes is effectively eliminated. Finally, the crop insurance database and RMA's accounting system do not interface with one another. Instead, RMA uses the database values at monthly cutoff dates to generate a monthly accounting report for each insurance company. These reports are sent to the companies for review and attestation and are ultimately signed and returned to RMA. RMA manually compares the current month's cumulative amounts to the prior month's cumulative amounts for each insurance company, and RMA accountants enter the calculated differences into the automated accounting system to make payments to or demand refunds from the individual insurance companies. RMA's current system makes it impossible to verify financial events at the transaction level and does not comply with Federal financial management and financial systems requirements. Our report on "Risk Management Agency Survey of Data Acceptance System Processing Controls" is scheduled to be issued in September 2003. We plan to do additional reviews of DAS, particularly testing the validity of the data including any changes to the database.

COMMON COMPUTING ENVIRONMENT AND GEOGRAPHIC INFORMATION SYSTEMS

The Department of Agriculture Reorganization Act of 1994 authorized the reorganization and modernization of USDA to achieve greater efficiency, effectiveness, and economy in program delivery. One major component of this effort targeted USDA's county-based agencies (FSA, the Natural Resources Conservation Service (NRCS), and the agencies in the Rural Development mission area). A key element under USDA's modernization initiative is the development of a common computing environment (CCE) to enable the county-based agencies to share data among themselves. USDA began implementation of the CCE in 1998 and plans to complete its installation in fiscal year 2004.

Another component of the modernization initiative is implementation of Geographic Information Systems (GIS) and Global Positioning Systems (GPS) technology. GIS and GPS will allow the county-based agencies, and other USDA agencies, to electronically analyze data on land and crops. GIS is a computer-based tool for mapping and analyzing geographic information. GPS is an accompanying technology that can be integrated with GIS for even greater analysis of real world information. GPS data layers, ortho-photography, soils layers, public land survey data, and many other data layers can be placed atop one another inside of one GIS project. FSA plans to use the geo-spatial data and tools to improve assessment of crop conditions and producer compliance with FSA programs, as well as to maintain and share farm records and maps digitally with other agencies as appropriate. Based on our discussions with RMA compliance staff, such geo-spatial data and tools have allowed them to closely and timely monitor crop conditions and producer compliance, particularly in situations where they have received complaints or their reviews indicate potential problems.

In our investigations, we have benefited from this modern technology by utilizing satellite imagery technology for crop identification and comparison during growing seasons. Specifically, thermal image technology has been used to determine acreage amount and whether or not a crop was planted, as well as the type of crop planted. Although this technology can be extremely useful in our audits and investigations, upfront costs, to include personnel expertise and training, are unknown at this time.

PENALTIES

RMA and FSA distinguish between participant errors and agency errors in the programs. In cases of participant error, RMA and FSA generally demand refunds of overpayments, but greater leniency is afforded in cases of agency error, including cases of misaction or misinformation. Further, there are legislated disparities in RMA's and FSA's handling of agency errors. For example, FSA's Finality Rule waives repayment after 90 days unless the participant had reason to know the payment was made in error. If the participant is not notified within 90 days of the county committee's approval of the request that a potential overpayment may have occurred, FSA is precluded from recovering overpayments resulting from agency errors. Since recovery is moot, a reviewer is discouraged from actively seeking and identifying overpayments that could be the result of agency waste. In our August 2002 report, "FSA—Limited California Cooperative Insolvency Payment Program—Tri Valley Growers," we found agency errors in approximately 20 percent of the program payments. Early on in the review, we raised these concerns to FSA who, in turn, notified participants of the potential payment problems. Fortunately, because of these notifications, FSA was able to issue bills of collections to recover these overpayments.

In contrast, ARPA provides a 3-year period for the recovery of improper payments attributed to an insurance company's error. To adequately enforce program compliance and integrity, remedies should be consistent across agency lines and for similar violations.

SUMMATION

You have asked us here today to talk about our experiences in auditing and investigating fraud, waste, and abuse within USDA mandatory programs. In each of the mandatory spending programs I have discussed here today, much has been done by the USDA agencies and Congress to address inherent weaknesses and vulnerabilities within USDA's programs.

In regards to the Food Stamp Program, FNS has a long history of identifying erroneous payments, as well as working with State administering agencies to lower error rates. What impact the recent legislative reforms will have on FNS' ability to continue to effect positive changes in State error rates will not be known for some time. We will continue to monitor this process. Also, both FNS and State administering agencies need to remain focused on using data available from EBT systems to target problem retailers and ensure program integrity. The eligibility issues in the National School Lunch and Breakfast Programs are more complicated and we would encourage the Congress to work with FNS to find a solution that will minimize erroneous payments and yet not deter those eligible from receiving program benefits.

We believe the recent legislative initiatives for the farm and crop insurance programs, if effectively implemented, should have a positive impact on program administration and integrity. Key to effective implementation of this legislation is the development of common data reporting requirements (i.e., definitions for common pieces of land), which will facilitate more effective data reconciliation and data mining to detect improper payments.

Overall, I see the Department's challenge in implementing the 2002 Improper Payments Information Act as a critical action item in the identification and prevention of erroneous payments. For USDA to be successful in reducing erroneous payments in its spectrum of programs, there must be management commitment, inter- and intra-agency coordination, adequate information systems and quality control processes, and effective enforcement actions. Each of these areas is an interrelated element of an effective and efficient internal control system to reduce fraud, waste, and abuse.

Commitment is the driving force of any system of internal controls: management (and Congress) must be willing to commit the necessary resources to the task of preventing and detecting errors and irregularities. Internal controls should not be secondary considerations or collateral duties. Program compliance and integrity must be impressed throughout the cultural climate as an integral part of program delivery.

In the last decade, Congress has done much to mandate and encourage a coordinated Departmental approach to program delivery. To create a seamless interagency team approach to program integrity, the Department must encourage individual agencies and employees to work across organizational lines to share information and coordinate compliance and data mining activities which may affect multiple programs, both inter- and intra-agency.

Integrated and collaborative information technology should also be a fundamental part of the Department's efforts to improve program compliance and integrity. Information technology is a means to pool the Department's limited resources to compare data throughout the Department and to identify and target anomalies for further analysis.

Finally, a system of internal controls does nothing to discourage or deter fraud, waste, and abuse unless participants and USDA employees are held accountable for errors and irregularities. The Department must work to ensure penalties are consistently and fully enforced across agency lines. We will continue working with the Department and its agencies to strengthen their programs and to identify areas where cost avoidance and savings can be achieved. This concludes my statement, Mr. Chairman. I would be happy to answer any questions that you may have.

Chairman NUSSLE. Next we will hear from John Higgins, who is Inspector General for the Department of Education. Welcome, and we are pleased to receive your testimony.

STATEMENT OF JOHN P. HIGGINS, JR.

Mr. HIGGINS. Mr. Chairman, members of the committee, thank you for the opportunity to testify about fraud, waste, and abuse in the student financial assistance programs. As you know, these grant and loan programs are very complex and involve many entities, and billions of taxpayer dollars.

There are over 37 million students and parents, 5- to 6,000 schools, more than 4,000 lenders, 3 dozen guaranty agencies and many contractors involved in these programs some way or another. Last year the Department disbursed and guaranteed approximately $65 billion and managed a $267 billion loan portfolio. To my knowledge, neither the Department nor my office has ever attempted to estimate the total amount of fraud, waste, and abuse in these programs. The Department does, however, estimate the amount of improper and erroneous payments each year.

My office identifies the amounts of sustained, questioned and disallowed costs. Through audits and our investigative work, it produces criminal fines, restitutions and civil judgments.

While I cannot provide you with a total estimate of the magnitude of the problems, I will give you a few examples. In the last 2 years, our audits of nine guaranty agencies found that the Federal Government should recover $164 million. In 1999, an audit of the death and disability loan discharges found that over $77 million was discharged to borrowers who falsely claimed disability or death.

Our audits in fiscal year 1996 found that $177 million in Pell Grants was disbursed because applicants understated their income on their application for aid. The Department updated and refined this estimate in 2001 to $336 million.

Indications are that the fraud is growing. In one case a collection agency paid $6.4 million in settlement of allegations that it submitted false claims for payment under its contract with the Department to collect defaulted student loans. The false claims were based on consolidated loans that did not meet the legal requirements.

Another investigation of a financial aid consulting business led to 411 settlements and a civil judgment totaling over $4 million. The owner of this business certified false Federal income tax returns that enabled ineligible students to qualify for financial aid.

I have included many other examples in my written statement, with corresponding recommendations. Today I would like to focus on two corrective actions that we believe would have the most impact for reducing fraud, waste, and abuse in these complex programs: first, a match that verifies income with Internal Revenue Service; and second, the need for the Department to increase and improve its monitoring. The IRS income match is the single action that would have the biggest impact. As I noted above, the estimate of the Pell Grants disbursed based on understated income figures from applicants is growing.

We have recommended such a match since 1997. While Congress amended the Higher Education Act in 1998 to permit the match, no corresponding change was made to the Internal Revenue Code. The Department has worked with OMB, the Department of Treasury, and the necessary changes to the Internal Revenue Code have been transmitted to Congress. We urge you to enact legislation to authorize this match permitting the Department to implement this significant control to guard against fraud, waste, and abuse in its programs.

The Department also needs to increase and improve its monitoring. Monitoring is an essential component for improving the financial management of and accountability for Federal education dollars. Vigorous program and contract monitoring helps ensure that Federal education dollars are administered effectively and efficiently and reduces the potential for fraud, waste, and abuse.

We found that the number of onsite program reviews conducted by the Department dropped significantly from 1996 to the present. And the Department performed only one program review out of all of its 4,000 lenders in fiscal year 2002. We have recommended to the Department that it increase program reviews at high-risk institutions, and improve its monitoring to help ensure that the institutions disburse the funds properly.

Early on, Secretary Paige made reducing risk in these programs a top priority of his Department, including removing them from the GAO high-risk list. We look forward to continuing to work with the Department and the Congress to help safeguard the Federal education dollars and ensure that these programs reach the intended recipients.

That concludes my statement.

Chairman NUSSLE. Thank you very much.

[The prepared statement of Mr. Higgins, Jr. follows:]

PREPARED STATEMENT OF HON. JOHN P. HIGGINS, JR., INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION

Mr. Chairman and members of the committee, thank you for the opportunity to testify about waste, fraud, and abuse in the student financial assistance programs within the Department of Education (the Department). As you requested, I will address some of these problems, their general nature, and corrective actions that have been, or that need to be, taken. I will also provide illustrative examples of problems we have identified.

Most importantly, I want to urge Congress to amend the Internal Revenue Code to allow the Department to match the information provided on student applications with the income data that is maintained by the Internal Revenue Service (IRS). As I discuss more fully below, the Department currently estimates that $336 million in Pell Grants were improperly disbursed because applicants understated their income in fiscal year 2001.

I. BACKGROUND ON THE STUDENT FINANCIAL ASSISTANCE PROGRAMS

The Department's student financial assistance programs are large and complex. The loan and grant programs affect over 37 million individuals and involve 5,000–6,000 schools, more than 4,000 lenders, three dozen guaranty agencies, and many contractors. Last year the Department disbursed and guaranteed approximately $65 billion and managed a $267 billion loan portfolio for these programs. The size and scope of the programs have increased greatly in recent years, with total program dollars doubling in the last 10 years alone.

These programs are inherently risky due to their complex design, reliance on numerous entities, and the nature of the borrower population. For example, borrowers are given access to Federal loan assistance even though they may have no credit or employment history.

The student financial assistance programs have been on the General Accounting Office's (GAO) high-risk list since 1990. The Department has made a strong commitment to remove the programs from the list, and it is making progress toward this goal. Reducing risk in these programs is one of the Department's strategic goals, and a top priority for the Secretary who, at the beginning of his tenure, established a senior level management team to resolve financial management issues throughout the Department and in these programs.

II. ESTIMATED MAGNITUDE OF WASTE, FRAUD, AND ABUSE

You have requested that we provide specific dollar amounts of waste, fraud, and abuse in the Department's student financial assistance programs. We do not have a total, comprehensive estimate of these amounts.

The Department is required to provide to the Office of Management and Budget (OMB) annually erroneous and improper payment estimates, and in 2002 the Department reported $401 million for student financial assistance programs. While we did not verify this figure, we think it is conservative.

We report on monetary results from our work in our Semiannual Reports to Congress. For the last five and one half years (October 1, 1998 through March 31, 2003), we reported more than $182 million in total sustained questioned and disallowed costs from our audits of student financial assistance programs.

During the same period, we reported that our investigations in these programs resulted in restitutions, criminal fines, and civil actions totaling more than $152 million. Of course, this represents only the waste, fraud, and abuse that we have been able to identify through our work, with our limited resources.

Following are some examples:

- During the last 2 years, we performed audits on nine guaranty agencies to assess the adequacy of their establishment of the Federal and Operating funds required under the Higher Education Amendment of 1998. These audits identified approximately $164 million that should be recovered by the Federal Government.
- In 1999, our audit of loan discharges based on death and disability found that over $77 million in loans were discharged to borrowers who falsely claimed they were disabled or dead. ("Improving the Process for Forgiving Student Loans," ED–OIG/ACN: 06–80001; June 1999).
- Our audit of the 1995–96 award year found that over $177 million in Pell Grants was improperly disbursed because applicants understated their income on their applications. The Department updated and refined this estimate to $336 million for fiscal year 2001. ("Accuracy of Student Aid Awards can be Improved by Obtaining Income Data from the Internal Revenue Service," ED–OIG/ACN: 11–50001; January 1997).
- Our investigation of a financial aid consulting business led to 411 settlements and civil judgments totaling over $4 million. The owner of this business certified false Federal income tax returns to verify false income amounts that enabled ineligible students to qualify for financial aid. We identified over 700 students who used this service.
- A collection agency paid $6.4 million in settlement of allegations that it submitted false claims for payment under its contract with the Department to collect defaulted student loans. The alleged false claims were based upon consolidated loans that did not meet legal requirements.

III. GENERAL NATURE AND ILLUSTRATIVE EXAMPLES OF THE CURRENT CHALLENGES

Based upon our work, we conducted an analysis of patterns of waste, fraud, and abuse in student financial assistance programs. We supplied this analysis, and suggestions for preventive measures, to the Department in March 2003. Implementation of our suggestions could save millions of dollars by preventing loans made to

ineligible students, inappropriate loan discharges, abuse by guaranty agencies, and other types of mismanagement. Examples of the major issues we identified are provided in the following sections.

A. Fraud from lack of eligibility verification

The Higher Education Act of 1965, as amended (HEA), requires applicants to provide eligibility information on their Free Application for Federal Student Aid (FASFA). Some applicants provide false information—for example, about their income or their dependency status—in order to receive funds for which they are not eligible.

1. Income match. As I mentioned earlier, the Department currently estimates that in fiscal year 2001 $336 million in Pell Grants was improperly disbursed because applicants understated their income. The most effective way to detect this falsification is to match the information that applicants provide with the information maintained at the IRS. We have recommended this match since 1997.

Though a provision in the Higher Education Amendments of 1998 was intended to permit this match, no corresponding change was made to the Internal Revenue Code. The Department has worked with OMB and the Department of Treasury on the necessary changes to the Internal Revenue Code, and they were submitted to the Congress. This legislative authority is one of the single most significant steps that Congress could take to reduce waste, fraud, and abuse in student financial assistance programs.

During the 1990s we effectively used the process of computer-based matching of records to identify control weakness in the verification process for students applying for student financial assistance. In each of three successful matches, the OIG identified hundreds of millions of ineligible awards, and recommended corrective actions to prevent future ineligible awards. In response to each audit, the Department implemented management and system controls to address the abuses.

2. Default match. In March 1992, we reported on a weakness in the screening of FAFSAs, that we estimated could cost the Department and the taxpayers $800,000 a day in ineligible funds being disbursed to previous defaulters. No edit check existed in the system controls to check for previous defaulters. In response, the Department quickly responded and implemented the edit check within 3 months of our report by matching applicants against the default data.

3. Death and disability match. In an audit in 1999, we identified approximately $77 million in student loans that were discharged for total and permanent disability and death ($73 million disability, $4 million death), even though the borrowers were apparently not totally and permanently disabled or deceased according to Social Security Administration's Master Earnings file. Improper discharges occurred because of control weaknesses in the system for determining borrower eligibility for the disability or death discharge. We also found that 6,800 new loans totaling about $20 million were awarded to borrowers who had previously received disability loan discharges totaling $11.5 million. The Department implemented the following corrective actions:

- Borrowers requesting total and permanent disability cancellations must use a revised form that includes the physician's State license number.
- A certified or original copy of the death certificate is required.
- Regulations published on November 1, 2000, require that a previous loan that had been discharged based on the disability of the borrower must be reinstated before the borrower can regain eligibility for new loans and grants if they return to school.
- The regulations also contain a provision for a 3-year conditional period for loan disability discharges. Before the loan is permanently discharged, the Department will verify to determine if the borrower has earned income that exceeds a threshold based on the poverty level. If the borrower's income has exceeded the established threshold, the loan will be reinstated.

4. Citizenship match. An OIG audit performed for award year 1992–93 determined that the citizen verification process allowed ineligible, non-U.S. citizens to receive Pell Grants totaling over $70 million during award year 1992–93. We matched the applicants claiming U.S. citizenship against the citizenship status maintained by the Social Security Administration (SSA). The ineligible non-citizens had indicated they were U.S. citizens on their applications. Although the Department verified the status of those applicants who marked on their applications they were non-U.S. citizens, the edit process did not verify the accuracy of applicants who indicated U.S. citizenship. The Department changed the edit process to match all applicants with the SSA.

We also have investigated cases involving false citizenship information. Recently, a university director of foreign students and two professors were indicted on 113

counts for conspiring to commit student visa fraud, allowing ineligible students to receive student financial assistance.

B. Identity theft fraud by ineligible students

Identity theft typically occurs on the FAFSA when a person intentionally uses someone else's name and Social Security number to fraudulently obtain student aid. People who obtain loans through identity theft almost always default on those loans. We have experienced an increase of these cases in recent years, and we have asked the Department to require that postsecondary institutions verify students' identity using picture identification, such as a driver's license.

C. Fraud by financial aid consultants

We have investigated a number of financial aid consultants who submitted false FAFSAs and tax returns on behalf of their clients, enabling these clients to fraudulently qualify for aid. For example, we investigated a consultant who charged approximately $300 for weekly seminars, advising and assisting parents and students in preparing FAFSAs that deliberately misstated their income. For this single case, we identified a potential loss to the government of $800,000.

Our investigation of another financial aid consulting business led to 411 settlements and civil judgments totaling over $4 million. The owner of this business certified false Federal income tax returns that contained false income amounts, enabling ineligible students to receive financial aid. We identified over 700 students who used this service.

D. Fraud and abuse by collection agencies

A collection agency paid $6.4 million in settlement of allegations that it submitted false claims for payment under its contract with the Department to collect defaulted student loans. The alleged false claims were based upon consolidated loans that did not meet legal requirements.

In an audit, we found that another collection agency owed more than $800,000 to 177 schools. Our subsequent investigation of that collection agency's officials resulted in a restitution order of more than $1 million because they used client trust funds for personal and operating expenses, instead of remitting the funds to clients. ("Review of Collection Activities at Unger and Associates", ED–OIG/ACN: A06–90011; February 2000).

E. Fraud related to foreign schools

The regulations for foreign schools' participation in the Federal Family Education Loan (FFEL) program include fewer controls than those for domestic schools. FFEL funds are disbursed directly to students in foreign schools, while students in domestic schools receive FFEL funds through the schools they attend.

We have investigated many cases of individuals who apply for FFEL loans, receive the loan money, and never attend the foreign schools. Our investigations of foreign schools to date have resulted in restitution of over $2 million. We have suggested that the Department require independent verification that the students are enrolled in the foreign schools before disbursing FFEL funds.

F. Fraud from failure to make refunds

We have investigated cases in which schools deliberately failed to calculate or pay a student's refund of student financial assistance as required by law. We have suggested that the Department be alert for instances of this type of fraud when it conducts on-site reviews at high risk schools.

G. Waste and abuse from inadequate monitoring

Our work has repeatedly documented instances of waste, and abuse that have been allowed to continue because of inadequate monitoring. As we noted earlier, the student financial assistance programs are complex and have many participants, including lenders, schools, guaranty agencies, collection agencies, and financial aid consultants. More effective monitoring of these participants would reduce the waste, and abuse that occurs in these programs. Some examples of our work documenting the need for increased monitoring follow.

1. Insufficient program review monitoring. The Department is responsible for monitoring schools, guaranty agencies, and lenders. In an audit, we found that the number of on-site program reviews of schools dropped from 746 in fiscal year 1996 to 128 in fiscal year 1998. We also found that by fiscal year 1999, the average program review liability had dropped to $4,624, from $71,209 in fiscal year 1996. In response to our recommendation, the Department agreed to increase the number of program reviews at high risk institutions. ("Review of Case Management & Oversight's Program Review Function", ED–OIG/ACN: A04–90003; September 2000).

In the management letter accompanying the fiscal year 2002 financial statement audit, the auditors noted that the Department performed only one program review at a lender during the year. There are approximately 4,000 lenders in the FFEL program.

2. Abuse by guaranty agencies. During the last 2 years, we performed audits on nine guaranty agencies to assess the adequacy of their establishments of the Federal and Operating funds required under the Higher Education Amendments of 1998. These audits identified approximately $164 million that should be recovered by the Federal Government, including:

- Approximately $48.3 million that was not transferred to the Federal funds, or inappropriate expenses from Federal funds;
- Outstanding issues about the Federal interest in $10.9 million in non-liquid assets remaining at several of the guaranty agencies; and
- Approximately $103 million in excess Federal funds at one guaranty agency that should have been recalled by the Department.

The Department's program reviews at the same nine guaranty agencies conducted during fiscal years 2001 and 2002 did not detect these monetary findings.

We audited only nine of the 36 guaranty agencies. Therefore, the potential exists for additional funds due to the Federal Government from the remaining 27 guaranty agencies we did not audit.

3. Abuse in cash management. We have completed several audits identifying institutions that did not disburse Pell Grant and Direct Loan funds in accordance with student financial assistance program regulations. These institutions transferred funds to their operating accounts before identifying eligible students, as required under HEA. For example, we examined one institution that improperly kept over $146,000 in interest on Direct Loan funds it deposited into a money market fund. We have recommended that the Department improve its monitoring, to help ensure that institutions disburse funds in compliance with regulations. ("Bennett College's Compliance with Cash Management and Refund Procedures for Department of Education Funds for the Period July 1, 1997, through June 30, 2000", ED–OIG/ACN: A04B0015; September 2002).

H. Waste from use of inaccurate guidance

We alerted the Department that its Federal Student Aid Handbook contained inaccurate guidance that could result in schools disbursing student financial assistance to non-citizens who are not eligible for the aid. We found that the guidance the Department provided to schools on the interpretation of HEA's citizenship requirements was inconsistent and inaccurate. We estimated that this guidance contributed to the disbursement of approximately $5.4 million in aid to more than 2,000 potentially ineligible students. The Department is revising its guidance.

IV. CORRECTIVE ACTIONS NEEDED TO REDUCE WASTE, FRAUD, AND ABUSE

In recent years, the Department has focused on removing student financial assistance programs from GAO's high-risk list, and it has taken a number of management actions designed to achieve that goal. We believe the most immediate actions it needs to take to reduce waste, fraud, and abuse in the student financial assistance programs are to increase monitoring and to implement the IRS income match.

A. The department needs authority to implement the IRS income match

As I noted earlier, we have recommended implementation of an IRS income match since 1997, and the Department has been working with OMB and the Congress for additional authorizing legislation. We have documented, and the Department concurs, that significant improper payments could be prevented with this match. The estimate of Pell Grants disbursed based upon understated income figures from the applicants is growing, from our $177 million estimate for award year 1995–96, to the Department's current $336 million estimate for fiscal year 2001. We urge Congress to enact the legislation necessary to implement the IRS match.

B. The Department needs to increase monitoring

The Department needs to increase its monitoring of schools, lenders, guaranty agencies, and other participants in these programs. Increased monitoring is needed to improve the financial management of, and accountability for, Federal education expenditures. Vigorous program and contract monitoring helps ensure that Federal education dollars are used effectively and efficiently, and it reduces potential for waste, fraud, and abuse. GAO has also informed the Department that monitoring the effectiveness and sustainability of its corrective measures is necessary to remove student financial assistance programs from the high risk list.

Our audits have repeatedly cited deficiencies in the Department's oversight of schools, including a significant decrease in program reviews and inconsistent enforcement of financial responsibility. For example, as we discussed above, audits at nine guaranty agencies identified approximately $164 million due to the government. These monetary findings were not detected by the Department in its program reviews of the same nine agencies.

GAO has also informed the Department that monitoring the effectiveness and sustainability of its corrective measures is necessary to remove the financial assistance programs from GAO's high-risk list.

We will continue to assist the Department in its efforts to reduce waste, fraud, and abuse, to safeguard Federal education dollars and help ensure that these funds reach the intended recipients.

Chairman NUSSLE. Next we would like to hear from Dara Corrigan from the Department of Health and Human Services. Welcome. We are pleased to receive your testimony.

STATEMENT OF DARA CORRIGAN

Ms. CORRIGAN. Thank you very much, Mr. Chairman and members of the committee. My job is to prevent and hopefully eliminate fraud, waste, and abuse at the Department of Health and Human Services in their programs, primarily in the Medicare and Medicaid programs.

Those two programs are particularly vulnerable because of their sheer size. To give you an idea, as I am sure you know, those programs could cost $435 billion in fiscal year 2003. Health care fraud, waste, and abuse cost taxpayers billions in lost and wasted dollars. But, perhaps more importantly, they deprive vulnerable beneficiaries of the care and the support that they need.

We often hear about the complexities of the Medicare and Medicaid programs, and how difficult they are to administer. It is important and necessary to think about the underlying causes of those problems, to think about the appropriate remedies for those problems, and to try and prevent them from recurring in the future.

Now, not all health care fraud, waste, and abuse is that complicated. I have worked on cases and our office has worked on cases where doctors billed for more than 24 hours in a day, where people billed for services that aren't provided at all, where others lie about beneficiaries' diagnoses, and where people lie about whether or not people need certain medical procedures. Those cases aren't difficult, and people understand that that is wrong.

What is difficult in these cases is finding out about the fraud in the first place, investigating it, and proving it to a court. In the past year, this office has investigated and prosecuted many cases. I wanted to give you some examples so that you would have an idea about the magnitude of the problem.

One recent case was the HCA case. HCA was formerly known as Columbia HCA, and it is a large hospital chain in this country. In the last month, they settled the case with the government for $631 million. The allegations were that they had falsified cost reports and had paid kickbacks to doctors for referring beneficiaries to HCA hospitals. In addition to the $631 million, HCA also paid the Centers for Medicare and Medicaid Services $250 million to settle outstanding administrative liability.

And back in the year 2000, in December, several subsidiaries of HCA pleaded guilty to substantial criminal conduct and paid $840 million for various improper activities.

Other examples in the past year come from the pharmaceutical industry. I can name three cases: TAP Pharmaceuticals, AstraZeneca Pharmaceutical and the Bayer Corporation that all settled with the government for substantial sums of money for what amounted to problematic and difficult prescription drug pricing practices. Those settlements were for $875 million, $355 million, and $14 million respectively.

And while those settlements sort of catch your attention because they are big dollars, I think it is also important to think about the cases that involved individuals and smaller fraudulent schemes, because it illustrates the extent of the problem that we are dealing with the Medicare and Medicaid programs.

I will give you two quick examples. There was one case in Indiana where a doctor was billing the Medicare program for chemotherapy services, when what he was actually providing was something called "live cell therapy," which was taking cells from pigs and cows and injecting them into people, then billing Medicare for chemotherapy. While that is not a big dollar case, I think it is just as significant in terms of the beneficiaries of the Medicare program.

The other case example that I will give you was a case in Massachusetts where a lab was submitting many, many claims for laboratory tests for terminally ill dialysis patients, again tests that were totally unnecessary, invasive to the beneficiary, and ultimately totally unnecessary for the treatment of the patients.

Beyond the settlements that we work on, there are also systemic vulnerabilities in the Medicare and the Medicaid programs, and I will just mention a few. I will start with prescription drugs on the Medicare side, which has been debated actively in a different way both by this body and by the Senate in recent months.

With prescription drugs, what I want to focus on is the pricing structure for prescription drugs. As you know, Medicare only pays for a very limited family of drugs at the present time. But in fiscal year 2002, they paid $8.2 billion for those drugs. And our office's conclusion over the past few years is simply that Medicare is paying too much for these drugs compared to everyone else. And what our research has shown is that for 24 of the leading drugs that Medicare paid for in 2000, we paid $887 million more than physicians and suppliers paid for those drugs. And perhaps even more interesting—or significant—is that we paid $1.9 billion more than prices available on the Federal Supply Schedule that is used by the Veterans Administration and by other government purchasers.

It is a complicated question, Medicare pricing, but it is one that our office has looked at very carefully, and we have concluded that it is caused by a number of factors, including exploitation of the existing rules and flaws in the reimbursement system. And while the current system is based on something called "average wholesale price," that term is not really defined, and it allows it to be exploited in a way that basically allows Medicare to pay a lot more than anyone else.

Another area that is also subject to exploitation in Medicare is our payments for medical equipment and supplies. Now, what I mean by that is things like power wheelchairs and oxygen and nebulizers and things that physicians prescribe for someone to use at home. And it is a very big area in Medicare in terms of dollars; it is $9.4 billion in claims in 2002.

And again, part of the problem with medical equipment and supplies is the pricing structure, where Medicare pays based on charges submitted in 1987, adjusted in certain ways, but that is essentially what Medicare is relying on. And all of the Office of the Inspector General studies have shown that Medicare is paying too much for this equipment and that the prices have no relationship to actual costs or any relationship to what other payers are paying.

Medicaid has different challenges, because it is like 50 separate programs. So you can have problems that are specific to a State or you can have problems that are nationwide.

And the two that I would focus on are, one, again pricing for prescription drugs in Medicaid, which is a larger problem because Medicaid pays for a lot more drugs than Medicare. And the other one that I would just throw out there is the upper payment limits, which is the way that the Federal Government limits how much the Federal Government can pay to the States for their health care services.

While the Centers for Medicare and Medicaid Services have made some effort in the past year to try and limit that by regulation, there still is a problem that some States are not using Medicaid dollars for Medicaid services. And that is something that we have looked at in the past, we pointed out, and we think needs continued vigilance into the future.

Beyond the investigations and looking at vulnerabilities, our office thinks it is very important to try and prevent fraud rather than going after it after the fact. We have reached out to providers with compliance guidance and with town hall meetings to try and educate people about how to comply with the rules. We will continue to be a part of the error rate auditing at the Centers for Medicaid and Medicare Services, which is the way that CMS measures the fee-for-service erroneous payments.

We have been an integral part of that for the past 7 years, and now it is going to an outside contractor. We hope that with CMS's more expanded use of this tool, they are going to have error rates on many more areas like contractor error rates, provider-specific error rates and error rates that are targeted to specific spending, like on power wheelchairs, and that we will be able to use that and that others will be able to use those error rates to be able to reduce the error rates at CMS even more.

I think that HHS, and in particular the Office of Inspector General, has concentrated on eliminating fraud, waste, and abuse in the past, basically since HIPAA was passed. But it is important that we realize that all of this fraud has serious and profound consequences for the beneficiaries. I am particularly concerned about deliberate fraud that we know continues.

I think that we are doing our best to stay on top of this situation, and we would hope that Congress as our partner would continue

its work in enacting legislation that closes loopholes and fixes some of the exploitation of program vulnerabilities.

From my part, our office is willing to continue to work with the Congress, and we welcome your input and suggestions and any questions that you might have. And I thank you for letting me speak today.

Chairman NUSSLE. Thank you for your testimony.

[The prepared statement of Ms. Corrigan follows:]

PREPARED STATEMENT OF DARA CORRIGAN, ACTING PRINCIPAL DEPUTY INSPECTOR GENERAL, U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

Good morning, Mr. Chairman and members of the committee. I am here today to discuss fraud, waste, and abuse in the Medicare and Medicaid programs.

My job is to prevent and eliminate fraud, waste, and abuse in the many programs of the Department of Health and Human Services, including Medicare and Medicaid. The Office of Inspector General uncovers innocent errors, carelessness, mismanagement, exploitation of the programs, malfeasance, and outright fraud every day. Improper behaviors include providers billing for services not rendered, falsification of diagnoses, and unnecessary tests or services, abusing and neglecting beneficiaries, and accepting kickbacks. These activities cost taxpayers billions in lost and wasted dollars and deprive vulnerable beneficiaries of the care and support they need.

The Medicare and Medicaid programs are managed by the Centers for Medicare and Medicaid Services (CMS), which is the largest component of the U.S. Department of Health and Human Services (HHS). The two programs are particularly vulnerable because of their sheer size. Combined, they constitute the largest single purchaser of health care in the world with fiscal year 2003 projected Federal outlays of over $435 billion. Medicare and Medicaid outlays represented 33 cents of every dollar of health care spent in the United States in fiscal year 2002. Both programs have inherent risks not only because of their high outlays, but because of their complex reimbursement rules and decentralized operations. Medicare alone serves approximately 40 million beneficiaries and processes almost 1 billion claims annually.

With increasing dollars at stake, and with a growing beneficiary population, the potential for vulnerabilities in these programs is greater than ever. Fraud, waste, and abuse schemes are becoming increasingly complex, national in scope, and constantly changing in response to the latest oversight efforts by the congress, CMS, our office and our law enforcement partners.

RECENT MAJOR SETTLEMENTS

There is no better way to illustrate the problems we are facing in the area of fraud, and abuse than to describe some of our most recent settlements. The government alleged that HCA Inc. (formerly known as Columbia/HCA and HCA The Healthcare Company) submitted false hospital cost reports to the government and paid kickbacks to physicians in exchange for their referral of beneficiaries. HCA routinely prepared two sets of cost reports, one that was submitted to the Medicare program, and a set of "reserve" cost reports reflecting how the filed cost reports might be adjusted downward if Medicare were to audit them. The information in the detailed "reserve" cost reports showed that a variety of costs on the filed cost reports were intentionally inflated, including interest charges and capital expenditures. The government also alleged that HCA paid physicians illegal remuneration in the form of free rent, free staff, vacations, recruiting bonuses, payments for "consulting" work that was not, in fact, performed, and phony partnership distributions. Last month, HCA agreed to pay the United States $631 million in civil penalties and damages to resolve its civil liability for these activities.

HCA also entered into a separate administrative settlement with CMS under which it will pay an additional $250 million. Previously, on December 14, 2000, subsidiaries of HCA pleaded guilty to substantial criminal conduct, and HCA paid more than $840 million in criminal fines, civil restitution and penalties for a variety of conduct, including exaggerating the value of services, submitting separate bills for lab tests that should have been bundled, and issues related to the acquisition of home health agencies. This case involved the most comprehensive health care fraud investigation ever undertaken with total recoveries of $1.7 billion, by far the largest recovery ever reached by the government in a health care fraud investigation. More needs to be done on all levels to prevent such behavior from occurring.

Other examples come from the pharmaceutical industry. Three pharmaceutical manufacturers recently entered into large settlements relating, in part, to their prescription drug pricing practices. TAP Pharmaceutical Products Inc., AstraZeneca Pharmaceuticals LP, and the Bayer Corporation agreed to pay $875 million, $355 million, and $14 million, respectively. The government alleged that each company reported their wholesale prices at levels far higher than the actual acquisition cost paid by the majority of physicians and other customers, and marketed the "spread" between the acquisition cost and the reimbursement, thereby causing their customers to receive excess Medicare and Medicaid reimbursement.

MEDICARE VULNERABILITIES

Specific areas of the Medicare program are particularly vulnerable to fraud, waste, and abuse or quality control problems. They include the following:

PRESCRIPTION DRUGS

As indicated by the settlements I described, prescription drug pricing is particularly problematic for Medicare. Because prescription drugs are essential to proper treatment, it is important that Medicare beneficiaries' access to pharmaceuticals not be hindered by overpricing. While the Medicare program covers only a limited family of drugs outside the hospital setting, the cost is quite substantial. Medicare and its beneficiaries paid more than $8.2 billion for covered drugs in fiscal year 2002.

Our office has consistently found that Medicare pays too much for these drugs—more than most other payers. For example, Medicare payments for 24 leading drugs in 2000 were $887 million higher than actual wholesale prices available to physicians and suppliers and $1.9 billion higher than prices available through the Federal Supply Schedule used by Veterans Affairs and other Federal purchasers. This excessive payment continues to grow as the amount paid by Medicare grows larger.

Excessive Medicare prescription drug payments are caused by a number of factors, including billing errors, misinterpretations or abuse of existing rules, and flaws in the reimbursement system. By law, Medicare's payment is based on the drug's average wholesale price. However, our reports have shown that published wholesale prices used to establish Medicare payment rates often bear little or no resemblance to actual wholesale prices available to physicians, suppliers, and other large government purchasers. The Medicare program does not receive average wholesale prices directly from drug manufacturers or wholesalers. Instead, Medicare relies on prices published by data reporting companies that base the reported average wholesale price, in part, on the information provided by manufacturers. Because physicians and suppliers keep the difference between the actual price they pay for a drug and Medicare's reimbursement (based on its published average wholesale price), they have a financial incentive to buy from a drug company with the highest published amount. Thus, manufacturers may have a financial incentive to exaggerate their wholesale price in an attempt to gain market share.

MEDICAL EQUIPMENT AND SUPPLIES

In fiscal year 2002, Medicare allowed $9.4 billion in claims for medical equipment and supplies, of which beneficiaries paid at least $1.9 billion out of their own pockets. Medicare covers nine varieties of medical equipment and supplies, such as durable medical equipment. These are items that can withstand repeated use and include oxygen equipment, hospital beds, wheelchairs, nebulizers, and other equipment that physicians prescribe for home use. Medical supplies include catheter, ostomy, incontinence, and wound care supplies. Medicare also covers braces and artificial limbs.

Medicare pays too much for certain items of medical equipment and supplies because Medicare reimbursement rates for these items are based on charges submitted to the program in 1987. As a result, Medicare payments bear little resemblance to prices currently available in the marketplace or to the actual cost of manufacturing and distributing the equipment. We have also uncovered flaws in payment methods and practices for specific kinds of medical equipment.

As part of a congressional request, we compared Medicare prices for 16 medical equipment and supply items with the prices from the Department of Veterans Affairs (VA), State Medicaid agencies, Federal employee health plans, and retail suppliers. These 16 items, including standard wheelchairs, IV poles, and certain hospital beds and walkers, accounted for more than $1.7 billion of the $6.8 billion Medicare paid for medical equipment and supplies in 2000. This work confirms findings from previous reviews where we found that Medicare pays higher than market prices for some items. For example, we found that the VA median prices ranged

from 31 to 88 percent less than the Medicare prices. In addition, Medicare prices were more than the median retail price for 10 of the 16 items. These median prices were as much as 73 percent less than Medicare prices. If Medicare based reimbursement on such lower prices, the program could save an estimated $84 million to $958 million a year.

In another review, we found that Medicare paid substantially more for maintenance on rented equipment than repairs on purchased equipment. Under current statutory requirements, Medicare pays for maintenance even if the supplier does not need to service the equipment. We found that only 9 percent of the rental equipment actually received any maintenance and servicing. We estimated that Medicare could save approximately $100 million per year by eliminating maintenance payments and instead paying only for repairs when needed.

MEDICARE CONTRACTORS

The Medicare program is administered by CMS with the help of 47 contractors that handle claims processing and administration. The contractors are responsible for paying health care providers, providing a full accounting of funds, and conducting activities designed to safeguard the program. The two main types of Medicare contractors are fiscal intermediaries and carriers. Intermediaries process claims filed under Part A of the Medicare program from institutions, such as hospitals, skilled nursing facilities and home health agencies; carriers process claims under Part B of the program from other health care providers, such as physicians and medical equipment suppliers. The CMS also uses specialty contractors such as payment safeguard contractors, which focus on matters related to fraud, waste, and abuse at the carrier and intermediary level, and the durable medical equipment regional carriers, which specialize in analysis and processing of billings for medical equipment and supplies.

Of all the problems we have observed, perhaps the most troubling has to do with the contractors' own integrity such as misusing Government funds, actively trying to conceal these actions, and altering documents and falsifying statements that specific work was performed. This was illustrated by the 2002 settlement with General American Life Insurance Company, Inc., in which the company agreed to pay the government $76 million. The settlement resolved allegations that the former Medicare carrier engaged in improper claims handling and quality assurance reporting practices to maintain a high performance ranking. However, this is only one example. To date, the Federal Government has settled 19 cases involving contractor fraud, with settlements ranging from approximately $48,000 to $76 million.

In some cases, contractors prepared documents that inaccurately indicated superior performance, which Medicare then rewarded with bonuses and additional contracts. Some contractors adjusted their claims processing so that system edits designed to prevent inappropriate payments were turned off, resulting in misspent Medicare Trust Fund dollars. Contractor cost reports were found to contain improprieties, such as double billing and claiming private insurance business costs as if they were costs incurred under Medicare contracts.

OTHER EXAMPLES

The results of recent investigations reveal the great variety of fraudulent behavior that we must deal with. Here are a few examples.

Cancer treatments. A physician in Indiana developed a scheme to defraud Medicare and several other insurance providers by providing unapproved treatments to terminally ill cancer patients. The doctor injected these patients with live cells from pigs and cows under the guise of "live cell therapy." He also provided "shake and bake therapy" by injecting the patients with a sand-like substance that caused the patients temperature to rise to a point where they convulsed under the theory that the cancer was being baked out of the patients' systems. All of these therapies were billed as if chemotherapy was being provided.

Nerve conduction tests. A South Carolina doctor schemed to defraud the Medicare program by forcing his patients to undergo unnecessary nerve conduction tests. These tests were conducted regardless of the patients' diagnoses or symptoms. The doctor would withhold the patients' medications until they agreed to undergo the tests.

Lab tests. In Massachusetts, a laboratory submitted claims for unnecessary tests and blood draws on terminally ill dialysis patients. The blood drawn from these patients was then used to run series of unnecessary tests to receive Medicare reimbursements.

Equipment and supplies. In Florida, over 30 people conducted a large-scale scheme to defraud the Medicare program by billing for durable medical equipment

supplies that were not provided to beneficiaries and/or not medically necessary. This scheme involved billing Medicare for motorized wheelchairs and other high-cost equipment by more than 40 companies. Kickbacks were paid to doctors in return for their signing of required Certificates of Medical Necessity. Co-pays that should have been paid by the beneficiaries for the equipment were waived in order to establish "good will" with the beneficiaries and to keep them from possibly complaining. Much of the proceeds from this scheme were sent to overseas bank accounts.

MEDICAID VULNERABILITIES

The Social Security Act authorizes grants to States to provide medical assistance to needy persons. The Medicaid program is administered by the various States in accordance with approved State plans. While States have considerable flexibility in designing their State plans and operating their Medicaid programs, they must comply with broad Federal requirements. Medicaid programs are jointly financed by the Federal and State governments according to a defined formula. The Federal percentage ranges from 50 percent to 83 percent, depending on each State's relative per capita income.

PRESCRIPTION DRUG PRICING AND DRUG REBATES

Like Medicare, the Medicaid program faces significant vulnerabilities in the prescription drug area, a weakness that is compounded by the fact the Medicaid currently reimburses for many more drugs than does Medicare. These vulnerabilities arise in two areas: reimbursements for prescription drugs and the collection of rebates under the Medicaid drug rebate program.

The Medicaid program faces many of the same problems as Medicare in paying for prescription drugs. States generally use the average wholesale price minus a percentage discount as a basis for reimbursing pharmacies for both brand name and generic drug prescriptions. The average discount for both brand and generic drugs combined was about 10.3 percent nationally in 1999. We believe larger discounts are warranted because of the wide disparity between what a Medicaid agency pays pharmacies for the drug as compared to the actual pharmacy acquisition cost. As discussed in the Medicare section, reimbursement based on the average wholesale price creates certain adverse incentives and is subject to abuse.

Following are the results of our brand name and generic prescription drug reviews. These reviews were limited to ingredient acquisition costs and did not address other areas such as the cost of dispensing the drugs. Generally, States pay retail pharmacies for the ingredient cost of the drug (average wholesale price minus a certain percentage) plus a dispensing fee. We have recommended that CMS require the States to bring pharmacy drug reimbursement more in line with the actual acquisition costs of both brand and generic drugs. CMS concurred that an accurate acquisition cost should be used to determine drug reimbursement and will encourage States to review their estimates of acquisition costs in light of our findings.

Brand name drugs. In a final report issued in August 2001, we pointed out that about $1 billion in savings could have been realized for 200 brand name drugs with the greatest amount of Medicaid reimbursement in 1999. Our review of pricing information from 216 pharmacies in 8 States estimated that pharmacy actual acquisition costs nationwide averaged about 22 percent below the average wholesale price in 1999.

Generic drugs. In a report issued in March 2002, we concluded that significant savings could be realized on generic prescription drugs reimbursed by States under the Medicaid program. Our review of pricing information from 217 pharmacies in 8 States estimated that pharmacy actual acquisition cost nationwide for generic drugs averaged 65.9 percent below average wholesale price rather than the 10.3 percent discount most States averaged. For the 200 generic drugs with the greatest amount of Medicaid reimbursement in 1999, we calculated that as much as $470 million could have been saved if reimbursement had been based on a 65.9 percent average discount. Our current recommendations center on an additional analysis that I will describe next.

Multi-tiered pharmacy reimbursement system. As a follow-up to our previous work on brand and generic drug pricing, we conducted an extended review by identifying discounts off the average wholesale price for specific categories of drugs. This analysis showed that there is a wide range of discounts for purchases depending on the category of drug that is being purchased. Accordingly, we recommended that if States continue to use a reimbursement system based on average wholesale price, CMS should encourage States to bring pharmacy reimbursement more in line with the actual acquisition cost of drug products.

Drug rebates. As a condition for having their prescription drugs reimbursed by the program, Medicaid requires pharmaceutical manufacturers to enter into written agreements with the Department and to pay rebates to the States. This is a feature absent from the Medicare program. The Medicaid drug rebate program, for which no final regulation has ever been published, requires a manufacturer to report certain pricing information, including its best price, to CMS and to pay rebates to the State Medicaid programs based on the reported prices. A manufacturer's failure to properly determine and report its best price can lead to the significant underpayment of rebates to Medicaid. Three major pharmaceutical drug manufacturers recently settled False Claims Act cases for their failure to comply with requirements of the Medicaid drug rebate program and to pay appropriate rebates to the States. Bayer Corporation, GlaxoSmithKline and Pfizer Inc. paid approximately $257 million, almost $88 million, and $49 million, respectively, to resolve these cases.

We have often said that Medicaid should have a level playing field on how it collects rebates and how it pays for drugs. Currently, rebates are based on the average manufacturer's price while reimbursement is generally based on the average wholesale price. Significant savings could be realized if drug rebates and drug reimbursements both had the same basis. If the basis for reimbursement and rebates is the same, any increase in the reimbursement basis would have a corresponding increase in rebates to Medicaid.

UPPER PAYMENT LIMITS

The Office of Inspector General has found problems with States billing the Federal Government for payments made to public providers when in fact the funds do not remain at the provider for use for medical services. For example, we found that some States required public providers to return Medicaid payments to the State governments through intergovernmental transfers. Once the payments were returned, the States would use the funds for other purposes, some of which were unrelated to Medicaid. Although this practice could potentially occur with any type of Medicaid payment to public facilities, we identified two instances in which such payments were prevalent: Medicaid enhanced payments available under upper payment limits and Medicaid disproportionate share hospital payments. I will discuss the upper payment limit provision first.

State Medicaid agencies have flexibility to set the rates they pay to hospitals and nursing facilities. There is a limit, however, as to how much can be paid in the aggregate within the State. In regulation, this is termed a Medicaid upper payment limit. This upper limit required that all the individual payments to the facilities cannot exceed what the Medicare program would have paid for similar services. Federal regulations in effect before March 13, 2001 established two groups of aggregate limits. One group pertained to all providers in the State (private, State-, city-, or county-operated). This second group applied to the State-operated facilities.

These payments were made as enhanced or additional payments that exceeded the regular payments for Medicaid services. For example, if Medicaid paid $5,000 for a hospital inpatient service, but Medicare would have paid $6,000 for that same service, the $1,000 difference would have been the additional amount that the State could have claimed under the regulations. The States used this calculation to their advantage by claiming Federal funds up to the limit but did not always allow for the facilities to retain these funds to pay for actual delivery of medical services. The Federal funds returned to the State through intergovernmental transfers were then available to the States for any purpose, including issues not related to health care.

In short, this use of intergovernmental transfers as part of the enhanced payment program was a financing mechanism designed to maximize Federal Medicaid reimbursements by avoiding the Federal/State matching requirements. The result is a lack of accountability for Medicaid dollars, including their being used for purposes not intended by the Medicaid statute.

In an effort to curb these practices and ensure that State Medicaid payment systems promote economy and efficiency, CMS issued a final rule, effective March 13, 2001, which modified upper payment limit regulations in accordance with the Benefits Improvement and Protection Act of 2000. The regulatory action created three aggregate upper payment limits—one each for private, State, and non-state government-operated facilities. The new regulations will be gradually phased in and become fully effective on October 1, 2008. We commend CMS for changing the upper payment limit regulations. The CMS projected that these revisions will save $55 billion in Federal Medicaid funds over the next 10 years. The CMS also changed the enhanced payments that States may pay public hospitals from 100 percent to 150 percent of the amount that would be paid under Medicare payment principles. We recommended continuing to limit payments to 100 percent, and CMS implemented

the recommendation, achieving an additional savings of $24.3 billion over 10 years. At the request of CMS, our office will conduct audits to monitor compliance with the new regulations.

When fully implemented, CMS's changes will dramatically limit, though not entirely eliminate, the amount of State financial manipulation because the regulation does not require that enhanced funds be retained by the targeted facilities to provide medical services to Medicaid beneficiaries.

DISPROPORTIONATE SHARE HOSPITAL PAYMENTS

Medicaid makes special payments designed to assist hospitals that provide care to a large number of Medicaid beneficiaries and uninsured patients. These "disproportionate share" payments are important because public "safety net" hospitals face special circumstances and play a critical role in providing care to vulnerable populations. However, we found that hospitals that retained enhanced payments available under the upper payment limit regulations did not use the special payments for their disproportionate share of Medicaid and uninsured beneficiaries. Instead, audit results in several States showed that public hospitals returned large portions (80 to 90 percent) of the payments to the State Medicaid agencies through intergovernmental transfers. We have expanded our audit work to additional States to further review these special payments being made to hospitals.

In addition, we have found that disproportionate share payments to individual hospitals exceeded hospital specific limits imposed by OBRA of 1993. To date, we have identified about $645 million (Federal share) in payments that exceed the OBRA limit. The limits were exceeded for a variety of reasons, including the lack of a mechanism at the State level to ensure that the payments did not exceed the actual cost of providing services, duplication of costs, exceeding Medicare cost limits, and the inclusion of unallowable/non-hospital costs in uncompensated care costs.

We recommend that public hospitals retain the State and Federal shares of the enhanced Medicaid payments up to the 100 percent aggregate limit payable under Medicare payment principles and receive and retain 100 percent of the State and Federal shares of allowable disproportionate share payments and use the funds for delivering medical services to Medicaid beneficiaries.

REMEDIAL MEASURES

HEALTH CARE FRAUD AND ABUSE CONTROL PROGRAM

The problems that I have discussed with you today are extremely complex. The Office of Inspector General helps prevent and detect fraud, waste, and abuse through a comprehensive and sustained program of audits, investigations, evaluations, enforcement, and outreach. Since the passage of the Health Insurance Portability and Accountability Act of 1996, our effectiveness has been strengthened through an increased and predictable funding base for our office and CMS for fraud, and abuse control efforts. Annual increases were authorized through the end of this year.

With these resources, our office conducted or participated in 568 successful health care prosecutions or settlements in fiscal year 2002. A total of 3,448 individuals and entities were excluded, many as a result of criminal convictions. In the same period, the Department acted on our recommendations to disallow almost $300 million in improperly paid health care funds, and another $1.5 billion is expected as receivables from investigative activities. Implementation of our recommendations to correct systemic vulnerabilites resulted in more than $19 billion in savings in fiscal year 2002.

The Office of Inspector General does not work alone. We are joined by the Department of Justice and a host of other partners, among them the State Medicaid Fraud Control Units (MFCUs) and State auditors.

MEDICAID FRAUD CONTROL UNITS

The responsibility for detecting, investigating and prosecuting fraud, and abuse in the Medicaid program is shared between the Federal and State governments. Each State is required to have a program integrity unit dedicated to detecting and investigating suspected cases of Medicaid fraud. Most States fulfill this requirement by establishing a Medicaid Fraud Control Unit. Each of the Medicaid State agencies also has a Medicaid Management Information System. A subpart of this data system is the Surveillance and Utilization Review Subsystems Units. These units are charged with ferreting out fraud by conducting preliminary reviews of providers and beneficiaries with aberrant claims or billing patterns that possibly indicate criminal

fraud. When potential fraud cases are detected, the cases are referred to the MFCUs.

Since the inception of the Medicaid fraud control program, the MFCUs have recovered hundreds of millions of program dollars. The Office of Inspector General, MFCUs, and other law enforcement agencies work together to coordinate anti-fraud efforts. These partnerships have greatly enhanced our ability to carry out our mission. In fiscal year 2002, we conducted joint investigations with the MFCUs on 218 criminal cases and 37 civil cases. During this time there were 70 criminal convictions and 17 civil settlements or judgments on cases worked jointly with the MFCUs.

STATE MEDICAID AUDIT PARTNERSHIP

Another important cooperative effort includes State Medicaid audit partnerships. The partnership plan was created as a way to provide broader coverage of the Medicaid program by collaborating with State auditors, State Medicaid agencies, and State internal audit groups. The level of involvement of each partner is flexible and can vary depending upon specific situations and available resources. The OIG role might entail sharing our methodology and experience in examining similar Medicaid issues. In other cases, we may join together with State teams to audit suspected problems.

For example, an audit conducted with the Delaware State auditor indicated that a State agency had overpaid Medicaid managed care organizations and other health care providers $364,000 for services rendered on behalf of deceased recipients. The overpayments resulted because of major weaknesses in internal controls. The State agreed to recover the overpayments and has begun to strengthen internal controls. Other issues examined in this partnership program with State auditors include 'Medicaid outpatient prescription drugs, unbundling of clinical laboratory services, outpatient non-physician services already included as an inpatient charge, excessive costs related to hospital transfers, excessive payments for durable medical equipment, acquisition costs for Medicaid drugs, and program issues related to managed care.

To date, these joint efforts have been developed in 25 States. Completed reports have identified $263 million in Federal and State savings and included recommendations for improvement in internal controls and computer systems operations.

INDUSTRY OUTREACH AND EDUCATION

The Office of Inspector General is interested not only in detecting and dealing with fraud, waste, and abuse, but also in preventing it. One way we do this through outreach. We have engaged in numerous outreach efforts designed to work with the health care industry to assist providers in preventing fraud, waste, and abuse, and to increase their compliance with Federal health care program requirements. Information about these outreach efforts and results of our audits, investigations, evaluations, and enforcement initiatives are routinely made available through the Internet on our website at *www.oig.hhs.gov*. Our office continues to work with the health care industry to gain an understanding of the issues confronted by the industry as providers implement and maintain compliance programs. Prevention initiatives, such as those listed below, inform and assist the health care industry and program beneficiaries.

Compliance program guidance. Compliance program guidances promote industry awareness of models for corporate integrity and compliance programs. Thus far, we have issued 11 compliance program guidances for various sectors of the health care industry such as hospitals, laboratories, home health agencies, and ambulance services. Each guidance provides concrete suggestions for designing and implementing internal controls and procedures to address identified risk areas for the applicable health care sector. These guidances are not mandatory. They provide recommendations on the voluntary establishment of systems, structures and policies that enhance compliance with Federal health care program requirements.

Advisory opinions. Through the advisory opinion process, parties can obtain binding legal guidance as to whether their existing or proposed health care business transactions violate the Federal anti-kickback statute, the civil monetary penalties laws, or our office's exclusion authorities. The advisory opinion process enhances OIG's understanding of new and emerging health care business arrangements and informs our development of new safe harbor regulations, fraud alerts, and special advisory bulletins. We have issued 20 advisory opinions in fiscal year 2002 and 14 to date in fiscal year 2003. More than 100 advisory opinions have been issued since 1997.

Corporate integrity agreements. Many health care providers that enter into agreements with the United States in settlement of potential liability for violations of the False Claims Act or Civil Monetary Penalties Law also agree to adhere to a "corporate integrity agreement." Under the agreement, the provider commits to establishing a program or taking other specified steps to ensure its future compliance with Federal health care program requirements. The duration of most agreements is 5 years, during which time providers must undertake audits of their billings to the Federal health care programs, typically conducted by an independent review organization, such as an accounting firm, and submit periodic reports to our office. Integrity agreements require a substantial commitment by the provider to ensure that the organization is operating in accordance with Federal health care program requirements and the parameters established by the agreement itself. Breach and default provisions in the CIAs help to ensure compliance with their requirements. As of the current date, we are monitoring more than 350 corporate integrity agreements.

ASSESSMENT OF PROGRESS IN ADDRESSING THE CHALLENGE

To help ensure the financial integrity of the Medicare program, and the continued availability of Medicare benefits, it continues to be essential that documented and accurate bills are submitted for correct payment for properly rendered health care services. We reported that improper payments under Medicare's fee-for-service system totaled an estimated $13.3 billion during 2002, or 6.3 percent of the $212.7 billion in fee-for-service payments processed by CMS. That estimate is about half of the $23.2 billion that was estimated for 1996, when OIG developed the first national error rate. The error rate does not include improper payments made as a result of falsified documents, kickbacks, or other types of undetectable fraud. It does reflect progress in reducing waste due to improper billings. Our 7-year analysis indicates that over 80 percent of the claims that did not meet reimbursement requirements were attributable to unsupported and medically unnecessary costs two areas that will receive ongoing monitoring. As in past years, we estimated that over 92 percent of the 2002 fee-for-service payments met Medicare reimbursement requirements. CMS has demonstrated continued vigilance in monitoring the error rate and developing appropriate corrective action plans. In addition, due to CMS's work with the provider community to clarify reimbursement rules and to impress upon health care providers the importance of fully documenting services, the overwhelming majority of health care providers follow Medicare reimbursement rules and bill correctly.

In fiscal year 2003, CMS will fully implement its Comprehensive Error Rate Testing Program and the Hospital Payment Monitoring Program to produce a Medicare fee-for-service error rate. This methodology will establish, for the first time, baselines to measure each contractor's progress toward correctly processing and paying claims. The results will reflect the contractor's performance and will identify specific provider billing anomalies in the region. Contractors will then develop targeted corrective action plans to reduce payment errors through provider education, claim reviews, and other activities, and CMS will evaluate their rate of improvement.

CONCLUSION

As I stated at the beginning of my testimony, I believe a concentrated effort by a large number of people has resulted in tangible progress in combating fraud, waste, and abuse in recent years. However, the problems that remain are serious, complicated, and have profound consequences. I am particularly concerned about the deliberate fraud that we know continues. We must never let down our guard, and we must continue to dedicate the resources and make the concerted effort to reduce these problems.

We are doing our best to stay on top of this situation, and are continuously involving all of our partners in the enterprise. Since the Congress itself is one of our partners, I would like to take this opportunity to recommend for your consideration a dual strategy for dealing with fraud, waste, and abuse on the legislative front.

The first strategy is to prevent these abuses from happening. This can be done through legislation to address aspects of programs where their underlying statutes make them vulnerable or where changes in the statutes would be more conducive to effective administrative action. One good example is the authority for Medicare payments for prescription drugs, frequently mentioned in my testimony. This problem needs prompt action to prevent wasteful spending of hundreds of millions of taxpayer dollars every year, with the losses mounting with each passing month. Additional proposals are found in our Red Book of savings that we publish annually based on our audits and evaluations.

Of course, it is important to make sure that legislation for new programs does not create new vulnerabilities. Protection from fraud, waste, and abuse needs to be crafted into the legislation itself. We stand ready to assist the Congress in this regard. Indeed, one of our responsibilities under the Inspector General Act is to provide advice on proposed legislation.

The second strategy is to ensure that adequate, reliable, and predictable resources are available to our office and our law enforcement and administrative partners. Most of the achievements by our office were made possible by the enhanced resources provided through the Health Care Fraud and Abuse Control Program. As stated previously, funding under this program at enhanced levels is essential to our continued success in addressing the problems I have identified in my testimony today. It will also further assist our office in its continued outreach activities with the health care industry to increase the industry's awareness and further improve its record of voluntary compliance.

I appreciate the opportunity you have given me today to focus attention on the continuing problems and vulnerabilities that confront us and to share with you some of our efforts and recent initiatives. I welcome your questions.

Chairman NUSSLE. Our final witness on this panel is Kenneth Mead, Inspector General for the Department of Transportation. Welcome. We are pleased to receive your testimony.

STATEMENT OF KENNETH M. MEAD

Mr. MEAD. Thank you, Mr. Chairman. The target the committee set for Transportation was about $500 million, a little less than 1 percent of the DOT's budget request of $54 billion. Your target is not unreasonable in my opinion. Your timing is also impeccable.

As many of you may know, highways, transit programs, the aviation program, and the maritime programs are all up for reauthorization this year. Amtrak reauthorization expired last year and the appropriators did give them money, of course, but Amtrak really needs a reauthorization at some point in time.

I want to say right up front that Secretary Mineta, Deputy Secretary Jackson, and the modal administrators have been extremely supportive of our work in every way. We really could not ask for any more.

I would like to paint for the committee a frame of reference. You probably know that DOT relies very heavily on trust funds for its money. About 85 percent of the budget comes from Aviation/Highway Trust Funds. People don't always like to talk about this, but the revenue projections for both of those trust funds are down sharply. Over the next 4 years, Aviation Trust Fund revenue is expected to be about $10 billion less than projections; a big drop has also occurred in the Highway Trust Fund Revenue. Revenues there fell about 20 percent, from $39 billion in 1999 to $31 billion in 2001. Over the next 4 years we expect about $18 billion less than had been projected.

So, when you take the declining trust fund revenues and you couple that with a deficit of over $400 billion in 2003, the urgency of cost control is manifest.

I would like to speak today to some opportunities for savings in the highway, transit, aviation, and maritime areas, and would like to close with some observations about Amtrak.

First highways and transit. The key issue for the Federal Highway Administration and Transit Administration is ensuring that major projects are delivered on time, on budget, and free from fraud. You know, whether funds are lost to cost overruns, schedule delays or fraud, the result is fewer dollars for transportation

projects. And to put that in perspective, the staff gave me an interesting figure: if the efficiency with which the $500 billion that was invested by the Federal and State governments over the past 6 years, if that efficiency were improved by just 1 percent, you would have an additional $5 billion, which would be enough to fully fund four of the fifteen active major highway projects in the United States.

Here are some opportunities. Highways has to be more vigilant in identifying funds that are no longer needed by the States. We have found funds sitting idle on inactive projects that could be redeployed to fund active projects. We are not talking small change here. In 2001 we found $238 million in that category, in just the States we sampled. And we are going to report this year that the problem continues. So there is money that has already been appropriated; it is available, just not being used.

Second area. There are a number of large projects that stand as examples of good project management practices, but there are also glaring examples of projects that have been plagued by some ineffective management. This is an issue at both the State and Federal levels. For example, we have seen unreliable cost estimates on major highway and transit projects lead to substantial cost increases. One that everyone in the room I am sure is aware of is the Central Artery in Boston. That project increased from $2.5 billion to $14.5 billion.

The most recent example occurred in Virginia with the Springfield Interchange. That is a project that, as Mr. Moran knows—he requested us to do some work here—that moved from $300 million to about $675 million. The cost estimates for that project today, in today's environment, was shocking. They did not include something as basic as the cost of inflation.

Another problem is that finance plans, which identify elementary things like a project's cost, schedule, funding sources, and risk, are usually not required for highway projects under $1 billion. In our opinion, it is just common sense that projects costing $100 million or more of taxpayer dollars ought to have a finance plan. The Department, the administration, has proposed this in the pending reauthorization proposal for highways.

Our work has also disclosed that until very recently, the last couple of years, the Federal Highway Administration rarely focused on program and major project management and financial oversight. They took a partnership approach in exercising their oversight role on Federal highway projects. That is important, and it is good to have a partnership where it works. However, it is also important to keep the capability of stepping back and making the hard calls when necessary. We found that hadn't always been the case.

Another interesting one is that today's modern highway projects also require professional competencies in financing, cost estimating, program analysis, a whole range of multidisciplinary skills. But Highway's expertise in this area is very limited. Most of their people are engineers. The Central Artery in Boston: we spent time approving 14,000 design changes and missed $1.5 billion in overruns.

I think fraud in highway and transit construction projects remains a significant concern, not at the levels of the 1960s and

1970s, but it has tripled in the last several years, and we are very concerned about that.

Another issue I would like to put on your radar screen as a national problem is abuse of the disadvantaged business enterprise program where people, in order to secure contracts, go out and create false front firms.

Another significant opportunity exists to bolster revenue collections for the Highway Trust Fund. Fuel tax fraud is draining, it is estimated, about $1 billion annually from the fund.

I would like to turn to FAA for a moment. FAA's budget request for $14 billion is exceeding projected trust fund revenues by about $3 billion. In 1996, Congress give FAA direction to become a performance-based organization. Congress also gave them personnel reform and acquisition reform authority. Seven years later, I don't see sufficient progress in meeting the outcomes. Instead, we have seen enormous costs growth at FAA.

In terms of operating costs, the most discernible results of personnel reform have been higher salaries. The new pay system for controllers was a significant cost driver. Between 1998 and 2003, the average base pay for a controller increased by nearly 50 percent. It is now over $100,000 a year. That compares to an average salary increase for other FAA employees of about 30 percent.

Also, although linking pay and performance was a key tenet of personnel reform in FAA, roughly 36 percent of FAA employees today are based on—their pay is based on—individual performance. The remainder get largely automatic pay increases.

I think the critical tool that FAA needs to control costs is a cost accounting system. In 1996, Congress, by law, directed FAA to create one. At that time it was estimated it would cost $12 million and to be completed in 1998. Well, we are 7 years into development and have spent $38 million. They estimate $7 million to go, and I hope we have a cost accounting system in place sometime in 2004.

There are a number of opportunities for cost savings that we can get into in the Q and A if you would like.

I would like to say a word about FAA's experience with procurement reform. They are doing a good job of awarding contracts quicker, but their major acquisitions continue to experience large cost increases, extended delays, and performance problems.

We tracked 20 major air traffic control modernization acquisitions. They have experienced cost growth of over $4.3 billion and schedule slips of 1.7 years. That is simply not sustainable. That cost growth alone now exceeds 100 percent of a full year's appropriation for the facilities and equipment accounts.

And meanwhile, FAA is starting to launch and embark upon new multibillion-dollar procurements. At some point they have got to take some management actions to get control over these overruns.

Maritime Administration. They have the loan guarantee program. We audited it and found that it was in need of fundamental reform in nearly every phase. They have had about a half a billion dollars in defaults over the past several years. Congress recently required those reforms and the Department is acting on them. I think there is a lot of promise there.

In Amtrak, the message here is: the model that we have for Amtrak is broken. Amtrak is asking for $1.8 billion and the adminis-

tration has requested about $1 billion. I think there are several possible options for dealing with Amtrak and they are described in the testimony submitted for the record. Amtrak is awash in debt—$4.8 billion today; compared to $1.7 billion the last time you reauthorized them. Their annual operating losses are about $1.1 billion. They have a capital repair backlog of $6 billion, even though their ridership revenue is up. I would just encourage the committee to take Amtrak's governance structure and consider what we want for rail in this country. Fundamentally, we are not going to get out of the Amtrak problem by saving your way out of it.

Thank you.

Chairman NUSSLE. Thank you.

[The prepared statement of Mr. Mead follows:]

PREPARED STATEMENT OF HON. KENNETH M. MEAD, INSPECTOR GENERAL, U.S. DEPARTMENT OF TRANSPORTATION

Chairman Nussle, Ranking Member Spratt, and other members of the committee, we appreciate this opportunity to testify today about opportunities to control costs and improve the effectiveness of Department of Transportation (DOT) programs. At this committee's direction, the concurrent resolution on the Budget for fiscal year 2004 requires House and Senate authorizing committees to identify opportunities to eliminate waste, fraud, and abuse in programs under their jurisdiction. Efforts to combat waste, fraud, and abuse take on even more importance today, when we face significant financial challenges. The Congressional Budget Office recently updated its estimate of the fiscal year 2003 deficit to $400 billion, or close to 4 percent of gross domestic product.

This committee and the Senate Budget Committee also identified savings targets expected from each authorizing committee. The target for budget authority that was provided to the House Transportation and Infrastructure Committee totaled $491 million, a little less than 1 percent of DOT's fiscal year 2004 budget request. This approach calls for the committees with expertise about specific programs to target waste, fraud, and abuse associated with those programs. DOT, for example, administers several important transportation programs that contribute to meeting national economic, safety, and mobility goals. Overall, DOT's fiscal year 2004 budget request is $54.3 billion, of which $46.2 billion (85 percent) is from DOT trust funds and $8.1 billion (15 percent) is from the General Fund.

We believe the committee's target of identifying about $500 million in waste, fraud, and abuse in DOT programs is reasonable and can be achieved by implementing administrative and legislative opportunities to (1) improve the efficiency and effectiveness of DOT programs, (2) avoid unnecessary program cost increases, and (3) cut costs and reduce losses to fraud, and abuse.

We in the DOT Office of the Inspector General have attempted to do our part to identify program improvements, cost avoidance opportunities, and direct cost savings to reduce program cost growth and ensure that we get the most from our transportation investments. From fiscal year 1997 through the first half of fiscal year 2003, we made over $6 billion in recommendations to put funds to better use, and we have questioned more than $475 million in costs. Our investigators also completed 1,486 convictions and obtained over $260 million in fines, restitutions, and civil judgments—bringing funds back to the U.S. Treasury or to affected programs.

I want to use our time today to focus on opportunities we have identified to use funds more efficiently and effectively, avoid unnecessary cost increases, and reduce costs in (1) Federal Highway Administration (FHWA) and Federal Transit Administration (FTA) grants to States and localities; (2) Federal Aviation. Administration (FAA) operation, maintenance, and acquisition programs; and (3) Maritime Administration's (MARAD) Title XI Loan Guarantee Program.

Finally, I will conclude my remarks with a few observations about Amtrak, which presents a different type of challenge because its program structure is fundamentally broken and needs to be rethought.

DOT management has been responsive to our recommendations to correct the deficiencies in most of these areas. In particular, Secretary Mineta, Deputy Secretary Jackson, and the Administrators have emphasized the need to improve oversight to get more value from the Federal investment. This has included making tough calls in project funding decisions and proposing significant legislative changes to

strengthen stewardship, oversight, and fraud detection and prevention provisions related to highway and transit investments.

FEDERAL HIGHWAY ADMINISTRATION AND FEDERAL TRANSIT ADMINISTRATION

FHWA has requested $30.2 billion (all from the Highway Trust Fund) for grants to States and local governments to build and repair highways and to reduce highway injuries and fatalities. FTA requested $7.2 billion ($5.9 billion from the Highway Trust Fund and $1.3 billion from the General Fund) for grants to transit operators, and to State and local governments for the construction of transit facilities and purchase of transit equipment.

However, Highway Trust Fund tax receipts have fallen from $39.3 billion in fiscal year 1999 to $31.5 billion in fiscal year 2001, a 20 percent decline. Current estimates show that between fiscal year 2003 and fiscal year 2006, Highway Trust Fund tax revenues will be about $18 billion less than projections made in April 2001, and are not expected to return to the fiscal year 1999 level until fiscal year 2008.

Whether funds are lost to cost overruns, schedule delays, or fraud, the result is the same—fewer resources are available for important transportation projects. To illustrate, if the efficiency with which the $500 billion invested by the Federal Government and the States over the last 6 years on highway projects had been improved by only 1 percent, an additional $5 billion would be made available—enough to fund 4 of the 15 active major highway projects.

Although proposals have been made to increase funding for Federal-aid Highways, and these proposals may have merit, we believe considerably more can and should be done to stretch Federal dollars by ensuring that funds are spent cost effectively.

We have identified a number of ways, based on our audits and investigations, that FHWA and FTA could do a better job. These are:

MAKING BETTER USE OF AVAILABLE FUNDS

FHWA must be more vigilant in identifying funds that are no longer needed by States. These funds, sitting idle on inactive projects can be redeployed to fund active projects. We found $238 million in funds that States no longer needed on projects that should have been redirected to other projects. Of this amount, $54 million had been idle for 16 years on a freeway project in Connecticut that had never been started.

STRENGTHENING PROJECT MANAGEMENT

We have reviewed projects in which management and oversight were ineffective, leading to significant cost increases, financing problems, schedule delays, or technical or construction difficulties. These projects include the Central Artery, the Woodrow Wilson Bridge, the Springfield interchange in Virginia, Puerto Rico's Tren Urbano, the Los Angeles Metro Red Line, and the San Francisco Bay Area Rapid Transit (BART) Airport Extension.

One problem we have repeatedly seen is that cost estimates on major highway and transit projects have been unreliable and have led to substantial cost increases in the long run. For example, we found the Virginia Department of Transportation understated project cost estimates by $236.5 million, or 35 percent, on the Springfield Interchange project by not including estimates for some known and planned costs. Significant cost estimating problems also occurred on the BART Airport Extension. Our April 2000 report noted that the project's costs had increased by $316 million over the initial cost estimate.

Another problem is that finance plans are not usually required for highway projects under $1 billion, although such projects can also burden a State's management resources. A finance plan is a management tool that is vital in providing project managers and the public with information on how much a project is expected to cost, when it will be completed, whether adequate funding is committed to the project, and whether there are risks to completing the project on time and within budget.

In our opinion, finance plans should be prepared for projects costing $100 million or more, and responsibility for approving those plans should be delegated to the States, with the Secretary reserving the right to review any plan. If the States are going to spend $100 million of taxpayer money, it is reasonable to require them to develop an approved finance plan that identifies project costs, milestones, and funding sources. The Department has incorporated this new requirement in its reauthorization proposal.

Our work has identified two reasons for ineffective oversight of Federal-aid highway projects. First, until recently, FHWA managers rarely focused on program and

major project management and financial oversight. FHWA took a partnership approach in exercising its oversight role of Federal-aid Highway projects, with FHWA channeling money for highways to the States and working with State highway personnel to administer highway contracts. This partnership is important, but it is equally important that FHWA be willing to step back and make the hard calls when necessary.

Second, today's highway projects require professional competencies in emerging technologies, financing, cost-estimating, program analysis, environmental processes, and schedule management. Yet, FHWA's expertise in these areas is severely limited because its workforce is structured almost exclusively around engineering skills that were in greater demand during construction of the interstate system. FHWA should restructure its staffing mix to bring the right set of skills to bear on oversight activities.

DETECTING AND PREVENTING FRAUD

During the last 4½ years highway and transit-related fraud indictments have tripled, convictions have doubled, and monetary recoveries totaled more than $80 million. We currently have over 100 ongoing investigations of infrastructure projects or contracts. Fraud schemes that we are commonly seeing today include bid-rigging and collusion among contractors; false claims for work or materials not provided on the project; product substitution by contractors or vendors who provide substandard or inferior materials; bribery of inspectors to look the other way on their duty to ensure quality of work or materials; failure by contractors to pay workers required prevailing wages; and fraud against the Disadvantaged Business Enterprise (DBE) Program for minority and women contractors who are used as "false front" companies.

DBE fraud is an area with serious enforcement and compliance problems that requires more attention and appears to be nationwide in scope. In an effort to protect the Government's interest against fraud on transportation projects we recommended the Department adopt language in its highway reauthorization proposal to make debarment mandatory and final when a contractor is convicted of a fraud. In addition, since State programs are the ones damaged by fraud, allowing States to share in any recoveries would help them restore their programs and provide support for further fraud deterrence and detection efforts.

INCREASING REVENUE COLLECTIONS

Fuel tax fraud drains the Highway Trust Fund of an estimated $1 billon annually, which can be mitigated with strengthened enforcement and investigative efforts to increase tax collections. Cross-border bootlegging of fuel and diversion of aviation "jet" fuel are two areas needing further attention. Federal and State legislative changes could facilitate more effective tax collections and investigations.

FEDERAL AVIATION ADMINISTRATION

In 1996, Congress acted to make FAA a performance-based organization by giving the agency two powerful tools—personnel reform and acquisition reform.

The expectation was that, by being relieved of Government personnel and procurement rules, FAA would operate more like a business—that is, services would be provided to users cost effectively and air traffic control modernization programs would be delivered approximately on time and within budget. Seven years later, FAA's budget has grown from $8.2 billion in fiscal year 1996 to $14 billion in fiscal year 2004—an increase of $5.8 billion, or over 70 percent. About half of that increase was attributable to FAA's operating budget. During this period, we have also seen large cost overruns and schedule slips in FAA's major acquisitions.

Continued growth of that magnitude is unsustainable, given the multibillion-dollar declines in projected Aviation Trust Fund receipts and greater dependence of FAA in the General Fund. In fact, projected tax receipts to the Aviation Trust Fund for fiscal year 2004 have dropped from approximately $12.6 billion estimated in April 2001 to about $10.2 billion estimated in February 2003. Over the next 4 years (fiscal year 2004 through fiscal year 2007), Aviation Trust Fund tax revenues are expected to be about $10 billion less than projections made in April 2001.

APRIL 2001 TF ESTIMATE FEBRUARY 2003 TF ESTIMATE

We see three areas based on our audits and criminal investigations that need to be addressed to ensure that Federal funds are spent cost-effectively.

FAA'S SPIRALING OPERATING COSTS ARE UNSUSTAINABLE AND NEED TO BE BROUGHT UNDER CONTROL

To date, the most visible results of personnel reform are increased workforce costs. While there has been improved labor/management relations with controllers (FAA's largest workforce), FAA's operating costs, which are primarily payroll, have increased by $3 billion, going from $4.6 billion in fiscal year 1996 to $7.6 billion in fiscal year 2004—an increase of over 65 percent. The new pay system for controllers was a significant cost driver. Between 1998 (when the new system was implemented) and 2003, the average base pay for controllers increased from $72,000 to over $106,000—a 47 percent increase. This compares to an average salary increase for all other FAA employees during the same period of about 32 percent.

Additionally, although linking pay and performance was a key tenet of personnel reform, only about 36 percent of FAA employees receive pay increases based on individual performance. The remainder of FAA employees receives largely automatic pay increases.

We also found that there are somewhere between 1,000 and 1,500 side bar agreements or Memorandums of Understanding (MOUs) that FAA managers entered into. These agreements cover a wide range of issues such as implementing new technology, changes in working conditions, and—as a result of personnel reform—compensation, bonuses, and benefits. While many of the agreements serve legitimate purposes, we found some that had significant cost and/or operational impacts on FAA. For example, as part of a new pay system for controllers, FAA and the National Air Traffic Controllers Association (NATCA) entered into a national MOU providing controllers with an additional cost-of-living adjustment. As a result, at 111 locations, controllers receive between 1 and 10 percent in "Controller Incentive Pay," which is in addition to Government-wide locality pay. In fiscal year 2002, the total cost for this additional pay was about $27 million.

Despite the cost implications, at the time of our review FAA management did not know the exact number or nature of these agreements, there were no established procedures for approving MOUs, and their cost impact on the budget had not been analyzed. Because of the significant control weaknesses, we briefed the FAA Administrator about our concerns in January 2003—two months after initiating this review. FAA has moved expeditiously to address this issue, including identifying those MOUs that are problematic or costly and opening discussions with NATCA to reopen several agreements.

To effectively control costs, FAA needs accurate cost accounting and labor distribution systems. In 1996, Congress also directed FAA to have a fully functioning cost accounting system so it, as well as others, could know exactly where its costs were. Now, after nearly 7 years of development and over $38 million, FAA still does not have an adequate cost accounting system, and it expects to spend at least another $7 million to deploy the cost accounting system throughout FAA. In our opinion, the principle reason that FAA does not have an effective cost accounting system is because it has not experienced any consequences for not having one. FAA also has not been held accountable to operate like a business, which must be able to identify costs by specific services, activities, and locations to support management decision making.

To have an effective cost accounting system, FAA also needs an accurate labor distribution system. Cru-X is the labor distribution system FAA chose to track hours worked by air traffic employees. As designed, Cru-X could have provided credible workforce data for addressing controller concerns about staffing shortages, related overtime expenditures, and how many controllers are needed and where. That information, in turn, is especially important, given projections of pending controller retirements. Unfortunately, Cru-X has not been implemented as it was designed.

Given the fiscal constraints facing FAA, the availability of critical, reliable, and competent data to make informed decisions about the agency's basic day-to-day operations must be an imperative for FAA. FAA needs to redouble its efforts to have a fully functional cost accounting and labor distribution system in place and operating. We are encouraged by FAA's response to our June 3, 2003 assessment of its cost accounting system, in which the agency agreed to have both its cost accounting and labor distribution systems in place and operating by September 30, 2004.

FAA also needs to look at existing opportunities to reduce costs. For example, we estimate FAA could realize cost savings of nearly $500 million over 7 years by reducing the number of existing automated flight service stations by over half in conjunction with deployment of new flight service software. We also identified that FAA could save over $57 million annually by expanding the contract tower program to 71 visual flight rule towers still operated by FAA. Clearly, these actions are controversial among certain groups; however, given the current fiscal issues facing

FAA, the agency needs to objectively consider these and other cost saving measures from a business perspective.

FAA'S MAJOR ACQUISITIONS CONTINUE TO EXPERIENCE LARGE COST INCREASES, EXTENDED SCHEDULE DELAYS, AND PERFORMANCE PROBLEMS

In terms of acquisition reform, FAA has made progress in reducing the time it takes to award contracts, but the agency has not held managers accountable or used the benefits of acquisition reform to control cost and schedule slips. We found that cost growth, schedule delays, and performance problems continue with 9 FAA's major acquisitions. Overall, the 20 projects we reviewed have experienced cost growth of about $4.3 billion (from $6.8 billion to $11.1 billion) and schedule slips of 1 to 7 years.

Billion dollar cost growth with acquisitions is not sustainable or affordable in light of declining trust fund revenues. Moreover, FAA is just starting complex, billion dollar efforts while continuing to fund projects that have been delayed for several years. If FAA does not exercise more management control over its acquisitions, existing projects will be delayed further, and new projects may not start as planned.

FAA must take a number of steps to control costs of acquisitions and get as much as it can with each acquisition dollar. We recommended FAA update the cost, schedule, and performance baselines for many of its major acquisitions. Those baselines are misleading because they do not accurately reflect the true cost, schedule, or performance parameters of the projects. This process may require FAA to establish a new strategy that accelerates some projects and defers others.

FAA NEEDS TO STRENGTHEN CONTROLS OVER PROGRAMS THAT HAVE BEEN SUSCEPTIBLE TO FRAUD, WASTE, AND ABUSE

Our work has also found that FAA has not followed sound business practices for administering contracts. We have consistently found a lack of basic contract administration at every stage of contract management, from contract award to contract closeout. For example, we found that Government cost estimates were prepared by FAA engineers, then ignored; prepared using unreliable resource and cost data; prepared by the contractor (a direct conflict of interest); or not prepared at all. To protect the Government's interests, FAA needs to hold managers accountable and adhere to the basic principles of contract oversight and administration.

We also found that FAA's Workers' Compensation Program continues to be subject to fraud and abuse, in terms of both stress-related claims and long-term injury claims. For example, we investigated one case of an FAA employee who received over $397,000 in workers' compensation claims over a 5-year period after allegedly falling out of a chair and injuring his back. While receiving those benefits, the individual obtained a pilot's license and was employed as a pilot at various organizations.

Workers' Compensation is also an area that could benefit from Government-wide improvements. One issue we previously identified is the number of claimants who continue to receive workers' compensation benefits long after they are eligible to receive retirement benefits. For example, in 2001 for FAA alone, there were nearly 1,500 claimants over the age of 60 who were still receiving workers' compensation benefits. In fact, there were 218 claimants still receiving workers' compensation benefits who were 80 years old or older.

Converting claimants from workers' compensation benefits to retirement benefits after they reach retirement age could result in significant savings Government-wide. However, changes of this magnitude would clearly require legislative actions.

Lastly, FAA needs to remain vigilant in its oversight of airport revenue diversions. Airports that receive Federal grants are required to put any revenue generated at the airport back into the airport operating or capital funds in order to minimize Federal assistance. Any other use of the revenue is considered a diversion. Examples of common revenue diversions include airport sponsors or local governments (1) charging the airport for property or services that were not provided, or (2) renting airport property at less than fair market value.

At a time when airports are continuing to look for new ways to fund their operations, we continue to find cases of airport revenue diversion. For example, at a sample of five airport sponsors reviewed, we found approximately $40.9 million in potential revenue diversions that were not detected by FAA's primary oversight methods. Since we completed our fieldwork, the American Institute of Certified Public Accountants and FAA have taken steps to better inform independent auditors about requirements for reviewing airport revenue use during single audits. In our opinion, those actions should improve FAA's ability to detect and prevent airport revenue diversions. However, to ensure that revenue diversions that occurred are

resolved, FAA needs to verify the status of the $40.9 million in potential revenue diversions that we identified and seek recoveries as necessary.

MARAD

In the last 5 years, MARAD's Title XI Loan Guarantee Program has experienced an increase in loan defaults and in the number of firms with loan guarantees filing for bankruptcy protection. Since 1998, nine loans have defaulted, totaling approximately $490 million, six of which have occurred since December 2001. The bankruptcy of one firm affected over one quarter ($1.3 billion out of $4.9 billion at the time of default) of the value of MARAD's Title XI loan guarantee portfolio.[11]

MARAD needs to improve administration and oversight in all phases of the Title XI loan process. During a recent audit, we identified a number of areas where MARAD could improve its Program practices, limit the risk of default, and reduce losses to the Government. For instance, in approving applications, MARAD agreed to waivers and modifications to Program financial requirements without adequate compensating provisions to reflect the increased risk to the Government. MARAD also lacked a formal process for closely monitoring the financial condition of borrowers and did not systematically monitor the physical condition of guaranteed assets.

WE ALSO NOTE THAT PUBLIC LAW 108–11, MAKING EMERGENCY WARTIME SUPPLEMENTAL

Appropriations for the fiscal year ending September 30, 2003, appropriated $25 million to MARAD for new loan guarantees. Before these funds can be obligated (these funds would likely guarantee loans with a face value of about $400 million), the law mandates that MARAD implement the recommendations in our report and that we certify to the Congress that our recommendations have been met. We are working with MARAD to analyze the new processes that it has proposed putting in place, and we will audit MARAD's compliance with the new processes once they are in use.

AMTRAK

We are including a brief discussion of Amtrak because even Federal funding levels of $1 billion a year are not going to solve the fundamental problem: the current Amtrak model is broken. The problem extends beyond funding to questions of who makes the decisions about and who controls the provision of service, including commuter service. The status quo pleases no one; it will require significant increases in funding just to maintain it; and it will not meet the mobility needs of this country in the years ahead.

Although Amtrak has received about $1 billion in annual Federal assistance during the past 6 years, the general state of Amtrak's infrastructure and rolling stock continue to deteriorate. Amtrak's deferred capital investment is estimated at about $6 billion. Except for a handful of routes, the system continues to suffer operating losses on all services offered. In fact, the fully allocated losses on some trains (including depreciation and interest) can exceed $500 per passenger. For the company as a whole, annual cash operating losses have averaged $600 million for the last 6 years and are estimated to range between $700 million and $800 million over the next 5 years.

OPERATING LOSS CASH LOSS

Amtrak has requested $1.8 billion for fiscal year 2004 in order to begin to address the capital backlog and to cover its large cash operating losses. The administration has requested $900 million for Amtrak for fiscal year 2004.

That concludes my statement, Mr. Chairman. I would be pleased to address any questions you or members of the committee might have.

[Supplemental information submitted for the record by the U.S. Department of Transportation follows:]

SUPPLEMENT TO THE TESTIMONY GIVEN BY HON. KENNETH M. MEAD, INSPECTOR GENERAL, U.S. DEPARTMENT OF TRANSPORTATION

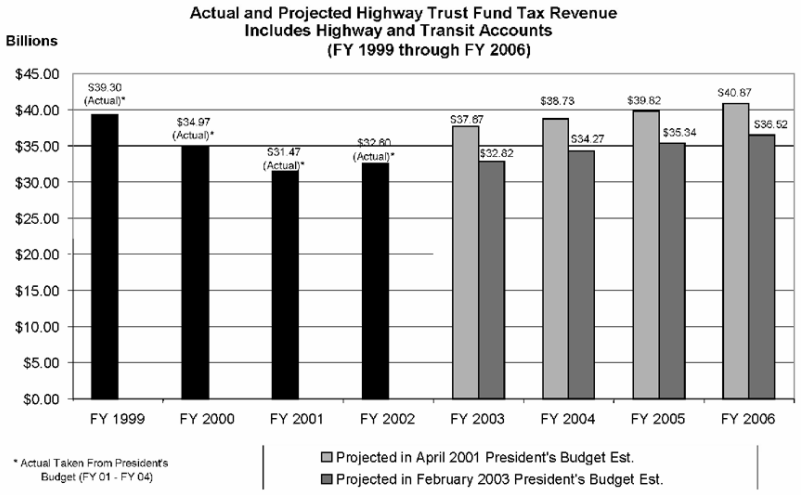
OPPORTUNITIES TO REDUCE COSTS AND IMPROVE THE EFFECTIVENESS OF DEPARTMENT OF TRANSPORTATION PROGRAMS FEDERAL HIGHWAY ADMINISTRATION AND FEDERAL TRANSIT ADMINISTRATION

In fiscal year 2004, the Federal Highway Administration (FHWA) requested $30.2 billion (all from the Highway Trust Fund) for grants to States and local governments to build and repair highways and to reduce highway injuries and fatalities. These investments facilitate economic growth, increase mobility, and improve safety. For fiscal year 2004, the Federal Transit Administration (FTA) requested $7.2 billion ($5.9 billion from the Highway Trust Fund and $1.3 billion from the General Fund) for grants to transit operators, and to State and local governments to construct transit facilities and purchase transit equipment.

However, Highway Trust Fund tax receipts have fallen from $39.3 billion in fiscal year 1999 to $31.5 billion in fiscal year 2001, a 20 percent decline. Current estimates show that between fiscal year 2003 and fiscal year 2006, Highway Trust Fund tax revenues will be about $18 billion less than projections made in April 2001, and are not expected to return to the fiscal year 1999 level until fiscal year 2008.

Whether funds are lost to cost overruns, schedule delays, or fraud, the result is the same—fewer resources are available for important transportation projects. To illustrate, if the efficiency with which the $500 billion invested by the Federal Government and States over the last 6 years on highway projects had been improved by only 1 percent, an additional $5 billion would be made available—enough to fund 4 of the 15 active major highway projects.

Figure 1



Although proposals have been made to increase funding for Federal-aid Highways, and these proposals may have merit, we believe considerably more can and should be done to stretch Federal dollars by ensuring that funds are spent cost effectively. The key issue for FHWA and FTA is ensuring that major projects are delivered on time, on budget, and free from fraud. Secretary Mineta has emphasized improving oversight and has fully supported our work to identify ways to get better value for the Federal investment. We have identified a number of ways, based on our audit and investigative work, that FHWA and FTA could do a better job. These are:

MAKING BETTER USE OF AVAILABLE FUNDS

• FHWA must be more vigilant in identifying and redeploying funds sitting idle on inactive projects. Our work has identified $238 million in funds no longer associated with valid projects or liabilities. Of this amount, $54 million had been idle for 16 years on a freeway project in Connecticut that had never been started. Funds on inactive projects should be redeployed to active projects.

STRENGTHENING PROJECT MANAGEMENT OF FEDERALLY FUNDED HIGHWAY AND TRANSIT PROJECTS TO MINIMIZE SIGNIFICANT COST INCREASES, FINANCING PROBLEMS, SCHEDULE DELAYS, AND TECHNICAL OR CONSTRUCTION DIFFICULTIES

• Unreliable cost estimates on major highway and transit projects have led to substantial cost increases in the long-run. We found the Virginia Department of Transportation (VDOT) understated project cost estimates by $236.5 million on the Springfield Interchange project, or 35 percent, by not including estimates for some known and planned costs.

• In 2002, Maryland officials managing the Wilson Bridge project did not adopt a value engineering proposal to change from one type of girder to another. At our request, FHWA advised the State to more objectively reexamine the proposal. Project officials accepted it as a design change and saved $59 million.

• FHWA and FTA should ensure that master schedules that tie together the work of all the contractors and identify and track the costs of labor, material, and equipment resources required to complete each task are used on major projects and are based on accurate and reliable data.

• FHWA had not ensured that the Central Artery/Tunnel project in Boston took aggressive action to recover costs of design errors or omissions caused by engineering consultants. Eight years of cost recovery efforts have led to only $30,000 in recoveries from a single consultant—less than one-tenth of 1 percent of the amount in question.

• Finance plans that identify cost, schedule, funding, and risks to projects are not usually required for projects costing under $1 billion, although such projects can also burden a State's management resources.

• State plans, which are representations to the taxpayers of how the States intend to use the taxpayers' money to meet their transportation needs, are not always realistic. We found that of the 152 interstate, primary, and urban construction projects in one State's plans for 1994–2000, 30 percent were started on time, 57 percent were delayed, and 13 percent were eliminated primarily due to understated cost estimates that led to insufficient funding.

• FHWA lacks the expertise to effectively oversee major projects and State management processes and should restructure its staffing mix to bring the right set of skills to bear on oversight activities.

PREVENTING FRAUD AND INCREASING REVENUE COLLECTIONS

• During the last 4½ years, fraud indictments have tripled, convictions have doubled, and monetary recoveries have totaled more than $80 million.

• Fuel tax fraud may drain the Highway Trust Fund of an estimated $1 billion annually, which can be mitigated with strengthened enforcement and investigative efforts to increase tax collections.

The demand for highway and transit funds remains great. The Department estimates that a $75.9 billion average annual capital investment from all levels of government will be required through 2020 to maintain the condition and performance of the Nation's highways and bridges at the 2000 level, and a $14.8 billion average annual investment will be required to maintain transit assets at the 2000 level. To expand system capacity and improve the condition of these assets, annual average investment requirements would increase to $106.9 billion for highways and bridges and $20.6 billion for transit. All of these investment projections are significantly above Federal, State, and local annual capital spending levels for highway, bridge, and transit investments in the last 6 years.

We have reviewed a number of large projects that stand as examples of good project management: projects such as Utah's I–15; New Jersey's Hudson Bergen Light Rail project; and California's Alameda Corridor. In contrast, we have reviewed projects in which management and oversight were ineffective, leading to significant cost increases, financing problems, schedule delays, and/or technical or construction difficulties. These projects include the Central Artery in Boston, MA; the Woodrow Wilson Bridge in the Washington, DC area; the Springfield interchange in Virginia; the Tren Urbano transit system in Puerto Rico; and the Los Angeles Metro Red Line and the San Francisco Bay Area Rapid Transit (BART) Airport Extension in California. In each of those cases, project management has agreed to take action to correct the deficiencies we reported. Many of these problems, as noted below, resulted from unreliable cost estimates; a not using proven management tools, such as finance plans and master schedules; and weaknesses in Federal oversight.

Redeploying millions of dollars in idle funds to other projects. FHWA must be more vigilant in identifying funds that are no longer needed by States. These funds, sitting idle on inactive projects, can be used to fund active projects. In 2001, we found $238 million in funding that was obligated but never spent on specific projects

that should have been redeployed to other projects. Of this amount, $54 million had been sitting idle for 16 years on a freeway project in Connecticut that had not been constructed. The funds were subsequently de-obligated and used for other valid transportation projects or returned to the U.S. Treasury.

Preparing reliable cost estimates. One problem we have seen repeatedly is that cost estimates on major highway and transit projects have been unreliable and have resulted in substantial cost increases in the long-run. The most recent example of this problem occurred on the Springfield Interchange project. We found that the Virginia Department of Transportation (VDOT) understated project cost estimates by $236.5 million, or 35 percent, by not including some known and planned costs, such as $43 million for preliminary engineering and design and $44 million for inflation. In addition, the baseline estimate for this project was prepared using design plans that were only 15–20 percent complete, which is far too early in the design to produce reliable estimates. VDOT agreed with our findings and has incorporated previously omitted costs in the project's $676.5 million budget. We also found unreliable cost estimates on the BART project. Our April 2000 report noted that the project's cost had increased by $316 million over the initial cost estimate.

As a result of finance plan requirements, FHWA has issued minimum cost estimating standards for projects costing $1 billion or more. Yet for the vast majority of projects, those costing less than $1 billion, FHWA has not established minimum cost estimating standards. In response to our recommendation, FHWA plans to issue draft cost estimating guidance for projects below $1 billion by August 2003.

Implementing the most cost-effective projects and engineering alternatives. To maximize the return on transportation investments, the Federal Government could do more to help project sponsors identify more cost-effective solutions both when analyzing alternatives when defining the specific project characteristics. Based on reviews of alternatives during the project development process, the Miami-Dade Transit Agency expanded its existing busway system after determining that a heavy rail system would have cost 10 times as much to build, and a light rail system would have cost 4 times as much. In the testimony before the House Appropriations Committee, Subcommittee on Transportation, Treasury, and Related Agencies, in April 2003, the FTA Administrator discussed FTA's plans to help project sponsors make decisions based on cost-benefit analyses.

FHWA's value engineering (VE) program, established in 1997, requires that a study be performed on all Federal-aid National Highway System projects with an estimated cost of $25 million or more and on other projects where using VE has a high potential for cost savings. According to FHWA's fiscal year 2001 Annual Federal-aid VE Summary Report, the latest report available, the States' VE studies included 2,013 recommendations estimated to save $2.4 billion. FHWA and the States approved about 50 percent of the recommendations made in fiscal year 2001, saving approximately $865 million, or 36 percent of the total value of VE recommendations.

For example, in 2002 Maryland officials who manage the Wilson Bridge project decided not to adopt a VE proposal to change from one type of girder to another. Maryland officials claimed that the VE proposal would cause significant delays that could result in additional costs. However, we conducted a review and found that the proposal was technically feasible and would not result in a cost increase or delay the schedule. After FHWA advised the State to more objectively reexamine the VE proposal, project officials accepted it as a design change and saved $59 million.

Recovering overpayments and resolving construction claims promptly. Change orders to contracts are initiated by the project or contractors in response to changes in the project's scope or differing site conditions. However, some change orders are a result of design errors or omissions caused by consultant engineers. Recovering funds paid on these change orders offers an opportunity to reduce project costs, which benefits the Federal and State governments. Maintaining tight control over change orders and promptly resolving outstanding construction claims are key in controlling project costs. For example, the Central Artery/Tunnel project (the project) in Boston might be able to reduce project costs by aggressively pursuing opportunities to recover costs of design errors or omissions caused by engineering consultants.

To date, the project's cost recovery efforts have been anemic. First, 8 years of cost recovery efforts have led to only $30,000 in recoveries from a single consultant—less than one-tenth of 1 percent (.056 percent) of the amount in question. Furthermore, the project has 295 unresolved change orders, valued at $188 million, of which 76 have been outstanding for 2–7 years. Finally, the project has 3,200 unresolved claims totaling about $1 billion and has reserved $633 million or 63 percent of the total exposure to cover the cost of settlements.

Preparing finance plans to identify cost, schedule, funding, and risks to the project. Finance plans are not usually required for highway projects costing under $1 billion,

although such projects can also burden a State's management resources. A finance plan is a vital management tool that provides project managers and the public with information on how much a project is expected to cost, when it will be completed, whether adequate funding is committed to the project, and whether there are risks to completing the project on time and within budget.

Our work has shown that adding a legislative provision in TEA–21 requiring finance plans for projects costing more than $1 billion was a wise decision on the part of Congress. FHWA reviews and approves those plans and should continue to do so. In our opinion, finance plans should be prepared for projects costing $100 million or more, and responsibility for approving those plans should be delegated to the States, with the Secretary reserving the right to review any plan. If States plan to spend $100 million or more of taxpayer money, it is reasonable to require them to develop an approved finance plan that identifies project costs, milestones, and funding sources. The Department has incorporated this new requirement in its reauthorization proposal.

Ensuring that statewide plans properly represent to the taxpayers how funds will be spent. State plans are representations to the taxpayers of how the States intend to use the taxpayers' money to meet their transportation needs and identify the projects that will be funded, their costs, schedules, and funding sources. However, these plans are not always realistic. For example, we found that of the 152 interstate, primary, and urban construction projects in one State's plans for 1994–2000, 30 percent were started on time, 57 percent were delayed, and 13 percent were eliminated. One reason this occurred was that cost estimates included in the plan understated the actual cost of the projects, making the funding identified for the overall highway construction program insufficient. Despite these problems, FHWA had approved the plans.

Refocusing FHWA efforts on project management and financial oversight. The failure to properly oversee States' project management practices has contributed to increased project costs. Our work has disclosed that until recently, FHWA managers rarely focused on program and major project management and financial oversight. FHWA took a partnership approach in exercising its oversight role of Federal-aid Highway projects, with FHWA channeling money for highways to the States and working with State highway personnel to administer highway contracts. This partnership is important, but it is equally important that FHWA be willing to step back and make the hard calls when necessary. For example, at the time the Central Artery announced a $1.4 billion cost increase in 2000, FHWA had approved thousands of engineering design changes. Nonetheless, FHWA was caught unaware when the cost increase was announced, even though it had just approved the project's finance plan.

Today's highway projects require professional competencies in emerging technologies, financing, cost-estimating, program analysis, environmental processes, and schedule management. Yet, FHWA's expertise in these areas is limited because its workforce is structured primarily around engineering skills that were in greater demand during construction of the interstate system. Of FHWA's workforce of 2,860 employees, 1,130 or approximately 40 percent, are highway engineers. Yet, in the remaining 60 percent, or 1,730 employees, specialists skills needed to oversee State management processes are in short supply. For example, FHWA employs 88 financial specialists, who primarily perform financial management tasks internal to FHWA, rather than analyzing project finance plans and evaluating State financial management processes. Accordingly, FHWA should restructure its staffing mix to bring the right set of skills to bear on oversight activities. This is not to suggest FHWA needs more staff. A strategy for achieving a more multi-disciplinary approach to oversight activities within current staffing levels could include a mix of actions such as:

- Hiring staff with private sector project management skills, that is, financing, program analysis, and cost estimating; and
- Streamlining and delegating project-level approvals to the States so that staff time can be refocused on overseeing program-level management and financial issues.

Detecting and preventing fraud. Fraud in highway and transit construction projects remains a significant concern, although it has not reached the levels experienced in the 1960s and 1970s. During the last 4½ years, highway and transit-related fraud indictments have tripled, convictions have doubled, and monetary recoveries have totaled more than $80 million. We currently have over 100 ongoing investigations of infrastructure projects or contracts. Fraud schemes that we are commonly seeing today include bid-rigging and collusion among contractors; false claims for work or materials not provided on the project; product substitution by contractors or vendors who provide substandard or inferior materials; bribery of inspectors

to look the other way on poor quality work or materials; failure by contractors to pay workers required prevailing wages; and fraud against the Disadvantaged Business Enterprise (DBE) Program for minority and women contractors.

We have found that DBE fraud is an area with serious enforcement and compliance problems, and requires more attention. Our work has disclosed that compliance problems with DBE Program regulations appear to be nationwide in scope with over 30 ongoing investigations in 16 States. This type of fraud typically involves prime contractors who conspire with "false front" DBE firms to fraudulently meet required DBE participation criteria in order to obtain contracts. In such cases, DBEs either do not perform the work or yield total control of personnel and operations to the prime contractors. This crime defrauds the integrity of the DBE program and harms legitimate DBEs who abide by the law.

In June 2003, as a result of its role in a DBE fraud scheme, a California concrete company operating as a DBE in the San Francisco Bay area, agreed to forfeit $1 million and accepted a voluntary 2 year exclusion from seeking contracts on DOT funded projects, as well as contracts with the City of San Francisco and the State of California. The company and its principals will also refrain from applying for any DBE certifications for 5 years.

Debarment-Debarment is one administrative tool that can be used to protect the government's interest against fraud on transportation projects. Under current regulations, the Operating Administrations have wide discretion in determining whether or not to debar convicted contractors who, even though they have been convicted of defrauding Federal-aid projects, are also allowed to appeal debarments at any time. For example,

• In 2001 three major construction companies in the New York City area, co-owned by the Scalamandre brothers, pled guilty to felony fraud charges involving payoffs to organized crime to influence labor unions on FHWA-funded road projects. Because debarment is not mandatory under the current Federal-aid rules, it took over 6 months after conviction to obtain a 3-year debarment. Now, one year after debarment, the companies are appealing to FHWA to lift their debarment. Should FHWA turn down this appeal, the companies can file subsequent appeals with FHWA burdening the agency by requiring it to invest additional time and legal resources to defend its action. At our recommendation, the Department has proposed language in its highway reauthorization proposal to make debarment mandatory and final when a contractor is convicted of fraud.

Sharing Federal recoveries with States. States are the first line of defense in preventing and detecting fraud in transportation projects. Since State programs are the first to be damaged by fraud, allowing States to share in Federal monetary recoveries would help to restore their programs and provide support for further fraud deterrence and detection efforts. However, States normally do not receive a portion of any monies recovered in successful fraud prosecutions because fines and recoveries from Federal case judgments must be returned to the Federal Treasury unless a judge determines otherwise or the law is changed to allow States to share in Federal fines and recoveries. For example:

• Recently, the United States and Louisiana shared a $30 million recovery stemming from a civil settlement with Contech Construction Products, Inc., and Ispat-Inland, Inc. involving product substitution fraud. The companies substituted substandard polymer-coated steel culvert pipe used in highway and road construction projects in Louisiana from 1992–97. Under the settlement agreement, the State of Louisiana received $5.2 million to compensate for the cost of the investigation and losses due to the product substitution, and another $5.4 million as a credit to its unobligated FHWA balance for use on future projects.

Increasing revenue collections. Although the exact loss is difficult to quantify, FHWA estimates that fuel tax fraud drains the Highway Trust Fund of an estimated $1 billion annually, which can be mitigated with strengthened enforcement and investigative efforts to increase tax collections. For example:

• Cross-border bootlegging of fuel typically occurs when bordering States have a significant difference in their motor fuel tax rates. Bootleggers profit from the difference between the taxes charged in low-tax and high-tax jurisdictions by purchasing fuel—and paying the associated tax—in a low-tax jurisdiction, and then smuggling the fuel into a high-tax jurisdiction where they sell it and pocket the difference in taxes. The Federal tax code restricts the Internal Revenue Service's ability to share taxpayer information with all State and Federal agencies having an interest in the information, which makes it extremely difficult to investigate this crime.

At the Federal level, aviation "jet" fuel tax evasion is an area several independent petroleum industry analysts allege is possibly costing billions of dollars of lost tax revenues, and which requires further examination. Tax evasion opportunities exist,

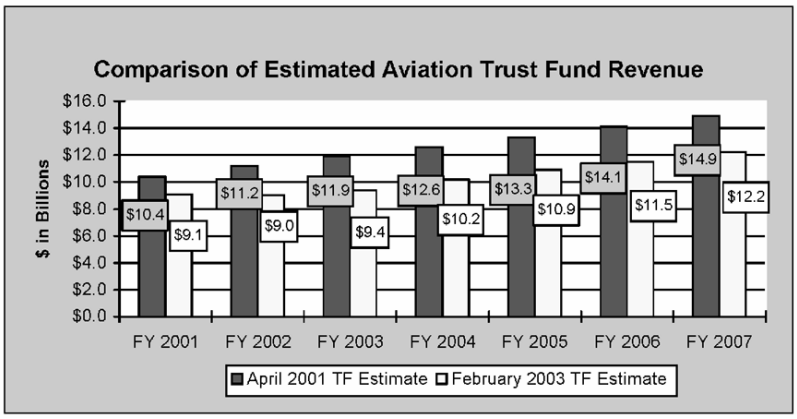
in part, because jet fuel is sold tax-free to wholesalers and is not taxed until sold to an end user such as an airline. Taxing jet fuel at the terminal rack[1] would bring it into conformity with Federal gasoline and diesel fuel taxes and could help reduce this evasion opportunity. For example, according to a recent KPMG Consulting analysis, on year after Florida began taxing aviation fuel at the rack in 1996 it experienced a 21.4 percent increase in aviation fuel tax collections. While Florida's experience is not conclusive, it does illustrate the potential to increase tax collections by moving the point of taxation to the rack and reducing tax evasion opportunities.

FEDERAL AVIATION ADMINISTRATION

For fiscal year 2004, the Federal Aviation Administration's (FAA) budget request is $14 billion, which is 26 percent of DOT's budget, representing a 3 percent increase above the fiscal year 2003 appropriations of $13.6 billion. FAA's budget request exceeds projected Aviation Trust Fund revenues in fiscal year 2004 by over $3 billion. In fact, projected tax receipts to the Aviation Trust Fund for fiscal year 2004 have dropped from approximately $12.6 billion estimated in April 2001 to about $10.2 billion estimated in February 2003.

Over the next 4 years (fiscal year 2004 through fiscal year 2007), Aviation Trust Fund tax revenues are expected to be about $10 billion less than projections made in April 2001. Assuming no new taxes or fees, this shortfall will have to be made up either by drawing down the uncommitted balance of the trust fund or tapping the General Fund.

Figure 2



In 1996, Congress acted to make FAA a performance-based organization by giving the agency two powerful tools—personnel reform and acquisition reform. The expectation was that, being relieved from government personnel and procurement rules, FAA would operate more like a business—that is, services would be provided to users cost effectively and air traffic control modernization programs would be delivered approximately on time and within budget.

Seven years later, we do not see sufficient progress toward achieving those outcomes. FAA's budget has grown from $8.2 billion in fiscal year 1996 to $14 billion in fiscal year 2004—an increase of $5.8 billion, or over 70 percent. About 33 percent of this increase was a result of higher airport funding, and about 15 percent was a result of increases in FAA's modernization budget, but the largest portion of this increase (52 percent) was attributable to FAA's operating budget. During this period, we have also seen large cost overruns and schedule slips in FAA's major acquisitions. Continued growth of that magnitude is unsustainable, given the multibillion-dollar declines in projected Aviation Trust Fund receipts, and greater dependence of FAA on the General Fund.

[1] The Tax Reform Act of 1986, effective January 1, 1988, changed the point of taxation for gasoline tax collection from the wholesaler/distributor to the fuel terminal (or "rack"), which is the last "bulk storage" point in the distribution chain. The Omnibus Budget Reconciliation Act of 1993, effective January 1, 1994, similarly changed the point of taxation for diesel fuels from the wholesaler/distributor to the fuel terminal (or "rack").

FAA'S SPIRALING OPERATING COSTS ARE UNSUSTAINABLE AND NEED TO BE BROUGHT UNDER CONTROL

• FAA operating costs, which are primarily payroll, have increased 65 percent since personnel reform. Much of the increase has been as a result of workforce cost increases negotiated under FAA's personnel reform authority.
• Although linking pay and performance was a key tenet of personnel reform, only about 36 percent of FAA employees receive pay increases based on individual performance.
• FAA has not implemented a cost accounting system and labor distribution system for measuring the costs and productivity of its activities and workforce.
• FAA needs to take advantage of existing opportunities to reduce costs, such as consolidating flight service station operations which could save FAA $500 million over 7 years.

FAA'S MAJOR ACQUISITIONS CONTINUE TO EXPERIENCE LARGE COST INCREASES, EXTENDED SCHEDULE DELAYS, AND PERFORMANCE PROBLEMS

• Fourteen of 20 major acquisitions that we track have experienced substantial cost growth totaling more than $4.3 billion, which is more than an entire year's budget for FAA's modernization account.
• Thirteen of those 20 acquisitions have experienced schedule slips of up to 7 years.
• Many projects—both old and new—do not have reliable cost and schedule baselines. As a result, FAA cannot effectively plan, manage programs, or meet expectations for improving the safety and efficiency of the National Airspace System.
• Billion dollar cost growth with acquisitions is not sustainable given there are several multi-billion, complex projects just getting started. FAA must fund these projects while at the same time funding projects that have been delayed for several years.
FAA needs to strengthen controls over programs that have been susceptible to fraud, waste, and abuse.
• FAA has not followed sound business practices for administering contracts. We found every stage of contract management, from contract award to closeout, was deficient, and lacked basic principles of sound contract administration.
• We found significant indications of abuse involving workers' compensation claims.
• At 5 airports sampled, we found approximately $40.9 million in potential airport revenue diversions that were not detected by FAA's primary oversight methods.

FAA'S SPIRALING OPERATING COSTS ARE UNSUSTAINABLE AND NEED TO BE BROUGHT UNDER CONTROL

Although Congress envisioned that personnel reform would result in more cost-effective operations, this has not happened. To date, the most visible results of personnel reform are increased workforce costs. While labor/management relations with controllers (FAA's largest workforce) have improved, FAA's operating costs, which are primarily payroll, have increased by $3 billion, going from $4.6 billion in fiscal year 1996 to $7.6 billion in fiscal year 2004—an increase of over 65 percent.

Much of that increase has been a result of salary increases negotiated under personnel reform. The new pay system for controllers was a significant cost driver. Between 1998 (when the new system was implemented) and 2003, the average base pay for controllers has increased 47 percent. This compares to an average salary increase for all other FAA employees during the same period of about 32 percent. Although linking pay and performance was a key tenet of personnel reform, only about 36 percent of FAA employees receive pay increases based on individual performance. The remainder of FAA employees receives largely automatic pay increases.

We also found that FAA and the National Air Traffic Controllers Association (NATCA), FAA's largest union, have entered into hundreds of side bar agreements or memoranda of understanding (MOUs) outside the national collective bargaining agreement. These agreements cover a wide range of issues such as implementing new technology, changes in working conditions and(as a result of personnel reform(compensation, bonuses, and benefits.

While many of the agreements we reviewed serve legitimate purposes, we found some that had significant cost and/or operational impacts on FAA. For example,

• As part of the controller pay system, FAA and NATCA entered into a national MOU providing controllers with an additional cost of living adjustment. As a result, at 111 locations, controllers receive between 1 and 10 percent in "Controller Incen-

tive Pay," which is in addition to government-wide locality pay. In fiscal year 2002, the total cost for this additional pay was about $27 million.

We also reviewed a number of MOUs that provided controllers with salary increases that, in our opinion, were neither justified nor in the best interest of the government. For example:

• One MOU we reviewed allows controllers transferring to larger consolidated facilities to begin earning the higher salaries associated with their new positions substantially in advance of their transfer or taking on new duties. At one location, controllers received their full salary increases 1 year in advance of their transfer (in some cases going from an annual salary of around $54,000 to over $99,000). During that time, they remained in their old location, controlling the same air space, and performing the same duties.

Some MOUs we reviewed provided large incentives to controllers for simply receiving training on new systems. For example:

• One MOU for a new software enhancement for controllers gave each controller a $500 cash award and a 24-hour time-off award for meeting certain training milestones on the new system. The MOU contained no distinction of awards for individual contributions other than coming to work and attending training. In fact, at two locations, 11 controllers received the total $500 cash award and 16 controllers received the 24 hours of time-off even though they were on detail, on military leave, medically disqualified, or on workers' compensation.

We estimate that at six facilities alone this MOU resulted in FAA incurring approximately $1.3 million in individual cash awards and 62,500 hours in time off. If a similar agreement were to be reached for the next 14 sites scheduled to receive the new software, we estimate FAA could incur $53 million in additional overtime costs, over $3 million in cash awards, and an additional 145,000 hours of time-off awards.

We found controls over the MOU process were inadequate. For example, at the time of our review there was:

• No standard guidance for negotiating, implementing, or signing MOUs;
• Broad authority among managers to negotiate MOUs and commit the agency;
• No requirement for including labor relations specialists in negotiations;
• No requirement for estimating potential cost impacts prior to signing the agreement; and
• No system for tracking MOUs.

Because of the significant control weaknesses, we briefed the FAA Administrator about our concerns in January 2003—two months after initiating this review. FAA has moved expeditiously to address this issue. For example, FAA is now in the process of identifying those MOUs that are problematic or costly and has begun correspondence with NATCA to reopen several agreements. FAA has also issued new procedures for MOUs, which include limiting approval authority and requiring that both the Human Resources and Budget divisions review proposed MOUs before they are signed by management. These are clearly steps in the right direction.

Cost accounting and labor distribution systems. To effectively control costs, FAA needs accurate cost accounting and labor distribution systems. At the direction of Congress, FAA began developing its cost accounting system in 1996, which was estimated at that time to cost about $12 million and to be completed in October 1998. Now, after nearly 7 years of development and over $38 million, FAA still does not have an adequate cost accounting system, and it expects to spend at least another $7 million to deploy the cost accounting system throughout FAA.

Although FAA's cost accounting system is producing cost data for two of its lines of business, which, according to FAA, represent 80 percent of the agency's costs, it still does not report actual costs for each facility location. For example, for the Terminal Service in fiscal year 2001, about $1.3 billion of $2.4 billion was reported in lump sum totals and not by individual facility locations. FAA cannot credibly claim to be a performance-based organization, nor can it function as one, until it has an effective cost accounting system.

FAA also needs an accurate labor distribution system to track the costs and productivity of its workforces. For example, there has been much discussion as to what extent overtime costs are being driven by staffing levels, but those questions cannot be credibly answered until FAA has an accurate labor distribution system.

Cru-X is the labor distribution system FAA chose to track hours worked by air traffic employees. As designed, Cru-X could have provided credible workforce data for addressing controller concerns about staffing shortages, related overtime expenditures, and how many controllers are needed and where. That information, in turn, is especially important, given projections of pending controller retirements.

However, an agreement between FAA and the controllers' union has removed many of the internal control features of Cru-X including features that record the ac-

tual start and stop times worked by controllers. In fact, under provisions of the agreement, Cru-X would automatically sign controllers in and out of their work shifts even if they were not there. It also strips the system's ability to track the amount of time controllers spend actually controlling traffic and performing other collateral duties.

Given the fiscal constraints facing FAA, the availability critical, reliable, and competent data to make informed decisions about the agency's basic day-to-day operations must be an imperative for FAA. FAA needs to redouble its efforts to have a fully functional cost accounting and labor distribution system in place and operating. We are encouraged by FAA's response to our June 3, 2003 assessment of its cost accounting system in which the agency agreed to have both its cost accounting and labor distribution systems in place and operating by September 30, 2004. FAA also agreed to make successful implementation of both systems a precondition to senior executives and program managers receiving annual bonuses.

Other opportunities to save costs. There are also opportunities for FAA to save government funds while maintaining safety and system efficiency. For example, we estimated FAA could realize cost savings of nearly $500 million over 7 years without reducing safety or service by reducing the number of existing automated flight service stations by over half in conjunction with deployment of new flight service station software.

We also identified that FAA could save over $57 million annually by expanding the contract tower program to 71 visual flight rule towers still operated by FAA. Clearly, these actions are controversial among certain groups; however, given the current fiscal issues facing FAA, the agency needs to objectively consider these and other cost saving measures from a business perspective.

FAA'S MAJOR ACQUISITIONS CONTINUE TO EXPERIENCE LARGE COST INCREASES, EXTENDED SCHEDULE DELAYS, AND PERFORMANCE PROBLEMS

In terms of acquisition reform, FAA has made progress in reducing the time it takes to award contracts, but the agency has not held managers accountable or used the benefits of acquisition reform to control cost and schedule slips.

We recently reported that 14 of 20 major acquisitions that we track have experienced substantial cost growth totaling more than $4.3 billion (from $6.8 billion to $11.1 billion), which is more than an entire year's budget for FAA's modernization account.[2] Also, 13 of the 20 acquisitions have experienced schedule slips ranging from 1 to 7 years. In addition, many projects—both old and new—do not have reliable cost and schedule baselines.

Problems with cost growth, schedule slips, and performance shortfalls have serious consequences—they result in costly interim systems, a reduction in units procured, postponed benefits (in terms of safety and efficiency), or "crowding out" other projects. For example, in fiscal year 2002 alone, FAA reprogrammed over $40 million from other modernization efforts (data link communications, oceanic modernization, and instrument landing systems) to pay for cost increases associated with the Standard Terminal Automation Replacement System (STARS)—new controller displays and related equipment for FAA terminal facilities. As a result, FAA is not getting as much as it can for its acquisition dollar.

Multi-billion-dollar cost growth with major acquisitions is not sustainable or affordable. If FAA does not exercise more management control over its acquisitions, existing projects will be further delayed, and new projects may not start as planned. A key focus for FAA must be effective cost control for new projects that are just getting started that are high risk efforts because of their size, complexity, and level of software development work required such as the En Route Automation Modernization program. This a complex effort to replace all software and hardware for facilities that control high altitude traffic and is estimated to cost over $2.1 billion.

FAA must take a number of steps to control costs of acquisitions and get as much as it can from each acquisition dollars. We recommended FAA update the cost, schedule, and performance baselines for many of its major acquisitions, including STARS and the Local Area Augmentation System (a new precision approach and landing system). Baselines for these and other major acquisitions are misleading because they do not adequately reflect the true cost, schedule, or performance parameters for the project. This process may require FAA to establish a new strategy for modernizing the National Airspace System that accelerates some projects and defers others. We also recommended FAA to develop—and use—performance goals for as-

[2] For additional details, see "Status of FAA's Major Acquisitions" (Report No. AV–2003–045, June 26, 2003).

sessing progress with its major acquisitions. This should involve holding staff and contractors accountable for keeping projects within cost and schedule.

FAA NEEDS TO STRENGTHEN CONTROLS OVER PROGRAMS THAT HAVE BEEN SUSCEPTIBLE TO WASTE, FRAUD, AND ABUSE

Contract oversight. Our work has also found that FAA has not followed sound business practices for administering contracts. We have consistently found a lack of basic contract administration at every stage of contract management, from contract award to contract closeout. For example, we found that government cost estimates were:

- Prepared by FAA engineers, then ignored;
- prepared using unreliable resource and cost data;
- prepared by the contractor (a direct conflict of interest); or
- not prepared at all.

In our September 2000 report on the Technical Support Services Contract (with a potential cost of $875 million), we found that FAA did not control costs by developing reliable cost estimates for proposed projects. We found that in the majority of cases, FAA used the contractor's project cost estimate to set the project's budget. We also found that FAA did not evaluate contractor work performance, and nearly 10 percent of the contract personnel reviewed did not meet contract standards for education and experience.

In November 2002, we found that contract oversight of the National Airspace System Implementation Support Contract (NISC) was seriously inadequate. We concluded that of the 46 active task orders having obligated funds totaling $97 million, approximately $10 million (10 percent) were in excess of the required amount to fully fund the task order deliverables. As a result, FAA reprogrammed $5 million from NISC to meet other agency priorities, and rebaselined NISC task orders to make better use of the remaining funds.

In our May 2002 report on the oversight of cost reimbursable contracts, we found that contracting officers exercised little effective oversight, and in most cases, lacked the basic information needed to properly manage, pay, and close contracts. We found every stage of contract management was deficient, lacked accountability, and did not adequately protect FAA from waste, fraud, and abuse. For example:

- For the 54 cost reimbursable contracts totaling $3.6 billion that we selected, FAA searched for 6 months and could not locate all or significant parts of 22 contract files totaling $274 million.
- For 19 of the 32 contract files FAA found, totaling $585 million, FAA did not have the required evidence showing the contractor's accounting system was adequate for cost reimbursable contracts.
- For 22 of the 32 contracts, totaling $2 billion, FAA did not obtain incurred cost audits as required. One contract for system engineering and integration work on the National Airspace System Plan had not received annual audits on the $1.1 billion of costs incurred for over 12 years.

To protect the government's interests, FAA needs to hold managers accountable and adhere to the basic principles of contract oversight and administration. FAA also needs to make greater use of Defense Contract Audit Agency audits and institute cost control mechanisms for software intensive contracts. In addition, FAA needs to (1) develop independent cost estimates for proposed projects that allow FAA to better analyze a contractor's proposed work plan to ensure that costs are fair and reasonable, and (2) institute greater controls over evaluating education and experience qualifications of proposed contractor personnel.

FAA HAS STATED THAT IT WILL TAKE ACTIONS TO ADDRESS THESE CONTRACTOR OVERSIGHT CONCERNS—THE KEY NOW IS FOLLOW THROUGH

Workers' compensation. Our review of the workers' compensation program within FAA's Air Traffic Services division found indications of potential fraud and/or abuse involving stress related traumatic injury claims. At several locations, we found stress related claims were being filed by controllers who were simply present when another controller was involved in an operational error (when controllers fail to maintain minimum separation requirements between aircraft) and did not experience the error themselves. Further, we found many of the stress related injury claimants were repeatedly diagnosed by the same doctors. At one facility, we found that virtually 100 percent of stress-related injury claimants went to the same two psychologists. These doctors, who distributed their cards at the facility, performed the same tests on each controller, completed a form letter on the individual, and specified the necessary time for recuperation. For these services, the doctors received payments from the government of up to $500 per claim.

We have also found cases of fraud involving long-term claimants. For example, we investigated one case of an FAA employee who received over $397,000 in workers' compensation claims over a 5-year period after allegedly falling out of a chair and injuring his back. While receiving those benefits, the individual obtained a pilot's license and was employed as a pilot at various organizations. FAA is currently considering administrative action against the individual pending resolution of this criminal case.

There are also government-wide improvements that can be made to the Workers' Compensation Program. One issue we previously identified is the number of claimants who continue to receive workers' compensation benefits long after they are eligible to receive retirement benefits. For example, in 2001 for FAA alone, there were nearly 1,500 claimants over the age of 60 who were still receiving workers' compensation benefits. In fact, there were 218 claimants still receiving workers' compensation benefits who were 80 years old or older. Converting claimants from workers' compensation benefits to retirement benefits after they reach retirement age could result in significant savings government-wide. However, changes of this magnitude would clearly require legislative actions.

Airport revenue diversions. The Airport and Airways Improvement Act of 1982 requires that all airports receiving Federal assistance to use revenues generated at the airport for the capital or operating costs of the airport. Any other use of the airport's revenue is considered a revenue diversion. Examples of common revenue diversions include local governments (1) charging the airport for property or services that were not provided, or (2) renting airport property at less than fair market value.

At a sample of five airport sponsors reviewed, we found approximately $40.9 million in potential revenue diversions that were not detected by FAA's primary oversight methods. These amounts were not detected because independent auditors of airport sponsors were not sufficiently aware of relevant Office of Management and Budget guidance on auditing airport revenue, and airport sponsors were not adhering to FAA requirements for airport financial reports.

Since we completed our fieldwork, the American Institute of Certified Public Accountants (AICPA) and FAA have taken steps to better inform independent auditors about requirements for reviewing airport revenue use during single audits. In our opinion, the actions taken by the AICPA and FAA, when fully implemented, should improve FAA's ability to detect and prevent airport revenue diversions. However, to ensure that revenue diversions that occurred are resolved, FAA needs to verify the status of the $40.9 million in potential revenue diversions that we identified and seek recoveries as necessary.

MARITIME ADMINISTRATION

Title XI of the Merchant Marine Act of 1936, as amended, established the Federal Ship Financing Guarantee Program to assist private companies to obtain financing for the construction of ships or to modernize U.S. shipyards. This program authorizes the Federal Government to guarantee full payment to the lender of the unpaid principal and interest of a commercial debt obligation, with the government holding a mortgage on the equipment or facilities financed.

MARAD NEEDS TO STRENGTHEN FINANCIAL OVERSIGHT OF BORROWERS AND ASSETS

- Our recent work found that all phases of the Title XI loan process need improvement.
- In the last 5 years, nine defaults totaling $490 million have occurred. One bankruptcy affected over one-quarter of MARAD's loan portfolio value.
- In approving applications, MARAD agreed to waivers and modifications to program financial requirements without adequate compensating provisions to reflect the increased risk to the government.
- MARAD lacked a formal process to continually monitor the financial condition of borrowers and did not systematically monitor the physical condition of guaranteed assets or ensure the maximum recoveries from foreclosed assets.

Between fiscal years 1985 and 1987, 129 defaults occurred in the Title XI Program, and MARAD paid out approximately $2 billion in guarantees. These defaults were attributed to a downturn in the economic conditions in two key industries—oil and agricultural products. The Federal Credit Reform Act of 1990[3] was established, in part, to measure more accurately the costs of Federal credit programs. In

[3] Public Law 101–508

the 5 years following implementation of this Act (fiscal years 1993 through 1997), only three loans defaulted, totaling approximately $12 million.

In recent years, however, the program has experienced an increase in loan defaults and in the number of firms with loan guarantees filing for bankruptcy protection. In the last 5 years, nine loans have defaulted, totaling approximately $490 million, six of which have occurred since December 2001. The bankruptcy of one firm significantly affected the program, although it does not threaten the program's immediate solvency. That firm's bankruptcy affected over one quarter ($1.3 billion out of $4.9 billion at the time of default) of the value of MARAD's Title XI loan guarantee portfolio.

MARAD needs to improve administration and oversight in all phases of the Title XI loan process. During a recent audit, we identified a number of areas where MARAD could improve its program practices, limit the risk of default, and reduce losses to the government. Specifically, we recommended that MARAD:

- Perform a rigorous analysis of the risks from modifying any loan approval criteria and impose compensating provisions on the loan guarantee to mitigate those risks;
- Formally establish an external review process as a check on MARAD's internal loan application review and as assistance in crafting loan conditions and covenants;
- Establish a formal process to continuously monitor the financial condition of borrowers, including requirements for financial reporting over the term of the guarantee as a condition of loan approval;
- Establish a formal process to continuously monitor the physical condition of guaranteed assets over the term of the loan guarantee; and
- Develop an improved process to monitor the physical condition of foreclosed assets and to recover the maximum amount of funds from their disposal.

MARAD concurred with our recommendations and is designing additional policies and procedures to strengthen its financial oversight practices. One area where MARAD could reduce costs is collecting fees from applicants that fully recover the costs of obtaining an independent analysis of the applications, as we recommended. These analyses would supplement MARAD's in-house reviews and provide valuable third-party expertise and assistance in devising loan packages that reduce the default and loss risks to the government.

AMTRAK

We are including a brief discussion of Amtrak because even Federal funding levels of $1 billion a year are not going to solve the fundamental problem: the current Amtrak model is broken. The problem extends beyond funding to questions of who makes the decisions about and who controls the provision of service, including commuter services. The status quo pleases no one; it will require significant increases in funding just to maintain it; and it will not meet the mobility needs of this country in the years ahead.

Although Amtrak has received about $1 billion in annual Federal assistance during the past 6 years, the general state of Amtrak's infrastructure and rolling stock continue to deteriorate. Amtrak's deferred capital investment is estimated at about $6 billion and its annual cash operating losses are expected to range between $700 million and $800 million over the next 5 years. Amtrak has requested $1.8 billion for fiscal year 2004 to begin to address the capital backlog and to cover its large cash operating losses. The administration has requested $900 million for Amtrak for fiscal year 2004.

CONGRESS AND THE ADMINISTRATION NEED TO CONSIDER NEW MODELS FOR PASSENGER RAIL-FOCUSED ON SHIFTING MORE DECISIONS TO STATES

- The current model is broken: the system is under-funded and perpetually faces collapse.
- Cash losses have increased considerably in the last 2 years and are expected to exceed $700 million this year.
- The investment backlog is approaching $6 billion.
- The vast majority of routes lose money—in some cases $500 per passenger.

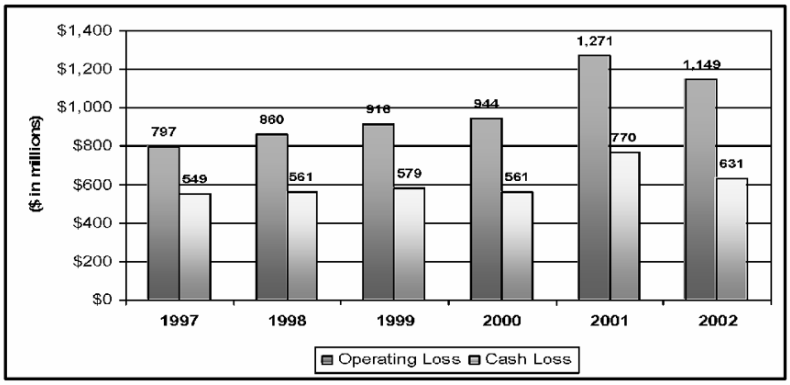
Over the last year, Amtrak's president and the Department have worked diligently to improve cost control and achieve expense savings, and to bring more order to Amtrak's accounting and financial statements. These efforts need to continue. In addition, the Department has been given more authority to oversee and control Amtrak's adherence to its budget, ensuring that it operates within the Federal funding provided.

Despite multiple efforts over the years to change Amtrak's goals, its structure, and its funding, the result always seems to be a status quo that is the product of

seemingly inevitable budgetary compromises. These compromises over the years have produced a system that limps along, never in a state of good repair, and perpetually one, two, or three steps from the edge of collapse. These dire straits have been repeated time and again over Amtrak's history. In the end, Amtrak has been tasked to be all things to all people, but insufficiently funded to be fully anything to anyone.

It is a system with a backlog of investment and maintenance needs that has reached at least $6 billion. Finally, this is a system that, except for a handful of routes, continues to suffer operating losses on all services offered. In fact, the fully allocated losses on some trains (including depreciation and interest) can exceed $500 per passenger. For the company as a whole, annual cash operating losses have averaged $600 million for the last 6 years and are estimated to range between $700 million and $800 million over the next 5 years.

FIGURE III.—GROWTH IN AMTRAK'S OPERATING AND CASH LOSSES, 1997–2002



Clearly, one option is to end the Federal role in intercity passenger rail services and leave all service decisions and 100 percent of the funding to the States. While this approach may seem appealing from a Federal budgetary standpoint, especially with large deficits looming, it would not address the mobility needs of certain congested regions of the country and the benefits that passenger rail may provide. Although these problems exist on local and regional levels, there is a national economic interest in assisting mobility that is the foundation for the Department's transit, highway, and aviation programs.

Another option is to reduce the demand on Federal funds by eliminating all long-distance trains. Although this might eventually save $300 million or more (after labor protection and other shut-down costs are amortized), it does not come close to solving the $2 billion funding dilemma. Furthermore, in the past, the long-distance trains have been the political glue that has held together support for intercity passenger rail and Amtrak. Eliminating these trains, without a clear plan to improve mobility through a restructured Federal program, would likely lead to a continuation of a status quo, "limp along" Amtrak.

A better option for the future of intercity passenger rail service lies in improving mobility in short-distance corridors around the country (not just in the Northeast Corridor) and in restructuring long-distance services to complement these corridor services. It is in short-distance corridors that the Federal Government and the States should focus their investments to increase speeds, increase frequency, and improve the quality of the services offered. For the $2 billion that would need to be spent on a steady-State Amtrak system, significantly better service to a greater number of passengers is possible through a refocused Federal program that gives the States more control and authority.

For the successful development of higher speed/higher frequency, short-distance corridors, there must be a new relationship established between the Federal Government and the States. An option is a transition to a Federal passenger rail program that is modeled more on the current transit program. This transition would likely require a number of years for institutional arrangements to be developed among the States (such as multi-state compacts) and for funding arrangements to be completed.

This approach would involve Federal capital grants to the States for investment in short-distance corridors where States would have a more defined and consistent role in determining what services are provided and by whom. The States might choose to contract with Amtrak to operate these services or seek bids from alternative operators. States would also decide on the service attributes such as speed, frequency, and quality.

With control comes funding responsibilities, and the States should be expected to provide capital funds to match in some proportion the Federal grants. Ultimately, these corridors should be self-sufficient from an operating (not necessarily capital) standpoint, either through farebox collections or through State and local subsidies. Currently, States provide about $138 million in operating support to Amtrak for corridor trains and provide capital funds on a project-by-project basis.

Chairman NUSSLE. And I thank all of you for your testimony today. It is like drinking out of a fire hydrant. So I am sure we could go in a number of different areas.

Let me ask, generally speaking, because it has been my frustration, and I know it is shared by a number of members, that some of the items that you have all mentioned have not been—have just not really received the attention that they deserve from Congress in a partnership sort of way.

All of you mentioned that you are interested in helping us help you do the job to eliminate fraud within your departments, and waste, and other concerns. So I guess my first question is: How do you do your work? And particularly, how do you interact with Congress? We just had a Medicare bill. I would like to know, did we put any of your recommendations into that bill?

We passed a farm bill. Were any of your recommendations in the farm bill? You know, we are—and higher Ed coming up this year. Are you talking—is the committee talking to you? Is anyone listening to your ideas?

We have a transportation bill. Each one of you has a vehicle that is either already passed or is about to pass. And what interaction is Congress—what hearing are you getting from Congress in putting any or all of your recommendations into these bills?

Since we just finished Medicare, let's start on one side and work down. If you would, just tell us how we are working with you to get this job under control.

Ms. CORRIGAN. Well, let me answer it this way. I have been in the office for 5 weeks. I say that because I don't want to answer a question that I don't really know the answer to. But I will say that the office has been certainly working very closely with Congress on a number of issues, including nursing home issues.

On the Medicare proposals, I know that certainly reports were provided, but I don't know the specifics of how the relationship worked. But I can get back to you, because I think it is an important relationship, and we would like to have input.

Chairman NUSSLE. While I have you, what is the fee-for-service error rate? You mentioned that there was an error rate, but you didn't mention what it was.

Ms. CORRIGAN. This year—last year, in 2002, it was 6.3, I believe. Yes. It was 6.3 percent. It started out about 7 years ago in 1996, at 13.8 percent. It has gone down to 6.3 percent.

Chairman NUSSLE. OK. Ms. Fong.

Ms. FONG. I have been at USDA IG for 6 months. My understanding is that last year there was a significant piece of legislation that went through on the Department of Agriculture reauthor-

ization, the farm bill, and that our office did work extensively with the oversight committees on a number of provisions, especially those dealing with animal welfare, which is another one of our major responsibilities.

In terms of what is coming up this year, I believe the food stamp reauthorization is up. And Mr. Gutknecht I see is here today. He will be having a hearing later this month, and we will be testifying and providing our insights on that program, as well as the Under Secretary.

Chairman NUSSLE. Thank you. Mr. Higgins.

Mr. HIGGINS. We have had a working relationship with the Congress and also with the Department as far as the reauthorizations in the past go, and we assume that we will have the same relationship with the upcoming reauthorization.

Do we get everything we want? No. We do fight for what we think are the more important issues. And it could be improved probably on all sides—more give and take perhaps.

Chairman NUSSLE. Mr. Mead.

Mr. MEAD. I feel that at both the appropriation level and the authorizing committee level, Congress has been very responsive to our work. I have been an IG at Transportation for about 6 years now. We testify frequently before those committees.

I gave one example in my testimony of FAA's cost accounting system, where Congress has directed FAA repeatedly to build a cost accounting system, because with a $14 billion annual budget. They have got to know what your costs are. Although FAA's cost accounting system is still not in place, FAA comes up to the Hill, gets more money, but suffers no consequences.

So I think Congress can do a better job of holding the agencies accountable. By that I mean the authorizing committees and the appropriation committees.

The other one, with all respect, like on Amtrak, every year we go through this—I don't know what the proper language for it is—but it is a tortuous path where we end up with a status quo that nobody likes, that is unacceptable, and Congress is probably the only one that can come to grips and closure on it. Otherwise, we are going to continue to limp along.

And finally, both authorizing and appropriation committees, I think, could keep the pressure on the States to have more vigorous fraud enforcement efforts.

Chairman NUSSLE. Mr. Mead mentioned that 1 percent was not unreasonable as far as being able to identify waste, fraud, and abuse within the Department of Transportation. Let me just ask the other three whether or not a 1 percent waste, fraud, and abuse target would be unreasonable within your departments.

Mr. HIGGINS. The 1 percent target for the Department would be about $250 million, is that right?

Chairman NUSSLE. I am not—right offhand I can't tell you that.

Mr. HIGGINS. The Department's own figures are that they estimate that there are $401 million a year made in erroneous payments. My office thinks that figure is a little conservative.

Chairman NUSSLE. So 1 percent would not be unreasonable?

Mr. HIGGINS. I don't know what the 1 percent is but if——

Chairman NUSSLE. I realize it sounds like a silly question. I know that you are, just by the way you are answering it, you think it sounds like that, but trust me this is not a silly question. We just had this debate. So let me ask from the Department of Agriculture is 1 percent an unreasonable figure?

Ms. FONG. Let me respond on a couple of levels. I agree with you there is waste, fraud, and abuse in the USDA programs. I think all of us recognize that much more can be done to tighten up how the Department delivers its programs. The issue that we have at USDA is that right now we don't have a good handle on exactly the level of improper payments or waste in many of the programs, which is why the Improper Payments Act that you passed last year is such a critical tool for all of us. What it will do is it will require the Department and its agencies to analyze its programs, figure out where the vulnerabilities are and how many payments are, in fact, improper or erroneous and then to take some corrective action to stop those payments or to recoup them. And in our view, that is where we need as an IG office to focus our efforts, to encourage the Department to help them do that so that we do have a handle on how much fraud, waste, and abuse we are dealing with.

Chairman NUSSLE. In the interest of time, I will yield to Mr. Spratt for his questions.

Mr. SPRATT. Ms. Corrigan, and all of you, thank you for your testimony. It has been very useful. When you mentioned a minute ago that the amount of overpayments or error payments had been reduced from 23 percent to about 6.3 percent over the last 5 or 6 years, does that number include improper and inadequately documented claims which when resupported qualify for payment? In other words, does it include negligent submissions as well as fraud and abuse?

Ms. CORRIGAN. Yes.

Mr. SPRATT. What percentage is true fraud and true abuse as opposed to lack of properly supported or improper payment?

Ms. CORRIGAN. Let me step back and answer the first part of your question perhaps. Because I think that much of the error rate in recent years has been improper documentation. The Office of the Inspector General got very good at getting documentation in determining whether or not the claim was properly paid. So I don't think that now much of it is improper documentation, but a lot of it is errors and improper payments that wouldn't be considered abuse.

As far as fraud, I think it is even more difficult because fraud has to be adjudicated by a court. And it is very difficult to determine whether somebody knowingly submitted a claim when you are doing a medical review, which is essentially what we are doing in the error rate testing program. I think what you can say is that every part of the error rate in the past has been those claims that have been improperly paid for all sorts of reasons. But it isn't broken down quite in the way that you are suggesting.

Mr. SPRATT. You mentioned that the government, Medicare, Medicaid manifestly are paying too much for prescription drugs within the scope of coverage now provided. And you gave as one measure of that the Veterans Administration's price payment list, which is substantially below Medicare. Have any recommendations

been made by the IG that the CMS or before that HCFA go to the same method of procuring drugs as the Veterans Administration?

Ms. CORRIGAN. My understanding is that the Office of the Inspector General has never made a particular recommendation about drugs. But what it has said is that for the policy makers who are thinking about this, look at the Federal supply schedule. Now the VA procures drugs differently. Medicare doesn't procure drugs directly, so it may need to pay more than the Federal supply schedule. But it should at least be considered as part of the policy makers' thinking because it is so much less than Medicare is paying. There has to be some cost savings that Medicare could benefit from looking at those prices.

Mr. SPRATT. Let me ask you if we were to pass a law which says that HHS, CMS, shall not engage or interfere in any price negotiations for drugs procured by the government, do you think that would help your efforts to produce savings?

Ms. CORRIGAN. Thinking about your question myself, negotiations would have to result in savings because the cost would be less. But my guess is that you would have a lot of opposition on the other side because of the way that Medicare pays for drugs. It is not like a wholesaler like the VA, so there would be some legitimate complaint about the lowering of the cost or the fixing of the cost at that rate.

Mr. SPRATT. What about CRADAs, have you looked at cooperative research and development agreements, particularly with pharmaceutical firms? One frequently offered example is Taxol, which NIH developed, at least initially investing $484 million, a pharmaceutical firm took over the perfection of the drug and then has sold it to the tune of about $9 billion total sales and our royalty payments only total $35 million. Has HHS taken a look at whether or not these are good deals for the government?

Ms. CORRIGAN. I am not sure whether we have. I am certainly willing—I think it is something we could look at.

Mr. SPRATT. OK. Thank you. One final question to the Department of Education, it would apply to all of you, let me ask of you would it help and do you think it would more than pay for itself if we provide you with more staff, more full time equivalents?

Mr. HIGGINS. Definitely.

Mr. SPRATT. Is that the case in HHS and HIPAA, we provided additional funds for oversight and for inspector generals in particular, and you cut your error rate to—your overpayment rate, missed payment rate from 13.8 percent to 6.3 percent.

Ms. CORRIGAN. I think that funding was critical.

Mr. SPRATT. Finally Department of Education, let's just take as an example, looking through your testimony it seems to me that you are claiming that the IG has filed a total of $334 million in disallowed costs and recoveries from criminal investigations in the student loan programs over the last couple of years, over the last 5½ years. If we ask you to increase that so that we could get $2.5 billion of savings, increase it by a factor of four, do you think it could be done? Can we squeeze out that much waste, fraud and abuse in the DOE programs?

Mr. HIGGINS. I don't really have any data to answer that question, to be honest about it. But the $334 million includes sup-

ported—sustained question and disallowed costs of $182 million, and $152 million was the result of criminal activities.

Mr. SPRATT. OK. Thank you very much.

Chairman NUSSLE. Mr. Thornberry. Mr. Ryun. Mr. Schrock.

Mr. SCHROCK. Thank you, Mr. Chairman. Thank you for having this hearing today and thank you all for testifying. I think this is something the Budget Committee has talked about for a while, cutting 1 percent, I can't imagine why we can't. It sounds like the Department of Education might be a candidate for 2 percent if we really want to be good citizens based on the figure you gave us, but I don't think that is going to happen. I know in my own account if we have to cut back we need to. Frankly, I would love to cut 10 percent of my personal budget. I say that personally. I say that especially because my wife is here, but I don't think it is going to happen. But it would be nice if we could do that at the government level.

I am really concerned, General Mead, you said that why can't we—why can't efficiency be increased 1 percent. I think it can. Obviously you are trying to get your hands around that. Is there a program in place to do that? Each of these agencies is so big I don't know how you get your hands around this to do that. But I would be curious to know. The Big Dig in Boston, of course we are building Big Dig part 2 across the street here. You can see what that is going to cost. So at some point that has got to happen. How do you all do that in your agency?

Mr. MEAD. Well——

Mr. SCHROCK. Answer too about the fuel tax fraud. That really interests me. I don't understand that.

Mr. MEAD. During my time there as IG I haven't seen a real effort to save money until the budget crunch that started last year. One of the reasons why, as mentioned in my testimony is that Congress passed a law requiring that virtually all of the trust fund money that came in be spent. And when that is done there is less incentive to cut your costs. And I know both the aviation and the highway programs are up for reauthorization. I think now that there is a budget crunch, behooves not only the Office of the Secretary, but each of the operating administrations to come up with a cost cutting plan in a way to secure efficiencies. Congress should insist on the submission of a plan like that to the appropriation committees, the authorizing committees, and the Inspector Generals, at least while we are going through this period of tight revenues.

Regarding fuel tax fraud, we used to prosecute a large number of cases and where people just wouldn't be paying the fuel tax. Congress plugged those holes, but we are now concerned that there are two other big holes. One is aviation fuel, which is very similar to the fuel used in trucks. You pay the tax for truck fuel at the rack—that is, before it is distributed to retail outlets. That same fuel, though, when destined for an airplane isn't paid at the rack. It is paid on delivery to the aviation facility. So you can say, well, I am taking this fuel for aviation purposes and instead divert it to trucking without paying tax. Pay taxes in a State with a low fuel tax, then sell it in a State with a higher fuel tax, pocketing the difference.

Another hole is: each State has its own State tax on fuel, some States are fairly low, other States are higher. Well, you say the gasoline is destined for a State with low tax, and then you take that gasoline and you go over to a high tax State, and you save a large amount of money.

We will need the help of the Internal Revenue Service to get to the bottom of the two holes I just described. But it is estimated that fuel tax evasion cost us over $1 billion a year. However, we will need the Congress' help to secure the commitment of the Internal Revenue Service to increase enforcement efforts.

Mr. SCHROCK. One more quick question. You talked about why don't projects have a finance plan. I would think they did. I hate to keep picking on the Big Dig. I saw it recently. I was amazed by it. If there was an amount certain that they were going to use by, and it has increased by billions and billions and billions of dollars, 14,000 change orders, did they have to get approval from you to do that or is it a cost plus type thing or what? Help me understand that.

Mr. MEAD. No. Certainly they don't need approval from the Inspector General. The Federal Highway Administration approves change orders and so forth. Under the law, only one highway project in the United States is capped by law in terms of how much Federal money will go to it. And that was when Congress got fed up at the price increases at the Central Artery and said no more Federal money to the Central Artery beyond a certain amount. It was a fairly severe remedy, but I can tell you this, it has slowed the cost growth at the Central Artery. Once Congress acted, I saw the brakes go on to cost increases.

Mr. SCHROCK. Maybe that is an answer, something we ought to look into. Thank you, Mr. Chairman.

Chairman NUSSLE. Ms. Majette.

Ms. MAJETTE. Thank you, Mr. Chairman. I have a question or a couple of questions for Inspector General Fong. I understand from your testimony that you said that more people were being certified for free and reduced lunches than were identified by the Census as being counted. Or eligible, is that—did I say that correctly?

Ms. FONG. Yes.

Ms. MAJETTE. Well, my question is: isn't it possible that those people are eligible but they just weren't counted in the Census so it is not necessarily a matter of fraud or abuse; it may be just a function of the undercount that took place in the Census? I believe you said that one of the places you talked about was New York, which had 69 percent variation. And as I recall there was a significant outcry in New York that there was a significant undercount with respect to the Census. So can you address for me those discrepancies and if there is a way that you can actually say or would be able to determine how much of that is fraud, waste, and abuse and how much it was just a function of our inability to determine who actually should receive those benefits?

Ms. FONG. You are absolutely right. This is a very complex area in terms of determining eligibility for these programs and how we really nail down what the error rates are. As I mentioned, the Census indicated that perhaps 27 percent of the people receiving these benefits were not eligible and FNS itself acknowledges that. Our

IG work indicated that there may be error rates ranging from 19 to 69 percent. These error rates are based on sampling and they are based on the fact that the responses to the income verification instruments may or may not have been received. So in fact these rates include, could include people who are truly not eligible as well as people who just did not respond to the verification questionnaires.

For example, if you have a child in public school—I am a parent, I have this—and they send home the questionnaires for you to certify, and you decide for whatever reason that you don't want to fill it out or that you don't believe it is important to fill out because in some districts meals are provided regardless of whether you fill it out, that raises issues as to exactly what we are dealing with. FNS understands that this is a complex issue. They have instituted a number of pilot projects right now going on in 22 States to try to get a good measurement of the accuracy rate here. And they will be completing these pilots within this school year. And then we should have a much better sense of exactly what we are dealing with.

Ms. MAJETTE. To follow up on that as a more general question, do you have any estimates of what the cost of recovery is? Is it going to be a matter of we are spending $6 million to recover $4 million, or $7 million to recover $2 million? In other words, I guess how much more is it going to cost than what we are already spending in terms of staff and all of those things? How much more is it going to cost to determine what amounts are being paid fraudulently and what is it going to cost to stop or to stem those alleged abuses?

Ms. FONG. That is one of the issues that makes this whole area very complex. I know that FNS's pilots are looking at a number of ways to verify eligibility, ranging from accepting certifications for other programs as an indication that you are eligible; for example, if you are eligible for food stamps, therefore you are eligible for school lunch. They are looking at another option which would actually require 100 percent verification and they are looking at a full range of options. It is going to have to be a cost-benefit analysis. I think at that point without having the results of the pilots and without knowing the amount of money that will be spent on these pilots to actually implement verification, it is probably premature for to us say at what point do we reach the optimum ratio of cost and benefit. But that is definitely one of the issues.

Ms. MAJETTE. Wouldn't you agree that is something that would need to be determined before we start cutting funding in these different areas?

Ms. FONG. I agree that that is an issue that should be looked at. My sense is that FNS could probably give you a better read on exactly what their experience with it is at that point.

Ms. MAJETTE. What is the plan for looking at it? Is there one?

Ms. FONG. The pilots are due to be completed this school year. The data should all be in very shortly and then the analysis will start. They will do their analysis. We should have some idea of where they are going I think shortly.

Ms. MAJETTE. I see that my time is up.

Chairman NUSSLE. Thank you. Mr. Hastings.

Mr. HASTINGS. Thank you, Mr. Chairman, for having this hearing. Thank all of you for testifying. I will just say at the outset if there is one thing that I think every American understands is that there could be efficiencies made in our Federal Government. Of course that generally always translates to saving dollars.

I want to ask Ms. Corrigan, if I may, on your testimony which I thought very helpful with what had been uncovered in the past, nevertheless, the most recent report shows that there is about over 13 billion, I think $13.3 billion, in improper payments this year, which is over a billion more than last year. This thing seems to be getting worse. My question to you is there something more that maybe the executive branch ought to be doing? If so, what should they be doing? And probably more important, since we are right now debating having conference now on the Medicare reform bill with prescription drugs and you identified prescription drugs as some of the areas where there is some abuse, are there some things that we should be focusing on specifically to address the issue today?

Ms. CORRIGAN. Well, I am hopeful that the data that comes out this year on the error rate will be more useful only if it shows more problems. I mean, I think it is very easy to criticize CMS because it is so large, but they are at least taking the step of focusing on themselves and saying, OK, we are going to look at everything in depth. We are going to look at every fee for service payment that we make, whether it is the hospital providers; we will look at our own contractors; we will look at every service that is provided. My guess is that some of those rates are going to be really high. What I think they are going to have to do is then take the next steps to fix the really high rates. I think they are on the path. But what I think needs to be done in the future is to perhaps focus on pricing. I mean, pricing hasn't really been focused on very much and it can't be done by the Department. And until there is some way to rationally pay for some of these services, I think you are going to have both problems where some services are—some doctors are not being paid enough for certain services and vice versa.

On prescription drugs and durable medical equipment, the prices are off the roof. Until there is some real debate, whether it is in Congress or in the executive branch, about how to somehow control what we are paying, there is no way that a lot of these problems are going to continue to exist. And people will come in and try and take some of that money. Where there are big pots of money it is known that people will try and take pieces of them. So I think what we have to keep doing is looking at where the big pots are, where the areas are that can be exploited.

Look at outlier payments of last year. It was all over the news. Outlier payments were intended to be made to really egregious cases; but, instead, the money is being moved around in ways that were never intended by Congress. And I think there has to be vigilance to close loopholes that people find. That would be my suggestion.

Mr. HASTINGS. Let me follow up because the chairman made an observation because there was a great deal of debate in this committee and on the floor about our suggestion that there ought to be 1 percent waste, fraud, and abuse, at least what I have heard

from several of you that there is probably some room within each of your budgets to go after that. My question, to me the pertinent question is this: What if the Congress were to say you are directed to find 1 percent waste, fraud, and abuse, would this be a means by which to kick off maybe some of the things that you are talking about to look at? And invite everybody else to look at this. In other words, if you were forced to make a decision could that decision be made more aggressively to try to find that 1 percent that we are trying to identify? I would ask all of you if you could just briefly in a short period of time address that.

Ms. CORRIGAN. I actually think that 1 percent is probably too much, but it is also very arbitrary. You would be forcing CMS, not us, to somehow reduce the error rate to 1 percent.

Mr. HASTINGS. Not necessarily reducing but trying to find, acknowledge that there is at least that much there.

Ms. CORRIGAN. CMS I think has acknowledged that already.

Mr. HASTINGS. Excuse me because my time is clicking down very quickly. It seems to me the next logical step would be, OK, we will force you, we will mandate to you from the Congress as policy that you find it. What is wrong with that? Again if could you, Mr. Chairman, indulge me.

Mr. MEAD. I think the answer to your question is that would go a long way toward making it work. I think that performance measures like that are good.

Mr. HIGGINS. The Department of Education has already identified $336 million of overpayments made, and we need the Congress to enact the legislation so we can verify the income with the IRS. So enacting that legislation would save you more than 1 percent in student aid programs.

Mr. HASTINGS. Mr. Chairman, thank you.

Chairman NUSSLE. Thank you. Mr. Moran.

Mr. MORAN. Thank you, Mr. Chairman. Let me start, Mr. Mead. First of all, I want to get what was the original figure on Springfield?

Mr. MEAD. I think it was—my numbers might be off a bit. I think it was around $265 million in the beginning and it is now $675 million. And since we issued our report, I think it has been holding.

Mr. MORAN. To what?

Mr. MEAD. $675 million.

Mr. MORAN. It went from $267 million to $675 million, Springfield. Now the——

Mr. MEAD. I am sorry. I misunderstood your question. The Central Artery project started at $2.5 billion and is now in the neighborhood of $14.5 billion.

Mr. MORAN. Up to $14.5 million from—$2.5 million to $14.5 million in 10 years. I was just trying to figure whether—compare it to our project at the Capitol Visitor's Center. It has gone from 300 million to what we now expect, if you include all the additional offices and so on that the leadership in the House and Senate have asked for, it will be about 500 million. But that really does pale in comparison. My friend Ed Schrock isn't here but I know there is going to be a lot of comparisons because the legislative branch bill is going to be on the floor today. But that doesn't mean that we

don't have to be sensitive to cost overruns. And I know that you are and you gave us an excellent report on the Springfield interchange overrun, but when I look at the examples that you use of waste, fraud, and abuse, and then consider the fact that this committee instructed the Transportation Infrastructure Committee to come up with $5.5 billion in budget authority for mandatory programs over the next 10 years, I don't see that in your testimony because basically what you tell us about the Federal Aviation Administration, Amtrak, et cetera, those are discretionary programs, appropriated by the Appropriations Committee. Do you really think that you could come up with $5.5 billion in budget authority over 10 years for mandatory programs?

Mr. MEAD. No.

Mr. MORAN. The answer is no.

Mr. MEAD. The answer would be very difficult. But I also would take issue with respect to the characterization of the mandatory discretionary issue at Transportation. Why would I do that? Because both the aviation program and the highway program basically require—or at least in the past the current legislation requires the spending of money in the amount of the receipts.

Mr. MORAN. I appreciate that, Mr. Mead. I don't want to cut you short except I will run out of time. I don't want to ask for too much leniency on the part of the chairman because I want to ask two of the other departments. The problem is that the legislation that the Budget Committee included referred to mandatory programs. And under our definitional structure, the programs you referred to I don't think are considered mandatory.

Let me get into the Department of Education because our Education Inspector General, and I appreciate your testifying as well, sir, you said we have found—you have found 334—actually you cited the 401 million but let's talk about the 334 million that you have repeatedly cited over the last 5½ years in disallowed costs and recoveries. That comes to about 6 million. But the Budget Committee has required, Mr. Higgins, that you come up with considerably more than that. Do you have the actual figure that you had to take out of mandatory programs?

Mr. HIGGINS. No.

Mr. MORAN. I think it is $2.5 billion in mandatory costs for waste, fraud, and abuse over the next 10 years. You cited $600 million, or $334 [million] over 5 years. Do you think it is possible to come up with 2.5 billion over the next 10 years in cuts to mandatory programs?

Mr. HIGGINS. No. I was assuming that the——

Mr. MORAN. The answer is no. I need to get those answers on the record here and kind of underscore them because I want to see how realistic is our requirement.

And then lastly and very quickly on, and again I don't mean to be rude here in moving so fast, but I have run out of time for my 5 minutes. The Agriculture Department is required to take $5 billion as well out of mandatory programs in waste, fraud, and abuse over the next 10 years. Let me ask Agriculture's Inspector General, do you think that is possible? And it is OK if you say no because you have two predecessors here, your two witnesses preceding you have said no. What do you think?

Ms. FONG. I am going to plead relative inexperience with the range of the Department's programs. I will say I don't know.

Mr. MORAN. You don't know.

Ms. FONG. I don't know.

Mr. MORAN. That is a "know" instead of a "no"?

Ms. FONG. Yes.

Mr. MORAN. But you are willing to have that requirement imposed on Agriculture from the Budget Committee. Do you think that is reasonable?

Ms. FONG. I think it would spark some very useful debate as to how the Department can tighten up its programs.

Mr. MORAN. I am trying to figure out how realistic is this idea of cutting so much money out of waste, fraud, and abuse out of entitlement programs. And from the testimony, although the testimony is very enlightening, I don't see where we can get that money out of any of these departments, Mr. Chairman.

Chairman NUSSLE. That is fine. Thank you, my friend from Virginia. Apologize for wasting your time today then. Mr. Brown.

Mr. BROWN. Mr. Chairman, on the other side of the coin, looks like to me that the 1 percent is a very workable goal and maybe in some areas might be even greater than that. I was amazed too as I listened to the testimony the amount of waste, fraud, and abuse that is in place. And Mr. Chairman, I am not so sure where the disconnect is. I think we all want to address it; we all want to identify it. We also want to prosecute those people that are abusing the system. But it seems like we all know about it, it is all on the table.

I guess my point is what is the next step, Mr. Chairman? How do we go from identifying the problem to eliminating the problem? And I know we mentioned somewhere about being a little bit more proactive in trying to prevent some waste, fraud, and abuse from happening. But I see so many areas that we are concerned about that we talked about the Big Dig, Mr. Mead, and Amtrak and some of those other areas that we feel like the solution is just to continue to put more and more money. If that is the solution, then certainly you know it could continue to grow and the waste, fraud, and abuse would never be addressed.

I was concerned also about the Food Stamp Program, where there is no disincentive for the States to be proactive, Ms. Fong. I don't know what we can do to build some kind of a checkpoint in that system to prevent that from happening. I understand, Ms. Corrigan, the differential in the cost of prescription drugs. I know one is a retail and one is a wholesale but there certainly shouldn't be that big of a disparity between those costs. So what can we do? Tell us what we can do to help you make these changes.

Ms. FONG. Well, I think have you taken a very good first step today in having us come forward to testify about areas where we find problems, and I think bringing these things to light is always a very useful thing to do. And I think it certainly helps me in terms of formulating priorities for our office and where we need to spend time in the future in terms of helping the Department address some of these issues and make some progress on them. So I think in that sense this is a very good thing to do.

Mr. BROWN. I know that you mentioned about the altered, you know, income tax returns in order to get kids to qualify for the free lunch program. Did we prosecute those parents?

Ms. FONG. I know we have investigations going on in all of our programs. And we receive allegations of fraud—whenever there is a government program there are allegations that people are trying to take advantage of these programs. In the Food Stamp Program what we have tended to do is to focus on the really big trafficking cases that involve retailers and multi-millions of dollars because we want to get the most bang for our buck. Where there are cases that fraud has been committed by an individual we will usually refer that to the State for prosecution unless there is a reason for us to pursue that ourselves. But, yes, we do receive allegations of fraud by individuals. Those allegations are reviewed and referred to the appropriate people.

Mr. BROWN. OK. Mr. Higgins, if I could address the question to you. Has IG ever made an estimate of the amount of fraud and waste in the loan programs that occur each year through unrecovered and improper payments and waste loan administrative funds?

Mr. HIGGINS. No. No, we have not.

Mr. BROWN. What percentage of loan funds do you think are awarded improperly?

Mr. HIGGINS. We don't have any data on the amount of loan funds that have been awarded improperly. The only data that we have is on the Pell Grant program.

Mr. BROWN. Some individuals who claimed to be disabled and unable to work were actually earning six figure salaries. We talk about a $400 hammer and all those others out there. But the Department has since put in place administrative measures to guard against improper loan forgiveness. Have the new measures been successful?

Mr. HIGGINS. We haven't gone back and audited it but they have taken steps where they are requiring the doctor's license number so they can verify that it is a real doctor. There is a conditional period where they monitor the salary of this individual for 3 years. And in the event that the person does start earning income again they reinstate the loan. If they come back in for another loan, they have to reinstate the loans that were discharged.

Mr. BROWN. I know my time just ended. I note as we deal with the reauthorization of the bill, looking to forgive more percentage of those loans if they go into certain Title I programs within certain accredited fields. I recognize there is a tremendous amount of waste, fraud, and abuse out there. I am sure that a 1 percent target is a very minimal figure. Thank you.

Chairman NUSSLE. Ms. DeLauro.

Ms. DELAURO. Thank you very much, Mr. Chairman. And I want to apologize to the panel for having to leave for some of the testimony. But I thank you for being here today, and I would echo what my colleague Mr. Spratt said about no one here from Defense, and as a matter of fact no one here from Treasury testifying here today. But I am hopeful that we will hear from them in the future. It is true we all want to crack down on waste, fraud, and abuse.

In fact, the Clinton administration's National Performance Review saved more than $100 billion, I might add. And we know there still is waste. Cracking down on mismanagement is particularly important now in the current budgetary climate.

I might add that it is—the administration's $1.2 trillion tax cut has stretched our resources to the limit. I have one question which I would like to have each of you answer. Looking through the mandatory programs under your jurisdictions, are you able to identify any areas of waste, fraud, and abuse that would generate savings even close to the $30 billion per year that we lose through the tax code through the underpayment of taxes? And in this respect these are taxes that are legally owed and we know who owes them. Do you agree that if we are truly committed to reducing fraud we should increase enforcement at the IRS to crack down on tax evasion? Right now 56 percent of noncompliant taxpayers with incomes over $100,000 get off scot free. Can I get each of you to respond to that question?

Ms. CORRIGAN. I think that every violation of the law should be looked at and priorities have to be set by the administration and by Congress. And if you think that is an area that merits more focus then I think it is your right to do that.

Ms. DELAURO. I understand that. But my question directly is do you believe you can generate savings even close to the $30 billion that we lose through the tax code through the underpayment of taxes? And that is per year in your department. Does your—do you reach that level of $30 billion?

Ms. CORRIGAN. I cannot imagine that we do.

Ms. DELAURO. You cannot imagine that you do. OK. Ms. Fong.

Ms. FONG. Let me just respond in terms of USDA programs. My staff has provided me with a list of mandatory programs within USDA. There are 70 of them. And leafing through them there are many of these programs that I am not familiar with. I am not sure our office has ever looked at them. So my answer is I do not know the extent of savings that we could generate from these programs. I am just not familiar enough with them.

Ms. DELAURO. So with the mandatory programs you have no idea how much money we can deal with in term of waste, fraud, and abuse at the U.S. Department of Agriculture?

Ms. FONG. We need to do a lot more work to nail that down.

Ms. DELAURO. Can you get that information to us, let us know what you believe.

Ms. FONG. I will try to provide you a response for the record.

[The information referred to follows:]

MS. FONG'S RESPONSE TO MS. DELAURO'S QUESTION REGARDING WASTE, FRAUD, AND ABUSE IN MANDATORY PROGRAMS IN THE USDA

Within USDA, only one of the mandatory programs, the Food Stamp Program, has a system in place to measure payment accuracy. As noted in my statement, the total erroneous payments for the last year tested, fiscal year 2001, were about $1.3 billion out of total issuance of $15.5 billion. Because so few agencies had systems to determine or estimate improper payments, Congress passed the 2002 Improper Payments Information Act. Once the provisions of the act are implemented, USDA should have data that would permit it to identify programs with unacceptable rates of improper payments. We plan to monitor USDA's efforts to implement the act.

Ms. DELAURO. Thank you. Mr. Higgins.

Mr. HIGGINS. Is your question can the Department of Education absorb the $30 million?

Ms. DELAURO. I am just saying can you generate savings close to $30 billion.

Mr. HIGGINS. Not close to $30 billion.

Ms. DELAURO. Not close. You may have said this before, what—well, you did talk about dollar amounts. I did hear Ms. Fong's comment about the amount that you thought you could save. So I won't go back. But you can't, you can't come close to that $30 billion?

Mr. HIGGINS. No.

Ms. DELAURO. Mr. Mead.

Mr. MEAD. I can't come close to that either. But I would say that we all have to do our part. And we could give you some tax collections on the Highway Trust Fund side. In my testimony I was referring to the motor fuel tax evasion. But I would need Congress' help to do that. We would need to agree on some jurisdiction, because right now it is pretty exclusively with the U.S. Treasury Department.

Ms. DELAURO. So in essence, I mean it is self-explanatory with your own answers, I obviously believe that the answer to the question we should increase enforcement at IRS. I think you would all concur, as Ms. Corrigan says, if we decide to do that we should do that. It would appear to me on a per annum basis that we could recapture $30 billion and this is in taxes, legally owed, and we know who owes them, and that quite frankly that we don't move in that direction but we—and everyone is for tightening up on waste, fraud, and abuse. It is a sense we probably ought to have some level of priority in dealing with this effort and budgeting that I have understood in the past is that you kind of go for where the big numbers are and you see what you can do.

I would suggest that as soon as possible we try to talk with people at the Department of Defense and look into where we can save $30 billion a year. I think we could all put it to very, very good use, particularly in these very tight budget times. I thank you again for your testimony this morning.

Chairman NUSSLE. Mr. Garrett. Before the gentleman begins we have two votes on the floor. We will recess and come back after the second vote, immediately after the second vote.

Mr. Garrett.

Mr. GARRETT. Question first for Mr. Mead. The stories you tell are the gut wrenching ones that I hear from constituents at town hall meetings asking what are we doing with their tax dollars. A study with regard to cost overrun, part of your testimony shows that researchers have found international studies that 90 percent of projects suffer from cost overruns. There is no difference whether you are talking about big projects or little projects. This has been the case over the last 70 years. My question to you is what can I tell my constituents as far as what are the ramifications or the repercussions to both the private and public sector on the private side for the firms that are engaged in these cost overruns? Do we continue to allow those firms to be employed and have contracts with the Federal Government and in the public sector, for those people who are on the Federal payroll that are involved in these projects from day one; are there repercussions to them when their

cost estimates are so egregiously wrong as the cases that we have right here in town and also on the examples that you gave as well?

Mr. MEAD. No, sir. I don't think so. I think you are speaking of accountability. And I think we need a much larger dose of that at the State level and the Federal level. I would say there are a couple things that you could do if you want some explicit suggestions. One would be that your State, as in all States, has to submit a State transportation plan. This, by law, is not supposed to be a wish list. This is a representation to the taxpayers, our taxpayers, of projects that we are going to undertake accompanied with a cost estimate. If those were made a lot more realistic, I think we would have a lot more accountability.

Secondly, in your consideration of the pending reauthorization of the highway and transit programs, you might put in a provision that explicitly requires the consideration of a contractor's prior performance in connection with future contract awards.

Mr. GARRETT. Thank you. This chairman and this committee worked hard on a budget that said we are going to try to reduce expenditures by 1 percent. Of course that went out the window once it got out of here. So is it fair to say that not only this Congress but past Congresses have basically been both encouraging and condoning this type of behavior?

Mr. MEAD. I don't think they are doing it consciously but sometimes, I think by indirection, that is the result.

Mr. GARRETT. With regard to Medicare and prescription drugs, prior testimony, we had someone else at this hearing previous on, gave an estimate as far as the—and you probably know the number off the top of your head as far as the fraud, waste, and abuse figure as far as the Medicare—ran a 5 percent figure that they were throwing out in the overall program. And now that we have a new $400 billion prescription drug program that is coming down the road conceivably, we are talking here about saving a million here, saving a million there when you can. We just are going to authorize the program's $400 billion, out of 5 percent waste, fraud, and abuse going into it you are looking at a $20 billion in additional waste, fraud, and abuse that we are basically authorizing at this point in time. And the 5 percent figure might be conservative inasmuch as the chairman—not this chairman, the chairman who crafted that bill, that says this is a bill that is so complex even he has a hard time getting his hands around it.

What are your projections of what we may be looking forward to in actual dollars in waste, fraud, and abuse in the prescription drug program that is now coming out of Congress?

Ms. CORRIGAN. That is a question I would have to give more thought to than I have thus far. But I will give you my preliminary thoughts on it, which is I think you are right to be very worried. I think any time you have that amount of money with complicated rules, it is a setup for, at the very least, abuse or misunderstanding, which results in the same type of loss that you are talking about, potentially a $20 billion loss.

So I think that in crafting the legislation there has to be given thought to how we are going to protect against that type of abuse. And either you have to have some accounting mechanism for all of the dollars or you have to have a verification mechanism in place

set by Congress that people will be held to or you have to provide more resources to the IG to look at the program.

Mr. GARRETT. Are any of those things in the bill as we see it right now?

Ms. CORRIGAN. No, as far as I am aware of.

Mr. GARRETT. Should I be, as a State that already has a prescription drug program that does not see that level of waste, fraud, and abuse, should I be concerned for my State that we will be funding the waste, fraud, and abuse for the other 49 States?

Ms. CORRIGAN. You should always be concerned about that, yes.

Chairman NUSSLE. Mr. Baird.

Mr. BAIRD. Thank the chairman. Thank the panel for this most informative hearing. I recently discovered a program, and this is for Ms. Fong, under the department the Farm Service Agency, which is really fascinating, Mr. Chairman, you might find this interesting as well, given the nature of this hearing, it is called the Livestock Compensation Program. And in essence what it does is provide compensation on a per head basis for farmers who have livestock in a disaster declared area. But what is intriguing about it is you don't actually have to sustain any damage to your herd. All you have to do if there is an earthquake in the area and you are in that area is send some documentation that you got some cattle or sheep above a certain weight or below a certain weight level and you get money for it. They don't have to have even fallen on the ground during the earthquake. You will just get money for it. You can't really blame the farmers for signing up for this. But it is really silly, and I would be very interested in working with the Department and others who are interested in this to try to solve this, because it just doesn't make any sense.

If we could follow up on this at some point I would love to chat with you about it. This was called to my attention actually by a newspaper who discovered it. And the farmers, if I can use the pun word, sheepishly applied for the money and got it back. So maybe we could work on this. It is call the Livestock Compensation Program. At the very least we ought to demonstrate that you have somehow sustained damage.

Second question I hear a lot—I am not really sure it relates to DHS and Agriculture—has to do with provisions that are made available to refugees who are immigrants our country in terms of eligibility for Federal funding. Food stamps are an example that I hear complaints about a lot. I hear also about Medicaid uses, et cetera. I wonder if you have any insights into that. Are there ways we can tighten up the controls on that? And any insights into that?

Ms. FONG. I am not sure that our audit work has focused on that specific aspect of eligibility for food stamps. I would have to go back and provide you a response on that to see if we can give you something more focused.

[The information referred to follows:]

MS. FONG'S RESPONSE TO MR. BAIRD'S QUESTION REGARDING FOOD STAMP ELIGIBILITY

OIG has not undertaken a review focusing on refugees or immigrants participating in the Food Stamp Program. Since this is an eligibility issue, FNS's quality control system would test for this and other eligibility factors.

Ms. CORRIGAN. I can do that for you on the Medicaid eligibility side. I am not sure we focused on it either, but we can certainly look at it and get back to you.

[The information referred to follows:]

MS. CORRIGAN'S RESPONSE TO MR. BAIRD'S QUESTION REGARDING REFUGEES' ELIGIBILITY FOR MEDICARE AND SCHIP

Certain refugees designated in 42 C.F.R. section 435.408 are eligible for Medicaid, and some refugees are eligible for services under the State Children's Health Insurance Program (SCHIP). Those newly arrived refugees who do not meet all the eligibility requirements for Medicaid or SCHIP may qualify to receive medical services under the Refugee and Entrant Assistance program. This program provides Federal grant funds to States to provide medical assistance and limited cash assistance to qualified refugees. It also provides funding for child welfare and foster care services to unaccompanied minors. Under the same program, States receive grants to help refugees become economically self-sufficient as quickly as possible, primarily through the provision of employment services.

Mr. BAIRD. I yield back.

Chairman NUSSLE. We probably should head to the floor for this vote. So we will recess until right after the second vote and we will continue with this panel.

[recess.]

Mr. HASTINGS [presiding]. The committee will reconvene, and we will continue with the hearing. Before I call on the next member for questioning, I would like to—I understand Mr. Higgins would like to clarify an earlier remark that he made. So, Mr. Higgins, you have the floor.

Mr. HIGGINS. Thank you.

When I was asked the question about whether the Department could absorb the 1 percent, the figure that Mr. Moran used was $2 billion, I think—and that was for a 10-year period. I did not hear him say for the 10-year period, and it sort of took me off guard.

But our mark is $220 million. The IRS match, we have an estimate on that, that the Department can save $336 million a year. So I would like to change my answer to yes, the Department could meet that with the IRS match. But, of course, the Congress has to enact that legislation to change the IRS code. That was my only point of clarification.

Mr. HASTINGS. You have made that clear, even under questioning that I have had. So that is the third time that I have heard that. I think the record will reflect that.

Next we will go to Mr. Diaz-Balart.

Mr. DIAZ-BALART. Thank you, Mr. Chairman. If I may, before I actually go to the question—I have a quick comment:

I frankly am a little bit in awe, when I keep hearing from some of our dear friends in the minority party the rationalization for not going after waste, fraud, and abuse, because there may be some areas where there is more abuse or more waste or more fraud, then that means that we shouldn't go after areas that may have smaller numbers of that. But those smaller numbers are, I think, totally intolerable and unacceptable and, frankly, immoral to accept.

I have a hard time dealing with—when you have, for example, according to GAO, in food stamps, improper payments totalling $1.34 billion in 2002. You know, when you look at a 12-month allotment of food stamps for one person costing $1,700, according to the USDA figures which I obtained from their Web site, that means

that the improper payments alone could have paid for a 12-month supply of food stamps for over 803,000 people. And to rationalize that we shouldn't go after that is, frankly, not only unacceptable in my humble opinion, but immoral, totally immoral. I just wanted to say that for the record, Mr. Chairman.

I do have a question for Ms. Corrigan, if I may, relating to Medicaid. In October 1999, the GAO issued a report titled "Health Care Fraud Schemes Committed by Career Criminals and Organized Criminal Groups, and Impact on Consumers and Legitimate Health Care Providers," not a real short title, by the way. But the report reviewed fraud, or at least alleged fraud, which was occurring in Florida, North Carolina, and Illinois between 1992 and 1998. GAO stated that legal actions are often ineffective in halting fraud.

Do you agree with that statement? And if so, what other remedies would you propose to control widespread abuse and fraud? If not, please explain why not; because I think there is a lot of anecdotal evidence that suggests widespread fraud and abuse.

Ms. CORRIGAN. I think a lot can be done to stop waste, fraud, and abuse. It is done every day. The problem is that as in any criminal area, the crooks get more sophisticated and they are able to devise more schemes. So I think vigilance is important. If you look at an area like murders in a city, I think that cities can take great steps to reduce them; but at the bottom, are you going to prevent every single one of them? I doubt it. It doesn't mean, though, that your vigilance should be decreased in any way, like you said.

I mean, just because some area is a smaller area, I still think you have to use the most effective means you have and go after as much as you can, given the dollars that you have.

Mr. DIAZ-BALART. Mr. Chairman, if I may. But are current legal actions ineffective?

Ms. CORRIGAN. I think current legal actions are very effective. In certain areas other legal actions might be helpful, but the False Claims Act has been incredibly successful in stopping fraud. I mean, the qui tam provisions of the False Claims Act expanded enormously the range of actions that were brought to protect—at least in the health care area—fraud, waste, and abuse.

Mr. DIAZ-BALART. And let me ask you, does that mean when a criminal steals from health care—a criminal steals from Medicaid, is that person more or less likely to be caught than if he or she were stealing from nonhealthcare-related areas? Is it less likely?

Ms. CORRIGAN. I don't know if I can answer that question. I don't know what the answer to that question is. All I know is the increased focus on health care fraud has certainly helped. And the resources have really helped in stopping certain areas in health care fraud that had been very pervasive up until HIPAA was passed.

Mr. DIAZ-BALART. Thank you, Mr. Chairman. Again, I just want to reemphasize one last thing. I want to thank the chairman of this committee. I want to thank the witnesses who have done a great job.

I, just for one, cannot rationalize, whether it is 1 cent or $10 or a billion or $50 billion, I cannot rationalize—because there may be some other areas that we are not looking at—the justification of permitting waste, fraud, and abuse.

I want to thank all of you. Thank you, Mr. Chairman.

Mr. HASTINGS. Thank you, Mr. Diaz-Balart.

Next, Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

I would like to shift the focus a little bit, because it seems to me that the key question is how do you incent individual civil servants and agencies as a whole to spend money more wisely? Because I think American taxpayers would like to see a lot of spending cut, but for worthy programs they would like to see it increased.

It seems to me that the central failure is a lack of incentives for the decisionmakers, those most intimately aware of the problems and benefits of programs, to do the right thing. In short, you cannot build a career in Washington, DC if you cut spending or eliminate agencies. We get rewarded with pens at the White House if we have a new agency created or a new program expanded.

Perhaps I should make an exception. Perhaps IGs can advance their careers by cutting spending. But you are about the only folks in this town who can do this.

So I would say that the problem is on both sides of the witness table. Can you help me think of any ways to incent individual civil servants or agencies to want to reduce spending? Because I think what the agencies fear is, if you go ahead and cut 1 percent, why then the next year somebody will ask you to cut even more.

The slower you achieve the cut, the more likely you are able to preserve your prerogatives. And individuals don't like to be whistleblowers and to expose the waste or fraud or abuse within their own agency, because it is not a popular thing to do. So the result is, the average American taxpayer trusts for-profit companies to be efficient, but they do not trust government to be efficient.

So how do we change that? Instead of continuing the 200-plus-year-old game that we play here about how everybody is going to root out the waste, fraud, and abuse using existing methods? We haven't done that.

What are some ways? Let me hopefully provoke some thinking. In the pollution reduction area, we moved to cap and trading systems, so that virtue for the first time would be rewarded. If you cut your pollution more than the law required, and did so voluntarily, you get a piece of paper that had value, and you could buy it or sell it in the marketplace.

This committee used to have budget discipline rules. For 12 years we had cap and pay go, so that an agency could not have spending increased unless it found ways to save money within the agency. Those rules, unfortunately, lapsed in 2002, so our equivalent of cap and trade is now no longer in place. But that would be a market-based way of encouraging agencies to find savings within their own bailiwick, so they could increase spending on their worthier programs in their own area.

Can any of the panelists help me think of other ways? Mr. Mead.

Mr. MEAD. I think generally it is more effective to use incentives than a club. And I would like, just to bring it back home to Transportation for a moment, to provide a specific example that Congress currently has an opportunity to act on. I don't know if you will. When we pursue a fraud investigation, a criminal fraud investiga-

tion, under current law if we secure a conviction and a fine, the money comes back to the U.S. Government.

The fact is, in the highway program, you have to have the States involved. We need the State auditors involved. We need the State attorneys involved. In most instances when there is a fraud committed against the highway program, the damage is done most directly and immediately to the State.

I think if Congress were to pass a law that allowed the States to retain some of the money secured in connection with the fraud conviction, that would incentivize the States to dedicate more resources to ferreting out fraud, which would in turn have a benefit for us. So that is just one example. But it is currently an opportunity for us, I think.

Mr. COOPER. So we could incent Federalism cooperation. Any other suggestions from the panelists?

Mr. HIGGINS. Yes. I will go back to the Department of Education. The bureaucrats take the lead from the new leaders of the agency when the administration changes parties or whatever. And when this Secretary came into Education, one of the first things he did was to established a task group of 10 to 12 career SES's to attack the management problems in the Department. And by doing this, the culture in the Department of Education is changing more to one of—they are more accountability conscious than it was 2 years ago. So I think the key is who you are putting in these leadership positions, and what they do is very important.

Mr. COOPER. I see that my time has expired. Thank you, chairman.

Mr. HASTINGS. Thank you, Mr. Cooper.

Mr. Gutknecht.

Mr. GUTKNECHT. Thank you, Mr. Chairman. And I ask unanimous consent that I be given 1 hour to question Ms. Corrigan. I hear objection. But I will have a chance later on to question Ms. Fong, so I want to get to her as well.

But let me make a couple of points, first of all. The gentleman just said that worthy programs should perhaps be increased, and those less worthy decreased. That is part of the problem that we have, though; and that is, all of the programs are worthy.

And the problem is that the way they are set up is, it is sort of this perverse incentive that no good deed goes unpunished, and if you really save, you get punished. So in some respects we have to change the system. One of the things, though, I think we have to do—and this hearing is a very good start—I think we ought to have hearings like this every 2 weeks. And I think we ought to have different people come and cast light on some of these things, because I do believe that sunshine is the best antiseptic.

Let me also say that in some respects, I made the comment before, we are a little like Scrooge, you know, after he had his transformation. He woke up on the day after Christmas and Bob Cratchit came in late for work, and some of you remember what happened. He said, "Well, Mr. Cratchit, I guess we have no choice but to raise your salary."

We have groups come in here, like the Defense Department. They can't account for something like $11 billion in assets. They don't know where they are. They have lost a boat. They don't know

where it is. And yet our answer is, well, I guess we have to increase your budget. And we do that year after year.

Ms. Fong, I want to come back, and I am going to have plenty of time to talk to you about the nutrition programs and how much there may or may not be in terms of abuse.

One of the fundamental problems is, isn't it, that when States aren't doing a good job, we increase their budget? Isn't that a fact? I mean, how do we ever recover from States that are doing a miserable job of managing these programs?

Ms. FONG. That is one of the problems with the Food Stamp Program. I am sure you are well aware of the system that exists currently. There are provisions in the current legislation that allow the Department to impose penalties when the error rate goes too high. And they also allow the States to reinvest those penalties. Instead of actually paying them back to the Federal Government, they can reinvest them in their own programs. That is, in fact, what generally occurs.

So one might ask, what kind of sanction effect does that have? That is a very good question. My guess is that it doesn't have much of a deterrent effect at all.

Mr. GUTKNECHT. I think that is a pretty good guess. But sometime in the next 2 weeks, hopefully, we can come up with some ideas and answers and begin to create a system that invites more accountability. Somebody used that word. And that is a very important word. It is a word our taxpayers want to hear more of coming from Washington.

Ms. Corrigan, I do feel—and I said this to you privately—I do feel like Diogenes. He is the guy that went around the world looking for an honest man. I finally have found someone inside the administration who acknowledges that we pay way too much for prescription drugs. I want to thank you for coming forward to say that publicly, because for a long time I thought either I am crazy or the rest of the Federal Government is crazy.

I want to know, exactly how did you find out what the VA is paying for drugs? Because we tried to find out from them. As a Member of Congress, and a member of the Budget Committee, a member of an oversight subcommittee, we could not get VA to tell us how much they paid for their drugs.

Ms. CORRIGAN. I believe that it was part of one of our either audits or evaluations. We found that in the context of that evaluation. But I can find out. I will find out specifically how we found out. And I will let you know.

MS. CORRIGAN'S RESPONSE TO MR. GUTKNECHT'S QUESTION REGARDING RESEARCH METHODS OF HHS

My testimony refers to a January 2001 evaluation report in which we found that Medicare and its beneficiaries would save $1.6 billion a year if 24 selected drugs were reimbursed at amounts available to the VA. We obtained a file from the VA containing second-quarter 2000 contract acquisition costs and used the Federal Supply Schedule price for comparison purposes. A conversion factor was used in some cases to ensure that the VA price and the Medicare price were for equivalent amounts. The report is available on our web site at *http://www.oig.hhs.gov/oei/reports/oei–03–00–00310.pdf.*

Mr. GUTKNECHT. I want to go back to the numbers you cited earlier in your testimony, because I only have 5 minutes, they didn't give me the full hour. You said we are spending about $8.2 billion

in Medicare today for approved drugs. You said that according to your figures, that was about $1.9 billion more than the VA.

That is more than—I mean if my arithmetic is correct, that is almost 25 percent more than just the VA. Did I hear those numbers right; $8.9 billion for Medicare-approved drugs, and that translated to about $1.9 billion more than those drugs if they had been bought at the VA prices?

Ms. CORRIGAN. Yes, that is basically correct. The $1.9 billion, that is for 24 specific drugs. And the $8.2 billion is for the entire Medicare payment for drugs, but it is the same thing.

Mr. GUTKNECHT. So it is roughly 25 percent more than just in VA?

Ms. CORRIGAN. Yes.

Mr. GUTKNECHT. Has there ever been an analysis done between what we pay in the United States for those drugs and what just regular consumers can buy them for in the G8 countries?

Ms. CORRIGAN. I don't believe we have conducted a study like that. I don't know whether someone else has.

Mr. GUTKNECHT. As far as I know, no one has. But what do we need to do to get that study done? In other words, if we came to you, or the GAO and asked for a study, would you be compelled to do that?

Ms. CORRIGAN. Certainly, if you made a request, if the committee made a request for us to look at that, we would want to. I think it is an area that is very important and we would be willing to do that, if we had the ability to do it. I just don't know how we would get those prices. But assuming we can do it, we would be happy to do it.

Mr. GUTKNECHT. Well, I have been able to get some of those prices, but I have a relatively small staff, and one of them happens to speak German, so we were able to buy some drugs in Germany and get some comparisons there. I mean, we are paying almost 2½ times more for those drugs here in the United States than they pay in Germany.

I do think this a very important issue, Mr. Chairman. When you start looking at where we can save money, it may well be that some of the programs can be difficult to find 1 percent, other programs I think the numbers are huge. And they are big numbers. I don't think we should just confine ourselves to an across-the-board-type scope. I think we need to look at every program, because I agree with Mr. Diaz-Balart: to say because we can't find 1 percent in one program, that we shouldn't look for savings anywhere else, it seems to me is just an abrogation of our responsibility.

As I say, I think the American taxpayers expect and demand that we find accountability in every single Federal program.

Thank you very much, and I yield back whatever time I have left.

Mr. HASTINGS. The gentleman's time had expired. Mr. Emanuel.

Mr. EMANUEL. Thank you. It may not be a full hour, but I will add another 5 minutes to this, since we are both sponsors of the same legislation, which deals with market access on prescription drugs, getting access to the best value and allowing you to buy anywhere within the G8.

My colleague, Mr. Gutknecht, has shown specifically where you can buy 10 drugs, same medications in Germany, for a total of about $300-and-some-odd dollars, here in the U.S. for $1,000; 700 bucks disparity.

And I believe that, I think it was last week or 2 weeks ago, we had a hearing on waste, fraud, and abuse, and the comptroller talked about not only waste, fraud, and abuse, but the other side of the coin having to deal with economies and efficiencies. And that is, if you can buy medications cheaper, more cost effective, whether that is through negotiating bulk prices like SAM's Clubs do, that is what we would advocate. And the other idea is to allow you to buy, whether it is from Canada or the other G8 countries, you would save billions of dollars. And I think if we are going to have the largest entitlement expansion in over 40 years, you would want to do it to get the best bang for your buck.

Now, I am going to be a supporter if we can ask you to study how the veterans have done something that we are prohibiting the HHS Secretary from doing. I have full confidence in the Secretary of HHS, Tommy Thompson's ability to negotiate. I wish my colleagues on the other side would have as much confidence as I do in a former Republican Governor, and now a member of the Cabinet in a Republican administration, that he can negotiate good prices.

That I think also has the ability, as our amendment does—it allows consumers, government, businesses, private insurers, to buy the cheapest price. And so I will be a supporter of that study that asks you to go out and review how the Veterans Administration can buy the same types of medications to the tune of about $2 billion in savings. That is essential. So if we are going to talk about waste, fraud, and abuse, I am sure all of you have analysis, your remarks are focused on waste, fraud, and abuse.

There are efficiencies in economies that you can bring to that same debate. And as I have for the Department of Education, Mr. Higgins, a question, which is—you know, I have noticed everybody talking about the virtues of low interest rates on student loans. I have looked at your remarks. I wasn't here for all of them, but I looked at the remarks earlier. And we talked about in the housing industry people refinancing their home mortgages. And yet everybody is taking advantage of the free market in the refinancing of the lower interest rates, yet we have locked students in, some students with their student loans at 6, 6½ percent, yet they are not being allowed to take advantage of where interest rates are today and being able to renegotiate like we have done in the home financing area.

So we have saddled families and students, who are emerging into a bad job market, with interest rates that are 200–300 basis points higher than you can get in the marketplace. We are not allowing students to take advantage of the low interest rates that exist in the market. So again, although we focus on waste, fraud, and abuse, I would hope that we would at some point take our attention to economies and efficiencies, which is what the comptroller said 2 weeks ago, both on the prescription drugs and on the student loans, that we can save the government money using market mechanisms, not mandated.

If we are supposed to talk about the virtues of globalization let's bring it to the prescription drug bill. We have the largest expansion of an entitlement in 40 years. A, we prohibit the Secretary of HHS from negotiating best price. Yet SAM's Clubs exist all over America where people are negotiating best price. B, allow people to buy from Canada, France, Germany, where the prices are cheaper. Why would we lock them into a captive market to the highest price? Let the free market bring prices down.

And, third, on the student loans, we are locking students in to 6½, 7 percent interest rates, when in the marketplace they can get them at 3½, 3¾.

So I would hope in your remarks, and hopefully later, that you would not only address waste, fraud, and abuse—because it is all dollars and cents—that if we can find savings and efficiencies in economies, you would also address that point to what you would do different.

If anybody wanted to grab—you have exactly 35 seconds, or the other 50 minutes of Mr. Gutknecht's hour.

Mr. HASTINGS. Thank you.

Mr. EMANUEL. I will take the silence as maybe yes. That is how my kids treat me at home.

Mr. HASTINGS. I don't want to comment on that.

Ms. Brown-Waite.

Ms. BROWN-WAITE. Thank you very much. My question, my first question is for Ms. Corrigan. I had a problem with Medicare+Choice in my area where they were just moving out, and yet they were flourishing in south Florida. I said to an entrepreneur who owns an HMO, Why don't you come up to north of the Tampa area? And his response to me took me totally by surprise. He said to me, I do a better job of rooting out fraud and abuse in south Florida.

And, Mr. Diaz-Balart, I am not impugning your part of the State at all. But he said, there is more fraud and abuse in south Florida than anyplace. He said he does a better job of catching the fraudulent providers in south Florida than the government does.

First of all, I would like your response to that.

Ms. CORRIGAN. Well, I don't know if that is true. If it is true, it is very sad. I think there historically has been a lot of fraud in south Florida. It is no surprise. Very captive beneficiary audience. And I think that it is likely a lot of people could catch fraud there, and that the government can always do a better job, but it has traditionally focused on that area and tried very hard there.

Ms. BROWN-WAITE. My next question to you, actually I guess I have 3 questions now. If fraud and abuse is so rampant in south Florida, tell me why, the way that Medicare+Choice is set up right now, my seniors have to pay a substantial copay, whereas everything is free if fraud is rampant, and yet in south Florida there is no copay.

Ms. CORRIGAN. I don't know the answer to that question off the top of my head, but I can get back to you. But I will say, and I think we may have to check with CMS, I am not sure how the HMOs that you are talking about the ability internally to set prices that is some way independent from CMS. So it may be that there

are efficiencies in certain HMOs that are not in others, that have no relationship to fraud.

But I will have to get back to you on that question.

[The information referred to follows:]

MS. CORRIGAN'S RESPONSE TO MS. BROWN-WAITE'S QUESTION REGARDING MEDICARE+CHOICE

Based on available data, it is our understanding that every Medicare+Choice plan in south Florida charges Medicare beneficiaries some form of copayment or premium charge. However, that does not mean that every service requires a copayment. The regulations on premiums and cost sharing can be found at 42 C.F.R. section 422, subpart G. In some situations, plans are able to offer a reduction in premiums or cost sharing as an additional benefit. With regard to the earlier question about fraud in south Florida, our office has been involved for several years with interagency task forces formed to deal with health care fraud in that part of the State. These task forces are led by various U.S. Attorneys and include our office, the FBI, the State Medicaid Fraud Control Unit, and other State and local officials as needed. If the entrepreneur you mentioned has information he would like to share with us, I would be happy to coordinate a meeting with our agents in Miami or the Tampa area.

Ms. BROWN-WAITE. My next question is for everyone on the panel. I was a State senator, and now in Congress I regularly hear about the problems of whistleblowers in agencies, if they go to their superior and aren't happy with reporting fraud and abuse and nothing gets done, and they go higher, that virtually they become isolated.

And I would just like to ask each and every one of you your reaction to that; that being a whistleblower at the Federal level is not a badge of courage, but rather a source of an underground discipline system. If you would begin with Transportation.

Mr. MEAD. I think there is truth to what you say. One reason you have Inspector Generals is so that the stature of legitimate whistleblowers is there and that retribution can't be taken.

I think in any bureaucracy it is a good thing to have an Inspector General operation. But I do think there is truth to what you say. I would like to see more whistleblowers coming from the private sector. We do—and the Federal Aviation Administration do as well—for example, a lot of contracting. And I would like to see more encouragement of whistleblowers at these firms that have multibillion-dollar contracts with the Department of Transportation.

I think we always have to be vigilant, though, to make certain that whistleblower protections are kept in place for the Federal employee.

Ms. BROWN-WAITE. Mr. Higgins.

Mr. HIGGINS. I also think there is some truth to that. In Education, though, I have been there almost 35 years. And I only know of one or two cases where the employees have alleged that there was retaliation. But I do think that there is this perception among the employees that it is not a good thing to do.

Ms. BROWN-WAITE. Ms. Fong.

Ms. FONG. Yes. We are very sensitive to the issue at USDA. I will say that I am very pleased to learn from my staff that we get a large number of our clues, our allegations as to wrongdoing, from USDA employees; which would seem to indicate a certain level of confidence on the part of Department employees in coming forth toward us.

And we do take very seriously our responsibility to protect the identities and to go after, actively go after issues where there may be retaliation and reprisal. And I think that has contributed to a positive atmosphere.

Ms. BROWN-WAITE. My time is up, so I would ask Ms. Corrigan to answer it in writing.

Mr. HASTINGS. Thank you.

[The information referred to follows:]

MS. CORRIGAN'S RESPONSE TO MS. BROWN-WAITE'S QUESTION REGARDING WISTLEBLOWER PROTECTION

Both the Office of Special Counsel (OSC) and my office may investigate allegations of whistleblower retaliation involving employees of the U.S. Department of Health and Human Services. However, my office only has the authority to investigate potential reprisal cases and forward the investigative findings to the Department. The OSC, on the other hand, has a broad range of powers available in whistleblower protection cases, including the ability to bring a disciplinary action against a supervisor who retaliates against a whistleblower, to take steps to prevent future reprisal, and to make an injured whistleblower whole. For this reason, we often advise whistleblowers who contact our office about possible retaliation that it might be in their best interest to report the allegations to the OSC.

Mr. MEAD. I have something that I would like to add to the question. You know, our Department, and I imagine the other departments here, we get a lot of Mr. and Mrs. anonymous complaints. I think there is a reason why people don't affix their name to that complaint.

Mr. HASTINGS. Thank you, Mr. Mead.

Mr. Wicker.

Mr. WICKER. Thank you very much, Mr. Chairman, members of the panel. I am Roger Wicker, I am supposed to be sitting down at the end of that table there, but I sort of feel like I am sitting in your laps if I am doing that. So that is why I am up here in Mr. Shays' chair.

This is a hearing about the waste, fraud, and abuse in mandatory programs. Let me just ask each of you if you have given any thought—and we will start down here at this end and go from my right to the left. Have you given any thought to whether there is more waste, fraud, and abuse in mandatory programs as opposed to discretionary programs? Assuming that there is more oversight of year-to-year discretionary programs, and oversight prevents waste, fraud, and abuse, is this something that we need to look at, or am I just down an empty pig trail?

We will start with Ms. Corrigan.

Ms. CORRIGAN. I think that we traditionally have looked at both the discretionary and the mandatory programs. Probably mandatory is about 80 percent of our budget and discretionary is about 20 percent. So your assumption is correct that the oversight over discretionary programs is much less. But that being said——

Mr. WICKER. The oversight over discretionary programs is much less in your Department?

Ms. CORRIGAN. Yes, much. That being said, we do our best with the limited dollars that we have to oversee those programs. But I do think that it is going to be an area in the future where scrutiny could be focused. For example, NIH receives a huge amount of funding and they give many grants. We have started to do studies and audits to see whether those grant moneys are being spent

properly. Many of the discretionary programs that we look at are grant programs.

So again, our role is to look at where are those grant funds going; how are they being spent? And we expect to find some problems. It isn't an area that has been focused on a lot in the past, but we feel like it is an area that is a huge part of the Department, and it merits a really good look, like we do to the mandatory programs.

Mr. WICKER. So that I can move along, Ms. Fong, are mandatory programs more or less susceptible to waste, fraud, and abuse than discretionary programs?

Ms. FONG. I don't think we have done an analysis coming from that perspective per se. We do look at the full range of programs within USDA and we have talked about the mandatory ones today, food stamps and some of the others.

There are other programs that are discretionary; the WIC Program—Women, Infant and Child Feeding Program—the rural programs, housing, loans and some of the other farm programs where there are examples of fraud, waste, and abuse also. We have done substantial work in those programs as well. So I would say, you know, the opportunity exists in all of the programs of the Departments.

Mr. HIGGINS. For the Department of Education, 93 percent of what we find in sustained questioned cost, civil cases and criminal cases, is in the mandatory programs. But, we also devote the majority of our resources to the mandatory programs because that is where the dollars are in the Department. That is where the big risk is in this Department. So I don't know if you can make the correlation.

Mr. WICKER. It is like the bank robber; that is where the money is.

Mr. MEAD. In the context of the Department of Transportation, I think probably most of it is. Like if you take the highway program, people automatically get the money. You automatically get the money, I think there is likely to be a little more abuse of it. And I think the same is true—FAA has a mandatory component to the airports. I think you would probably find that things were a little looser there in terms of the level of oversight.

Mr. WICKER. Alright.

Well, let me then just briefly direct a question to Ms. Corrigan. At a previous hearing, I raised the question of whether any attention has been given to the issue of medical errors being paid for—well, causing a double payment under Medicare. And basically here is my question.

A physician or provider commits a medical error. That procedure is paid for under Medicare. Then the corrective procedure is also done by a provider or a hospital, and often the same one. And that procedure is paid for under Medicare.

Do you have any information about that? Have you given any thought to it? Isn't this something that we need to look into?

Ms. CORRIGAN. It is a very legitimate concern. And, in the case that comes into my head, there was a class action suit for beneficiaries who had hip replacement surgery, and because there were actually defects in the hip replacement, the surgeries had to be per-

formed twice. The question was whether the manufacturer should be paying for the first one or the second one.

It is the same thing that you are saying. Should Medicare being paying twice? And that is what comes into my own mind. I don't know if there has ever been a study or an evaluation by my office on that issue. But, I think it is just a very different way of looking at the abuse or waste issue that we can certainly look into.

Mr. WICKER. Well, it would, it seems to me, be thinking outside the box. I can't give myself credit for thinking of the idea to begin with. But what would it take—and the Chair is indulging me for a second here—what would it take for you to feel like you were directed to look into this question? Would this committee have to make a formal request? Could one Congressman make such a request?

Ms. CORRIGAN. The committee would make a request, is my understanding.

Mr. WICKER. Thank you very much, Mr. Chairman.

Mr. HASTINGS. Thank you. Next, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. The good news is I appear to be your last questioner. The bad news is, inasmuch as I was attending a Financial Services Committee meeting today, I missed your testimony, so please forgive me if these questions are redundant, but at least they will be very helpful to my education.

In some of the written testimony and testimony that this committee has received in the past, we have seen where HUD lost roughly 10 percent of their entire budget in erroneous payments. I believe it was 2 years ago, roughly $3 billion; apparently Medicare had $13.3 billion in overpayments last year, we had $1.4 billion in erroneous payments in the Food Stamp Program, I believe that is approximately 9 percent of the program—9.3 billion in erroneous payments in the earned income tax credit.

We had apparently 25 percent of the people who had student loans that were forgiven because of disability were found to actually hold full-time jobs.

There seems to be a constant thread that runs through this, and that is that in many government programs we are just seeing anywhere from 10 to 30 percent of waste, fraud, and abuse.

Now, previous to being elected to Congress, I was a small businessman. And I can tell you out in the business world, if 10 to 30 percent of your money just disappears, either you go broke or somebody goes to jail. And in the culture of Washington, DC, it seems to be an excuse to ask for even more money next year. So I have several questions that follow from these observations.

And No. 1, is it your observation that indeed most of the programs that you oversee see these levels of money being lost? If each of you could address the question. Mr. Mead.

Mr. MEAD. I don't know if it is on the order of 30 percent. But yes, I gave an example in my testimony of the FAA acquisitions program, where you have $4.3 billion in cost overruns in air traffic control acquisitions, which equates to over 100 percent of an entire year's budget for air traffic control acquisitions.

Mr. HIGGINS. Well, as I have said before, the Department itself estimates that in fiscal year 2002, the erroneous and improper payments were $401 million. We think that is a conservative figure.

Again, I hate to keep on bringing this up, but if we had the IRS match, 366 million of that would be potentially eliminated.

Ms. FONG. As you mentioned in the Food Stamp Program, the Department has acknowledged an error rate that ranges over the last few years between 8 and 11 percent. So that is clearly on the record. In the school lunch and breakfast program, there is information that indicates that there are substantial overpayments being made. So there is a significant level of concern here.

Ms. CORRIGAN. In the Medicare program, the Medicare fee-for-service error rate has declined over the past 7 years from about 14 percent in 1996 to 6.3 percent last year. And while 6.3 percent represents a lot of money, it is a significant step toward the right thing, which is to really reduce these errors.

Mr. HENSARLING. Given these rates of error or fraud or waste, can you tell me what percentage of the budgets of your departments are devoted to policing and ferreting out the waste, the fraud, the abuse, the errors? Starting with you, Mr. Mead.

Mr. MEAD. Less than 1 percent. In fact, this may sound self-serving, you look at the IG budgets, you look at the financial benefits you get out of them, they are worth every dollar you put into them. In terms of the return, there are very few places you get a return on your investment like that.

Mr. HIGGINS. Well, the second area where we think the Department could have the most impact, is if they increased the monitoring that they are doing. We have seen a large drop in the amount of monitoring from 5, 6 years ago. I don't have an exact percentage on how much effort is spent on this, though.

Mr. HENSARLING. Well, seeing as how I am down to 8 seconds, Ms. Fong.

Ms. FONG. I don't have exact numbers either. I do know that the Food and Nutrition Service has, in response to our recommendations, increased its monitoring of providers to deal with some of these issues.

Ms. CORRIGAN. I can certainly get you those numbers. But, for example, CMS has a program integrity section that is devoted to looking for the types of things that you are talking about, in addition to the Office of the Inspector General, plus other programs have little pieces that also help in the effort. But, I am sure it is still a significantly small proportion of the budget overall.

Mr. HENSARLING. I am out of time. Thank you.

Mr. HASTINGS. Thank you, Mr. Hensarling.

I want to thank the panel for their testimony and for the members' interaction on this. I would agree with my colleague from Minnesota, Mr. Gutknecht, that we should have more of these. And, in fact, there are more of these that are planned, because as I mentioned in my open remarks, this is one area that you don't have to draw a real picture for the American people to understand. And I think to the extent that we can get a handle on this, I think everybody will be better off for that.

So I want to thank the panel for your testimony here today. Maybe sometime in the future you will be called back. But with that, we will dismiss the first panel. Thank you very much.

I would like to call the next panel forward, consisting of one individual, Mr. Leonard Burman. Mr. Burman, if you would take your seat. Thank you very much for being here.

Mr. Burman is a senior fellow with the Urban Institute, and he is the Co-director of the Tax Policy Center, research professor at the Georgetown Public Policy Institute.

Thank you very much for your indulgence earlier with that break in the first panel. Sometimes that prolongs the process. But I want to thank you very, very much for being here. And as per our rules with the first panel, Mr. Burman, you will have 10 minutes to take however you want.

And with that, I will just introduce you. Mr. Burman.

STATEMENT OF LEONARD E. BURMAN, PH.D., SENIOR FELLOW, URBAN INSTITUTE

Mr. BURMAN. Thank you, Mr. Chairman, Mr. Spratt, and distinguished members of the committee. I want to thank you for inviting me to share my views on waste, fraud, and abuse in the tax system. I applaud the committee for its recognition that fraud is not only a problem on the spending side of the ledger, but also appears on the tax side. And as I will explain, there are some serious numbers involved here.

Mr. Chairman, in an earlier hearing on the same subject, you noted that, quote, "wasteful Washington spending is not a Republican problem or a Democrat problem." When I was looking at this issue, it struck me that tax evasion is exactly the same situation. Whether you seek a larger role for government or you favor smaller government and lower taxes, tax evasion undermines your objectives.

In brief, here are my main points. Tax evasion is a huge problem costing the Treasury and honest taxpayers that get stuck with the disproportionate load hundreds of billions of dollars a year. The IRS needs more resources, and it needs to be able to focus those resources on addressing the most serious elements of noncompliance.

And although the IRS is doing many things right in this area, its preoccupation with the EITC noncompliance is not one of them. The EITC noncompliance is, unfortunately, a symptom of systemic problems and the appropriate solution is a broad based attack on noncompliance and the causes of noncompliance throughout the income tax system.

Former IRS Commissioner Charles Rossotti, estimates that in a given year the IRS assesses almost $30 billion in taxes that it will never collect. This isn't a theoretical measure of tax evasion. The $30 billion represents underpayment of tax that the IRS has identified but can't collect because its staff is spread so thin. Rossotti estimated that it would cost about $2.2 billion to collect that money. So in net there is $28 billion waiting for the IRS to collect.

It is also serious money. If we can collect these assessments, we could raise enough money over the next decade to pay for the new prescription drug benefit under Medicare. That is more than the entire cost of the tax bill that was just enacted last month.

But even this amount is tiny compared to the entire tax gap that is the IRS's measure of total taxes due but not collected. The IRS

estimates that $232 billion in taxes, almost 15 percent of the total due in 1998, were never collected. A figure at the end of my testimony, Figure 1, shows the composition of that gap.

These estimates are highly uncertain, because the IRS stopped systematically measuring tax compliance for all but working poor people after 1988, but it suggests that tax compliance is a huge problem, and there is a lot of evidence that it has been growing.

My written testimony discusses several reasons why the gap is so big. The main reason is that the IRS doesn't devote enough resources to audits and compliance activity. Its main responsibility is to run processing and customer service, answering telephones, et cetera. Compliance is the residual category and audits get squeezed when there are budget cuts or the IRS is asked to do other things.

And unfortunately, the IRS is often asked to do other things. As an example, the tens of millions of special refund checks that the IRS is rushing to get out right now, the advance payment on the tax cut that was just enacted, are likely to draw resources out of the residual category, tax compliance.

Tax evasion matters not just because it costs the government money, but it is also unfair. It costs revenues that could be used to make the tax system better, to pay down the debt or to provide additional government services. It wastes resources; that is, it hampers economic growth. It feeds on itself, reducing respect for the integrity of the tax system and leading to more cheating.

The IRS is doing a lot of sensible things to stem evasion. They are raising the probability that people will be caught. They have asked for a significant budget increases to increase compliance.

But the EITC compliance initiative is an exception. Now, admittedly, EITC noncompliance appears to be a problem. The IRS estimates that somewhere between 27 and 31 percent of earned income tax credits were issued erroneously in 1999 either because of taxpayer confusion or fraud. They estimate the EITC compliance gap at $7.8 billion in 1998. That is the number that corresponds to the table at the end of the testimony. For various reasons, that is likely to be an overestimate of the current problem. But even if taken at the face value, the $7.8 billion estimate is only about 0.5 percent of revenues or 2.8 percent of the total tax gap. EITC enforcement accounts for 3.8 percent of the total enforcement budget in 2003. Indeed, the IRS has requested a 68.5 percent increase in its EITC enforcement budget, while increasing other enforcement by only 3.3 percent.

I should point out, with some embarrassment, that there is a typo in the testimony that you have, that the 3.3 percent number was overstated in that version. In fact, the increase in the EITC enforcement would account for 45 percent of all new compliance dollars.

On the previous panel, someone was talking about his experience as a small businessman. I talked to a former student yesterday, and I talked to her about what I was going to testify on. She had run a business. I told her that there are $30 billion in uncollected assessments that the IRS can't collect, and they are spending most of their new resources trying to figure out how to find noncompliance among the working poor.

She said that she would never run a business that way. You go after the big debts first, and the small fish last.

Now, I admit to being a big fan of the earned income tax credit. As an economist, I have a great respect for the efficiency of markets, but I also recognize the market outcomes aren't always fair. Some people can work as hard as they can and never earn more than $5 or $6 an hour.

The EITC helps hardworking poor people to feed their families without interfering with the market determination of wages. That is why Ronald Reagan called it the best antipoverty program there is.

The apparently high rates of noncompliance for the EITC are troubling, for two reasons. First, cheating is wrong no matter who does it. Second, noncompliance threatens to undermine political support for a program that helps millions of people.

But it is necessary to put the noncompliance statistics in context. It is likely that much of the EITC noncompliance reflects compliance problems that are endemic to the entire income tax. If that is true, then targeting compliance activity of the EITC participants alone doesn't make a lot of sense. A lot of the noncompliance has to do with the definition of an eligible child for purposes of the EITC. If people think that they can get away with it, some will claim child benefits to which they are not entitled. And that happens throughout the tax filing population.

In 1986 the IRS started requiring taxpayers to list the Social Security numbers of their kids on tax returns. Overnight, 7 million dependents vanished. Treasury economists looked at the data on the EITC, and they looked at mistakes people made with eligible children, for the EITC, and they also looked at mistakes they made in claiming dependent exemptions. What they found is on those returns, people were more likely to make mistakes with dependent exemptions, and it is likely that this kind of problem exists throughout the tax filing population.

The study by these two Treasury economists also found on the EITC there was homemade marriage penalty relief. People pretended not to be married to claim more EITC.

Now, we don't have any data on this for higher-income people, because the IRS doesn't do systematic compliance assessments for higher-income people although they are planning to, going forward. My guess is that there are problems with roll your own marriage penalty relief with higher-income people as well, and chances are that any approach to that should be systematic and not just for low income people.

Some EITC recipients misstated their income. The ones most likely to do that were the self-employed. Based on very, very old compliance data, we know that self-employed people are also most likely to misstate their income for regular tax purposes.

There is a lot of evidence that some EITC noncompliance is unintentional. The program is complicated. These people have complicated lives. The solution to that is probably to make the program simpler. And also education and outreach.

Congress and the IRS have both taken steps to improve compliance. But the IRS is about to start a new precertification program for the EITC. Certain people will have to prove they are eligible be-

fore they can claim the credit. Although it would probably improve compliance, it would also significantly reduce participation in the program and might not save the government much money.

Those two Treasury economists compared the overall costs of the EITC, including the cost of noncompliance, with the cost of programs like food stamps and welfare. And they found that the overall costs are very similar. So the net effect of spending a whole lot of money on precertification might be to scare away a lot of eligible participants without actually making the program, overall, much more efficient, which would be a problem.

There are real issues in subjecting the EITC recipients to a precertification process that doesn't apply to other tax filers. We don't do that anywhere else in the tax system, even though we know there are lots of sources of noncompliance.

The IRS's proposed strategy now is to select about 45,000 single fathers and grandparents and other adults and have them prove that the child lives with them. Bob Greenstein has documented all the ways in which that is not going to work. Basically, a child living with her grandparent and who goes to an uncertified day care center, would not have any way of proving to the IRS's satisfaction that she is eligible. At a minimum, we should check that precertification meets its objective before subjecting 2 million or more taxpayers to it.

That concludes my testimony. And I would be pleased to answer your questions.

Mr. WICKER [presiding]. Thank you very much.

[The prepared statement of Mr. Burman follows:]

PREPARED STATEMENT OF LEONARD E. BURMAN, SENIOR FELLOW, THE URBAN INSTITUTE, CO-DIRECTOR, THE TAX POLICY CENTER, RESEARCH PROFESSOR, GEORGETOWN PUBLIC POLICY INSTITUTE

Mr. Chairman, Mr. Spratt, and distinguished members of the committee, thank you for inviting me to share my views on waste, fraud, and abuse in the tax system. The views I express are mine alone and should not be attributed to any of the organizations with which I am affiliated.

I applaud the committee's efforts to rein in waste, fraud, and abuse, and its recognition that fraud is not only a problem on the spending side of the ledger, but also appears on the tax side. Indeed, there is overwhelming evidence that tax fraud is epidemic, and the IRS has already identified tax underpayments that dwarf any amounts the distinguished Inspectors General who testified on the first panel are likely to unearth in their examination of cash transfer programs. The main issue is whether the IRS can deploy its resources to effectively collect a larger share of taxpayers' legal obligations.

Mr. Chairman, in an earlier hearing on the same subject, you noted that "wasteful Washington spending is not a Republican problem or a Democrat problem." I will argue that the same may be said for tax evasion. Whether you see a larger role for government or favor smaller government and lower taxes, tax evasion undermines your objectives.

I'd like to start with some startling statistics on tax evasion. I will then turn to the argument for trying to stem it, and discuss why IRS efforts so far have been disappointing. I will then focus on specific issues related to the earned income tax credit (EITC), since that program has been the center of a disproportionate amount of IRS compliance activity and current compliance plans raise many issues.

I. THE SCOPE OF THE TAX EVASION PROBLEM

Former IRS Commissioner Charles Rossotti (2002) estimated that in a given year, the IRS assesses almost $30 billion of taxes that it will never collect. This is not theoretical tax evasion. The $30 billion represents underpayments of tax that the IRS has identified, but cannot collect because its staff is spread so thin. Rossotti estimated that it would cost about $2.2 billion to collect that money. If you accept

that estimate, there is almost $28 billion in tax fraud and errors that are identified and ripe for collection.

Assuming that the amount grows with GDP, collecting on assessments would, over the next decade, cover the entire cost of the new prescription drug benefit under Medicare (although not the superfluous new savings accounts in the House version of the bill). It is more than the entire cost of the Jobs and Growth Tax Reconciliation Act of 2003 as scored by the JCT (although not enough to finance the extension of the myriad expiring provisions). It is serious money.

But it is tiny compared with the entire "tax gap"—the IRS's estimate of total taxes due but not collected. The IRS estimated that $232 billion in taxes were due in 1998, but never collected. (See Figure 1.) These estimates are highly uncertain because the IRS stopped systematically measuring tax compliance for all but working poor people after 1988, but it suggests that tax compliance is a huge problem, and it has been growing.

According to Commissioner Rossotti, "Despite significant improvements in the management of the IRS, the health of the Federal tax administration system is on a serious long-term downtrend. This is systematically undermining one of the most important foundations of the American economy."

Why is the gap growing? To begin with, the number of tax returns has been growing much faster than the IRS staff. This has occurred for several reasons. There are more head of household and single returns and fewer married filing joint returns because couples are marrying later, if at all, and the divorce rate is rising. Also, many more children are filing tax returns. (Plumley and Steuerle, forthcoming).

Moreover, after steady growth in compliance resources through the 1980s, IRS staff dedicated to compliance and enforcement plummeted in the 1990s. Between fiscal years 1992 and 2001, the IRS workload increased by 16 percent while its staff declined by 16 percent. Field Compliance personnel fell by 28 percent—more than 8,000 FTEs—between fiscal years 1992 and 2002.

The effect on examinations is even more striking. According to the Internal Revenue Service (2001), the number of field examiners fell by almost two-third between 1997 and 2000. The number of collection cases closed fell by nearly half over the same interval. The number of criminal tax cases not related to income from illegal activities fell by more than two-thirds, from 1,498 in 1997 to 409 in 2000.

A large part of the problem, according to the Commissioner, is "unrealistic assumptions about such items as pay raises, inflation and other mandates, including specific mailing and notification requirements." In the late 1990s, a key factor was the taxpayer bill of rights, which required the IRS to answer its telephones and focus its efforts on "customer service." The better service, while surely welcome, came at the expense of audit activity. This decade, Congress has twice mandated that the IRS interrupt its ordinary operations to mail out springtime checks to most taxpayers—advance payments on the low-end tax rate cut in 2001 and on the child credit increase in 2003. Without a supplemental appropriation to pay for additional staff, the staff managing these huge mailings must come out of existing employees, typically compliance staff.

Finally, the opportunities for evasion have been growing. While the overall number of returns grew by 16 percent, the number of tax returns reporting more than $100,000 of income grew by 342 percent. These people who face the highest marginal tax rates have the most to gain from tax evasion, and the most opportunities to engage in it. Commissioner Rossotti reported that "enormous amounts of money *** flow through 'pass-through entities'—such as partnerships, trusts, and S-corporations," which are ideally suited to hiding income. In tax year 2000, pass-throughs accounted for 4.8 million tax returns with over $660 billion of income.

Commissioner Everson has taken up where Mr. Rossotti left off calling for a renewed focus on enforcement: "***(T)he IRS is committed to ensuring everyone pays his or her fair share, including those who have the resources to move money offshore or engage in abusive schemes or shelters. We must focus our efforts on achieving greater corporate accountability and ensure that high-end taxpayers fulfill their responsibilities. Honest taxpayers should not bear the burden of others who skirt their responsibility."(May 20, 2003.)

II. WHY TAX EVASION MATTERS

Tax evasion undermines the tax system in numerous ways. It is unfair. It costs revenues that could be used to make the tax system better, pay down the debt, or provide additional government services. It wastes resources—i.e., hampers economic growth. And it feeds on itself, reducing respect for the integrity of the tax system and leading to more cheating.

Tax evasion is fundamentally unfair: unless they are caught, cheaters pay less tax than their law-abiding neighbors. But Figure 1 shows that getting caught is highly unlikely. Of the $282 billion of taxes not paid on time in 1998, only about $50 billion was eventually collected, and about half of that was voluntarily remitted by tardy taxpayers. Thus, the IRS only collected about 10 percent of underpaid tax through enforcement activity. The individual audit rate has fallen from 2.15 percent in 1978 to 0.58 percent in 2001. Almost 4 percent of individuals with business income were audited in 1995, because they were known to be comparatively noncompliant. That rate fell in half—to 2 percent—in 2001. In 1993, more than 3 percent of corporate income tax returns were audited. By 2001, despite a well publicized epidemic of questionable and illegal corporate tax shelters in the late 1990s, less than 1 percent of corporations were audited. (Indeed, that statistic makes one suspect that the corporate tax shelter boom was fed by the IRS's apparent indifference.)

Tax evasion undermines both Republicans' and Democrats' notion of a good government. The lost tax revenue inevitably means higher taxes on law-abiding citizens, less government services, or both. If we could close half of the tax gap, the IRS could raise close to $150 billion on tax year 2003 returns (assuming that the tax gap grows at the same rate as GDP). Over the decade, collections would increase by something like $1.7 trillion—the entire cost of the 2001 tax cut as scored by the JCT. With that money, we could (1) eliminate more than two-thirds of the public debt according to CBO projections, or (2) cut income tax rates across the board by more than 10 percent, or (3) provide health care for the uninsured and a generous prescription drug benefit under Medicare, or (4) fully fund the transition to individual accounts under Social Security. I don't mean to endorse any of these policy proposals (my four kids, however, think that paying down the debt is a very good idea), but they illustrate that this huge hole in our income tax is keeping us from getting the government any of us wants.

Second, some argue that tax evasion might be OK because it lowers tax burdens. That argument is obviously false in the aggregate-tax evasion simply reallocates tax burdens from noncompliant to compliant taxpayers. But, it also is a uniquely inefficient way to cut taxes. Companies alter their business practices to hide income from the IRS, as Bob McIntyre explained in his testimony in the earlier hearing. A good tax system interferes as little as possible in businesses' and individuals' decisions, but abusive tax shelters virtually always involve substantial distortions. Some companies now view their tax departments as profit centers—that is, they make money by hiding it from the IRS rather than by producing more and better products. Individuals make investment decisions not based on where they will earn the highest pre-tax rate of return, but where they can make the most money after subtracting taxes, promoters' fees, and legal fees. Thus, money is not going to where it can produce the most return, but to where it can produce the most tax savings. Moreover, the fees paid to tax shelter promoters, unethical lawyers, financial wizards, etc. are a pure waste of resources. Most of these intermediaries could be doing productive work if inadequate enforcement did not make tax evasion so lucrative.

In contrast, if the IRS stems tax evasion and uses the money to pay for debt reduction or tax rate cuts, the economy is sure to grow faster. First, there would be fewer distortions from the tax shelter arrangements. Second, debt reduction would reduce government crowding-out of private investment: that is, it would lower interest rates, making capital less costly for businesses. Or tax rate reductions would reduce the incentive to avoid tax by working less, saving less, or engaging in legal or illegal tax shelters.

Finally, tax evasion can create a vicious cycle of growing disrespect for the tax system, which undermines voluntary compliance. The IRS has some evidence that this is happening now from Roper surveys they commissioned in 1999 and 2001. In 1999, 87 percent of respondents said that cheating on taxes was unacceptable; in 2001, only 76 percent. In 1999, 96 percent of respondents agreed that it is everyone's duty to pay their fair share of taxes; in 2001, 91 percent. And, in 2001, respondents were skeptical that cheaters would be caught. A plurality of respondents (37 percent) said that cheaters were less likely to be audited in 2001 than in the past. Only one in three thought the odds of detection had increased.

III. SOLUTIONS

What can be done about the epidemic of tax evasion? Two things can deter those who are inclined to cheat: a high probability of detection and a high penalty if caught. In this regard, the first order of business ought to be to make sure that, barring extenuating circumstances, everyone who is caught underpaying their tax is made to pay what they owe. Correcting the alarming statistics reported by Commissioner Rossotti should be the first order of business: (1) 60 percent of identified

tax debts are not collected; (2) 75 percent of identified nonfilers are not pursued; (3) 79 percent of taxpayers who use known abusive devices to avoid tax are not pursued; (4) 78 percent of taxpayers identified through document matching programs are not pursued; and (5) 56 percent of noncompliant taxpayers with incomes over $100,000 get off scot-free.

Given the large amounts of money involved, it should be possible to solve this problem without costing anything. One option would be to raise the penalties and/or interest for taxpayers once they are identified as noncompliant. The clock on these excess penalties could stop for nonfrivolous legal challenges, but taxpayers who decided to try a rope-a-dope strategy with the IRS would find it unprofitable. A second option would be to allow the IRS to divert a fraction of the revenues it collects from enforcement action into a trust fund that could be tapped to pay for other enforcement activities. (Since money is fungible, this strategy only works if the Congress does not cut the rest of the IRS's budget at the same time that they are tapping the trust fund to finance enhanced enforcement.)

The IRS is taking steps to raise the probability of detection, which is good, both by expanding its document matching program and increasing the number of examiners (although the latter might be derailed by the rebate program and other competing demands for scarce resources). It is well known that compliance is much higher when the IRS has an independent source of verification.

There is, of course, a risk that compliance activity could go too far. Arguably, that is why the Congress terminated the taxpayer compliance measurement program (TCMP), which involved highly intrusive random audits. Arguably, the taxpayer bill of rights was aimed at redressing a system that favored the tax collector too much at the expense of law abiding citizens. Unfortunately, the resources to protect taxpayer rights came out of the resources used for enforcement, so the balance may have shifted too far in the other direction.

Given scarce resources, it is important that the IRS targets them where the payoff is greatest. The TCMP was designed to allow that, but was terminated because it was too intrusive on lawful taxpayers. The IRS is now engaging in a new audit strategy called the National Research Program, which will adjust audit rates based on the yield from less intrusive audits—many of which will not involve any taxpayer contact unless a problem is discovered. This is clearly a promising approach to balancing taxpayer rights with the imperative to improve collections.

IV. THE EITC COMPLIANCE PROGRAM

Amid all this enlightened activity by the IRS, one example stands out as a misallocation of resources and a failure to balance the rights of taxpayers against the need for enforcement—the EITC compliance initiative. EITC noncompliance appears to be a problem. The IRS estimates that somewhere between 27 and 31 percent of earned income tax credits were issued erroneously in 1999, either because of taxpayer confusion or fraud. They estimate the EITC compliance gap at $7.8 billion in 1998 (See Table 1), about 0.5 percent of revenues and about 2.8 percent of the total tax gap. But EITC enforcement accounts for 3.8 percent of total enforcement budget in 2003. Indeed, the IRS has requested a 68.5 percent increase in its EITC enforcement budget, while increasing other enforcement by only 3.3 percent. In fact, the increase in EITC enforcement would account for 45 percent of all new compliance dollars. (Internal Revenue Service 2003) On its face, this seems like an inefficient way to spend scarce compliance resources.

The apparently high rates of noncompliance are troubling, but it is necessary to put them in context. Indeed, it is likely that much EITC noncompliance reflects compliance problems that are endemic to the entire income tax. If that is true, then targeting compliance activity at EITC participants alone may not be the most effective use of IRS resources.

The IRS's current compliance initiative, which will for the first time since 1988 collect information about other than low income taxpayers, may help resolve some of these issues.

A. EITC Noncompliance in perspective

Two Treasury economists (Holtzblatt and McCubbin, forthcoming) used data from the IRS's 1999 EITC compliance study to draw out some comparisons between EITC compliance and compliance with other tax provisions that require some definition of an "eligible child." Of children claimed for both the EITC and the dependent exemption (97 percent of "qualifying children" claimed for EITC were also claimed as dependents), more tax filers failed the test for dependency status (for the exemption) than the test for qualifying child (for the EITC). It is striking that one-third of children were claimed in error for the dependent exemption, the EITC, or both. However, while 6 percent qualified as a dependent but not as an EITC-qualifying child,

11 percent (almost twice as many) were eligible for qualifying child status but not for a dependent exemption. That is, there were more children claimed in error as a dependent for purposes of the exemption than as an EITC-qualifying child. An additional 17 percent of children were ineligible for both.

While this level of noncompliance with both provisions is troubling, the statistics only apply to low income tax filers who were audited as part of the EITC compliance program. These statistics raise the question of whether higher income people have the same propensity to claim dependent exemptions for children who do not qualify. There is some historical evidence (from 1986) that people are prone to cheat with dependent exemptions when they think they can get away with it. In that year, five million children disappeared when the IRS started requiring reporting of Social Security numbers to verify dependent exemptions (Graetz 1997).

The ineluctable conclusion is that there are likely to be many dependents claimed incorrectly at all income levels—not just among the poor. Thus, the relevant policy response would be to study compliance in the entire taxpaying population, not just among low income people.

Another fascinating set of statistics drawn from the EITC compliance data relates to homemade marriage penalty relief. In 1999, 0.5 million people filed as head of household when they were actually married and living together, possibly to avoid EITC marriage penalties. Another 0.4 million filed as single when they should have claimed another unspecified status. Three-quarters of a million filed as head of household when they lived apart from their spouse for at least part of the year, but were still married and should have filed as married filing joint or married filing separate. The obvious question is the extent to which this type of roll-your-own marriage penalty relief occurs among higher-income taxpayers (who often have a far greater incentive to misstate their filing status).

Some EITC recipients with income in or beyond the phase out range of the credit underreported their income and thus increased their tax refund. Half of the unreported income was from self-employment, consistent with ancient evidence from the TCMP that self-employment income is an area of rampant evasion. Again, while the noncompliance among EITC recipients is troubling, there is no reason to think that it is any worse than exists among the taxpaying public generally.

B. How much noncompliance is intentional?

A key question is how much of EITC noncompliance is intentional, and how much inadvertent. If intentional tax evasion is rampant, then the solution is to ramp up enforcement. However, if a major source of noncompliance comes from taxpayer confusion, then education, assistance in preparing tax returns, and simplification of the tax law would be better-targeted policy responses.

Janet McCubbin (2000) reported that at least 28 percent of qualifying child errors are systematic, and thus intentional attempts to overclaim the EITC. Some of the remaining 72 percent may be influenced by other elements of code, such as the dependent exemption. How many of the 72 percent are simply confused tax filers?

There's certainly evidence of confusion. As Holtzblatt and McCubbin report, the IRS mailed notices to 194,000 taxpayers who appeared to be eligible for the EITC based on income and the presence of dependent children reported on their 1998 return. About one-third responded requesting the credit. The IRS also sent 680,000 notices to low-wage single filers notifying them that they appeared to be eligible. About 45 percent of them responded requesting the credit. The people who only requested the credit after being notified by the IRS almost surely underclaimed the credit unintentionally. Some of those who overclaimed are surely similarly uninformed.

It is also worth mentioning that not all of the EITC tax gap would be collected if EITC enforcement were perfect. In many cases where one person wrongly claims the EITC as the eligible custodial adult, another person might be eligible for an EITC, albeit possibly a smaller one. We have no evidence on whether someone else is eligible for the EITC when a person is found to be disqualified, although this is clearly an important measure of the costs of noncompliance to the Treasury. In addition, because of flaws in the design of the compliance studies, it is possible that actual noncompliance is much less than the IRS estimates. (Greenstein 2003b.)

C. Addressing EITC noncompliance

As in other areas of the tax law, there is a trade-off between administration and compliance costs on the one hand and targeting, compliance, and participation on the other. The question for policy makers is how to strike the right balance. The IRS could audit every return, which would minimize noncompliance, but would maximize enforcement and compliance costs. At the other extreme, the IRS could make all low-earning families eligible for EITC, without regard to children, which

would also reduce noncompliance, but at great cost in terms of tax revenues. In that context, one might argue that the current system does not do a bad job of balancing competing objectives.

The compliance problems with EITC may be viewed as comprising two parts, each of which has a specific policy implication: systemic problems and those specific to the EITC. There are errors and fraud that are endemic to the income tax, such as children claimed incorrectly, understated income, and incorrect filing status. The solution to that problem is system-wide enforcement, not a specific EITC compliance program. Indeed, targeting scarce enforcement resources on low-wage returns to catch systemic noncompliance would be a highly inefficient audit strategy, since so much more money is at stake on the high-income returns.

Certain errors are specific to the EITC. For example, a major factor in the 1999 data involves parents who violated the confusing AGI tie-breaker rule or were disqualified because of too much non-cash earned income (such as pensions, parsonage benefits, and the like). In these cases, Congress ultimately decided that the targeting rule was not worth the cost and the rules were simplified to reduce chances of inadvertent errors.

A similar example is the inconsistent definition of a child for different purposes. The Treasury has proposed rules to make the definitions more consistent and intuitive, and the Senate included them in the Relief for Working Families Tax Act Of 2003, but they have not yet been enacted. (Treasury 2002). Further simplifications would be possible, such as automatically allowing a dependent to be a qualifying child for EITC purposes so long as the other parent does not claim the child for the EITC. These simplifications all involve some cost in terms of tax revenues, but they would significantly reduce confusion for low income working families who do not tend to think like tax lawyers.

Another promising approach is to enlist the help of those who prepare tax returns for low income people. Almost two-thirds of EITC returns are prepared by paid preparers. IRS statistics show that more competent preparers—accountants, lawyers, enrolled agents, major tax preparation firms—produce returns with fewer errors than less competent preparers. Volunteer tax preparers have the lowest error rate, although the sample is too small to draw firm inference. It is at least possible that spending more time on tax returns reduces the likelihood of errors. It is also possible that differences in performance among preparers reflect self-selection—that noncompliant taxpayers are more likely to seek the help of disreputable tax preparers—but this conjecture should be tested.

In 1999, the IRS initiated a large-scale outreach program aimed at tax return preparers who had recently prepared at least 100 EITC returns. During those visits, preparers (other than national firms, CPAs, lawyers, and enrolled agents) received one-on-one instruction from Revenue agents on EITC compliance and preparers' due diligence responsibilities. Because most EITC claimants use paid preparers, such a strategy could prevent both unintentional and intentional errors on tax returns claiming the EITC. The value of this approach could be measured by comparing the accuracy of trained preparers with similar preparers who did not get training. However, no data are available yet and it is not clear that the IRS followed up. If not, they lost an important opportunity to improve compliance without adding extra burdens for low income taxpayers.

The other tool to improve compliance is to strengthen EITC enforcement. The IRS is about to start a new precertification program for the EITC. This probably would improve compliance, but also could significantly reduce participation, and might not save the government much money. The cash assistance programs that you heard about this morning cost about as much to administer as the EITC, including both the administration and compliance costs and the revenues lost due to noncompliance, but EITC participation is much higher than participation in direct transfer programs. (Holtzblatt and McCubbin, forthcoming). So the result of the IRS's EITC compliance offensive may be less payments to low income families, including many who are eligible but deterred by the new hurdles to participation, but little or no overall budget savings

The proposed precertification program is supposed to be non-intrusive, but it is not clear how the IRS can accomplish that. How can they determine that the residency requirement is met in advance, especially for households that are highly mobile? Arguably, it is unfair to single out the EITC. Eligibility for other tax benefits, such as head of household status and the dependency exemption, also theoretically require extensive record keeping. Resolving filing status errors would require fairly intrusive tests, which again might be hard to certify in advance. The fear among those who care about the EITC is that the precertification strategy is tantamount to a 100 percent audit rate (in advance) for certain people who claim the EITC.

There are also real issues in subjecting EITC recipients to a precertification process that does not apply to any other tax filers. People do not need to precertify before taking a charitable deduction for a used car or clothing, even though there is ample evidence that these deductions are overstated. Sole proprietorships do not need to precertify that they are not hiding cash from the tax authority before claiming deductions for inventories, rent, and equipment, even though sole props are notoriously noncompliant. And so on.

In point of fact, the IRS's proposed strategy now is to select about 45,000 single fathers, grandparents, and other adults who claim to care for a qualifying child for the precertification process. Bob Greenstein (2003a) has documented the ways in which the precertification requirements create a catch–22 for many grandparents and fathers who are lawfully eligible for the credit. For example, a grandparent who leaves her child with a nonlicensed family day care center cannot rely on an affidavit from the day care provider or from a relative or neighbor to prove that the child lived with her for the year. Since most low income people cannot afford expensive licensed day care facilities, this means that many eligible people will not be able to prove eligibility to the IRS. Add to this the problems of establishing eligibility for people who are transient or have language problems and you have a recipe for excluding many eligible recipients.

At a minimum, we should check that precertification meets its objectives before subjecting 2 million or more taxpayers to it.

CONCLUSION

Noncompliance is a serious issue that undermines the tax system and carries a huge cost in terms of higher taxes on law-abiding citizens, fewer government services, and more government debt. The IRS is taking a number of important steps to improve tax compliance. However, the IRS's preoccupation with EITC recipients seems like a poor use of scarce audit resources, that is likely to undermine the EITC program, and is unfair. It would be better to address the endemic problems in the income tax at all income levels. EITC compliance, and compliance in other areas, could also be improved by simplifying the program.

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Mr. WICKER. Questions now by Mr. Emanuel.

Mr. EMANUEL. Dr. Burman, if I get the gist of what you said at least as it relates to the earned income tax credit, that through simplification a lot of the $7.8 [billion] or $8 billion that one throws under the title of waste, fraud, and abuse, would be eliminated; that, because of the complexity of the actual form, there are other pieces to this problem, but a good portion—we can net a lot of the savings that we are looking for by just simplifying the form, making it clear.

We have the credit on the books. It has been endorsed going back from actually Milton Friedman through Ronald Reagan, through President Clinton; has in the past, at least until recently, bipartisan support.

But my understanding, the gist of what you basically said, simplicity would garner a good—and do you have a percentage number on that or a dollar figure on that?

Mr. BURMAN. It is hard to measure the actual dollar effect. Actually, the Congress enacted last year a provision that would allow parents to claim their children for purposes of the EITC even if they are living with someone else, like a grandparent. A lot of people couldn't understand why a mother couldn't claim the EITC with respect to her child, but the rules for targeting said the person with the higher income had to claim the credit.

I asked Treasury how much they could save. It was on the order of like $1 [million] to $2 million of the erroneous——

Mr. EMANUEL. One to $2 billion you mean?

Mr. BURMAN. One to $2 million returns were related to these qualifying child errors. I think actually if Congress were interested, they could simplify the EITC in a way that would vastly reduce noncompliance. A lot of the problems arise because with we have combined a program that is supposed to encourage work, with a subsidy for child rearing. If we actually separated the work subsidy from the child subsidy, things could be made a lot simpler.

Mr. EMANUEL. Since we only have 5 minutes to have this conversation, have you looked at on the precertification—not the EITC part, but what if we did that on the corporate side, what would happen?

Mr. BURMAN. That is a good question. We know there is a huge amount of corporate noncompliance. I mean, there are some large corporations that have live-in auditors with them, But still there is a lot that escapes Treasury's attention.

Treasury actually proposed in 2000, when I was Deputy Assistant Secretary, a whole set of disclosures for tax shelters—and those have never been enacted into law—that could raise several billion dollars and reduce tax evasion.

Mr. EMANUEL. I am cutting you off early, only because I have a few minutes here. But the Wall Street Journal the other day estimated that corporations dodge as much as about $11 billion. Have there been any studies done out there on how much money has actually been lost through abusive use of tax shelters?

Mr. BURMAN. A Stanford lawyer, Professor Bankman, I think, has studied this problem. And he had estimated the overall cost is like $10 [billion] or $11 billion. There is a problem in actually measuring the scope of the problem because it is hidden from the IRS. But we know that when Treasury—when the IRS has actually found these abusive shelters, they raised tens of billions of dollars already, things like lease-in/lease-out arrangements where companies lease city halls in Switzerland back to localities just to avoid tax.

Mr. EMANUEL. I want to follow up some pieces of questions on the corporate side. You basically said we have on the EITC a preregistry. We haven't thought about and haven't looked at it on the

corporate side. One of the questions on the corporate side is that we have abuse on the shelter side.

The other point you made was I think on—I want to sum up for you—is that we have a lot of moneys on the compliance side being dedicated toward the EITC, yet not equal dollars at all. Could you repeat the dollar spread or the percentage spread that you had earlier?

Mr. BURMAN. The estimate was that 45 percent of the new compliance money was going into EITC enforcement. The overall enforcement budget increased by 3.3 percent while the increase in the EITC enforcement budget is 68.5 percent.

Mr. EMANUEL. Some of the 3.3, 68 percent is going toward EITC? Is that correct?

Mr. BURMAN. It is actually 45 percent of the 3.3 is going to EITC.

Mr. EMANUEL. Thank you. Just wanted to make sure I understood. I have no other questions.

Mr. WICKER. Thank you, Mr. Emanuel.

Dr. Burman, let me just follow up on that point to begin with. I do not doubt your figures that there has been a 68.5 percent increase in the EITC enforcement as opposed to 3.3 percent in the other aspects. But I guess the more important statistic would be the base from which that increase began. I mean that, certainly on its face, is a startling figure. But it also might be because so little was being spent to begin with on the EITC enforcement. Wouldn't that be a better measure?

Mr. BURMAN. EITC enforcement accounts for 3.8 percent of the total enforcement budget, whereas the measured EITC noncompliance, which is probably an overestimate, is 2.8 percent of the overall gap. So it is still disproportionate.

Mr. WICKER. By 1 percentage point?

Mr. BURMAN. Yes.

Mr. WICKER. Now, you say that the IRS estimates that somewhere between 27 and 31 percent of earned income tax credits were issued erroneously. That does strike me as very troublesome and very, very high. Is there that high of an estimate in any other aspects of the IRS compliance?

Mr. BURMAN. Basically compliance is related to the IRS's ability to track the data—to track from independent sources. Compliance on wage income is quite high because of withholding.

Compliance where the IRS has document tracking programs, like dividends and interest, things like that is also fairly high, although not as high as for wages. There is very high noncompliance for self-employment income, at least based on what is now 15-year-old data. We haven't been tracking it lately. The noncompliance rate is the same order of magnitude or even higher. So basically——

Mr. WICKER. In other words, your testimony is that for self-employment, it is around 27 to 31 percent noncompliance?

Mr. BURMAN. I haven't looked at the data recently, but my recollection is that the numbers were at least 30 percent.

Mr. WICKER. It would be perfectly fine for you to supplement your answer.

Mr. BURMAN. I would be happy to do that.

[The information referred to follows:]

MR. BURMAN'S RESPONSE TO MR. WICKER'S QUESTION REGARDING THE IRS

In 1987 and 1988, the IRS estimated that self-employed people understated income by 32 to 49 percent. Those in the informal sector did so by between 81 and 87 percent. Farm income was also understated by an estimated 30 percent in 1998 (data were not available for 1997).

Mr. WICKER. In terms of loss to the Treasury, is your testimony that the Treasury loses some $7.8 billion per year because of fraud or error in the EITC?

Mr. BURMAN. The 7.8 billion actually corresponds to the chart in the packet. The IRS's most recent estimate for 1999 is $8.5 billion. The IRS's estimate might well be an overstatement of what the current loss is for a couple of reasons. One, based on a sample of taxpayers, they basically sent people letters, and said come into our office for an audit. Everyone who didn't come in was assumed to be noncompliant. But these are low income working people who often couldn't get away during working hours. Some of the sources of noncompliance might well have been dealt with through other IRS initiatives.

The IRS has access to something called the Federal Case Registry. Basically it is a registry of information from Health and Human Services of custodianship orders and divorce decrees. And basically they can track independently whether fathers are living with their children or not. That was a big source of noncompliance. And the IRS can now actually disallow a credit to a father who doesn't appear to be living with their child.

Now, the other thing is that——

Mr. WICKER. What is your best guess if $8.5 billion is an overstatement?

Mr. BURMAN. I can't tell you exactly. I am actually not trying to understate the size of the problem. There is a serious problem. I don't have a better estimate. But it is likely to be smaller, just because of things that have already been done and because of the errors in the study.

Mr. WICKER. Now, from the very beginning of your testimony, do I understand that the total loss to the Treasury in all forms of nontax compliance per year is approximately $30 billion? Is that your testimony?

Mr. BURMAN. Actually the total loss is $230 billion according to the IRS estimates. The $30 billion is Commissioner Rossotti's estimate of payments that the IRS is due that it is not collecting on. So these are actually people who have already been identified, people that didn't file tax returns, people who engaged in abusive tax shelters and things like that, and the IRS is just not collecting the money. That, to me, seems like it should be easy pickings, and I don't understand why we are not collecting that.

Mr. WICKER. That is a very good question. Mr. Neal.

Mr. NEAL. Thank you very much, Mr. Chairman.

Mr. Burman, one of the distinct advantages in this institution of not having term limits is it gives one an institutional memory and also an element of consistency in the sense that not only did I not vote for term limits, I thought it was a bad idea. There is an element, as you know, in this House that thought it was a grand idea at election time but didn't think it was such a grand idea after they

had been here for a while, and there is very little attention paid to what they said and did at the time.

But I want to go into a little bit of statistical data that you used in your testimony, and I am going to take you to that point about why an institutional memory is important. You cite a 16 percent drop in staff over the last decade, while cases with the IRS grew by 16 percent; a 28 percent drop in field compliance personnel, and field examiners having been cut by two-thirds over the last 5 years, with collection cases dropping in half, and criminal cases by two-thirds over the same period.

At the same time, the newly appointed IRS Commissioner has quote, "tossed in the towel," and said private collection agencies should come in to do what the IRS cannot seem to do. Well, we have to ask, does this stem from inefficiency in terms of our cuts to the IRS personnel? And does the advocacy of hiring nongovernment workers to collect taxes make sense?

Now, here is where I take you back to that term limits example. Our colleague and my classmate, Mr. Hancock from Missouri, did a credible job some years ago in citing why the IRS needed to have some changes institutionally made. And Mr. Hancock did a lot of good work on it. He brought a couple from Missouri, I believe, that had an age old problem, and we had a chance to meet with them. And Mr. Hancock was really a very nice fellow, and we had a pretty good working relationship within the Ways and Means Committee.

But my point is that at that time, 60 Minutes and a number of other investigative shows did a series of stories on what was wrong with the notion of bounty hunters going out to collect. That was the basis. That was the pretext. That was the premise for Mr. Hancock's assault on the IRS, which the House voted overwhelming to change.

Now, is the argument that is currently being offered that we ought to return to these bounty hunters, that we ought to return to those private collection agencies?

Mr. BURMAN. That seems to be the argument. It is a little bit baffling. Actually one of the problems that the IRS has is that there were highly publicized hearings, which I am sure you remember, in which taxpayers talked about ways in which they had been abused by the IRS. The IRS are doing is, they clearly seems to be treating taxpayers better. Also, a lot of those stories turned out to be false as it turned out.

The bad thing is that all of the resources for answering people's telephones, making sure that people got proper service from the IRS, came from reducing compliance, and at the same time they are cutting staff overall.

It doesn't seem to me to make a lot of sense for the IRS to lose control of the process of collection, which has to be one of the touchiest aspects of its dealing with taxpayers, and cede it to private collections agencies. I don't see how they can control them. And it is very important that people believe that the tax system is administered fairly, and the IRS has to be responsible for how its interactions with taxpayers go.

Mr. NEAL. Well, the enthusiasm for the term limits advocates, that turned out to be false as well. I run that point by you. You don't have to comment on that if you don't want to.

But let me speak also about the concerns that——

Mr. WICKER. If the gentleman would yield.

Mr. NEAL. Am I out of time?

Mr. WICKER. If the gentleman will yield—I just wanted to interject that he and I are unanimous both in our admiration for Mel Hancock and also our longstanding opposition to term limits.

Mr. NEAL. I thank the gentleman. I thank the gentleman for that, but I think one could argue that the majority today in some measure is the majority because they embraced the term limits notion, only not to abide by it once they became the majority. Or, to better state, that they really liked it, but since it had not become law, they felt that they had to stay for the good of the institution.

Mr. WICKER. Well, the gentleman is entitled to make his point. But I was never a devotee of that particular concept, and never ran on it. I am glad it didn't pass.

Mr. NEAL. Well, I am most appreciative of the chairman's position in this instance, but I think you could make the case that it was an item in what was also known as the "Contract With America." I think that was the cornerstone of the contract. In fact, the author of that contract proposed that there be a 12-year limit for Members of Congress, even though at the time he had been here 14 years when he proposed it.

So I think it—just in terms of raising that collective memory that we have. Mr. Chairman, since I yielded, will I be able to use an extra minute or so here?

Mr. WICKER. Absolutely. The gentleman can use several extra minutes.

Mr. NEAL. I thank the gentleman.

We are dedicating a large number of resources to pursuing this whole notion of the earned income tax credit. Do you have any idea what sort of resources are used against corporate taxpayers? Just last week, we heard about some action being taken against some of the accounting houses that were offering apparently a false premise for some of the tax shelters that they had advised clients that they should take advantage of.

And, more broadly speaking, do you have any idea of what sort of resources are being devoted at the IRS to cracking down on those companies that kind of move off-shore for the purpose of avoiding American corporate taxes?

I know some of it you can argue is legal. And despite the fact that I was assured that there would be a vote in this institution on that a year ago, and I haven't gotten that vote yet. But do you have any idea how many employees are devoted to tracking down some of those companies who move money back and forth in an effort to avoid the long reach of the IRS? I assume individuals couldn't get away with saying that they don't owe taxes by opening a post office box in Bermuda.

Mr. BURMAN. Until a couple of years ago, the IRS didn't even have a compliance program for corporate tax shelters specifically. I think that one of Commissioner Rossotti's last acts was to set up a group that would do that.

I don't know how many employees are involved, but I know that the overall level of corporate tax audits has declined markedly over the last decade. In 1993, 3 percent of corporate income tax returns were audited. By 2001 it was less than 1 percent, despite the fact that over the course of the decade, as you know, there was an epidemic of corporate tax shelters. So the IRS is seriously outgunned in this area.

Mr. NEAL. Have you picked up any information that would indicate that the IRS is developing any new plans to scrutinize some of these proposals?

Mr. BURMAN. I know the IRS has started a new corporate tax shelter compliance program within the IRS that they didn't have before. If you would like, I can find out more about it and I can get back to you.

Mr. NEAL. That would be helpful.

[The information referred to follows:]

MR. BURMAN'S RESPONSE TO MR. NEAL'S QUESTION REGARDING THE OFFICE OF TAX SHELTER ANALYSIS

Here is the IRS description of its Office of Tax Shelter Analysis, submitted for the record.

The Office of Tax Shelter Analysis (OTSA) was established in 2000 as part of the Large and Mid-Size Business (LMSB) Division of the IRS. The office serves as focal point for efforts to gather and analyze information relating to tax shelter activity and to coordinate appropriate responses. Their work includes: collection and analysis of tax shelter data, including registrations and disclosures required by Treasury regulation; analysis of current and emerging tax shelter transactions; technical support to the field; coordination of strategic actions for the many functional units involved in combating abusive shelters; and serving as public "hotline" point of contact.

OTSA has a full time staff of nine people. Additionally, there is a tax shelter analyst in each of the five LMSB industry offices.

Source: IRS Announcement 2000–12, March 2000; Henry B. Holmes, LMSB Communications Specialist

Mr. NEAL. Thanks to the chairman. Thanks to a long career.

Mr. WICKER. Four terms under my belt so far.

Let me just ask a couple of follow-up questions. And I will also say to our witness that we—the members of this committee are scattered to the four winds, and we mean no disrespect by the fact that it is only down to two of us.

You mentioned the complexity of the EITC system. Could you describe that to me, what is complex about filing for the earned income tax credit?

Mr. BURMAN. Well, I have actually prepared a number of returns for low income people, and I will tell you that even though I am supposed to be an expert on this, I get confused every year. I mean, the rules are aimed at making sure that low income people claim children who live with them for at least half of the year and that the people themselves are eligible for the credit.

There are tests that have to do with citizenship, with whether you and your child are living in the United States or not. The definition of a child for purposes of the EITC are different than the definitions that apply for other kind of child subsidies, like the child tax credit, and the dependent exemption.

There actually is a proposal in the Senate—the Senate version of the provision that would allow low income working people to take the child tax credit—that includes a provision that would

make more uniform the definition of a child across these different programs. It was a proposal made by the Treasury Department.

Part of the problem, low income people have is just documenting things like that they live with their child. They move around a lot. They are more mobile than higher-income people. A lot of them are homeless. And to claim the credit, you have to be living in the same home as your child for at least half of the year.

Mr. WICKER. A lot of recipients of the earned income tax credit are homeless?

Mr. BURMAN. For part of the year. They are moving around. I have done tax returns for one or two people who said that for a portion of the year they were living in a homeless shelter with their child, working poor people who are eligible for the credit but are just moving around a lot. I have done tax returns for people who said that for 2 months of the year they were living with an aunt, for another 3 months of the year they were living with a boyfriend; you know, for 4 months of the year they were living somewhere else.

Basically these are people—some of them are people on the edge, who are doing what they can just to provide a roof over the head of their child. They don't have checking accounts. We can sort of verify things. We can verify our financial arrangements by just looking at our check register. A lot of these low income people don't have checking or savings accounts.

You know, the rules have gotten a little bit simpler. There used to be this AGI tie-breaker test, so if you lived with a higher-income person you might become ineligible for the credit. And actually the AGI tie-breaker test still applies in the case where the mother doesn't claim the credit or isn't taking care of the child.

Just as an example, the IRS has proposed that people who would be subject to this percertification program should have to prove that the child lives with them for at least 6 months of the year. And they would target grandparents and fathers. I think there are serious problems in just going after men and not women. In the case of a grandparent or a father, if the grandparent has the child staying with a neighbor while she is working, she doesn't have any way of certifying eligibility to the satisfaction of the IRS under this new program. Neighbors are ineligible and noncertified child care providers are considered ineligible, because I think the IRS is concerned that these people would file an affidavit that was false.

But the problem is, if you don't have money, if you are not writing checks to people, your kids aren't in the same school for the whole year, it is going to be hard to get one of the eligible entities to verify that the child is actually living with their parent or grandparent or whoever.

Mr. WICKER. Well, if the process is anywhere near as complex as your answer was thorough, then it is complex.

How many pages must one fill out to get the EITC?

Mr. BURMAN. I think it is just a one-page credit worksheet, but the IRS has actually prepared a little pamphlet that people can go through to determine eligibility.

Mr. WICKER. There is an entire pamphlet about that one tax credit?

Mr. BURMAN. Several pages in the instructions.

Mr. WICKER. OK. Now, I know all of this is tax compliance, But there is no question that EITC is a form of social welfare. And you have cited a number of people who cited—who feel that it is a very good form of social welfare. Do you have any comparison with the compliance costs for EITC as opposed to compliance costs for other forms of welfare in our Federal Government? Are we putting way too much emphasis on EITC, or is it about the same as in the other departments of the Government?

Mr. BURMAN. Actually, one of the big advantages of the EITC is despite the complexity that I talked about, it is a lot easier to deal with than food stamps or TANF or something like that. Food stamps, you may have to go to a welfare office once a quarter, or sometimes even more frequently, to fill out your certification forms.

Mr. WICKER. So in terms of compliance, we may be spending an even larger proportionate amount on other forms of social welfare?

Mr. BURMAN. The two Treasury economists, Janet McCubbin and Janet Holtzblatt, wrote a paper that is going to be in a book published sometime this year, I think. And they compared the overall cost of food stamps with the cost of the EITC. And they find on food stamps they spend a whole lot more on compliance activities, keeping those welfare offices running, and the level of abuse seems to be lower. So they lose less from abuse.

In the case of the EITC, there seems to be a higher error rate, but the compliance costs for the IRS and for taxpayers for the low income families is lower. And EITC participation is a lot higher than it is for other programs. One of the big advantages is that a large percentage of the people eligible actually manage to get the credit.

That is less true in the case of programs like food stamps and TANF. And it is because there is no welfare stigma associated with it; you can get the credit just on your income tax return.

Mr. WICKER. We have a vote going and I want to get in two other quick questions. Could your statement about complexity also apply to the IRS code in general? And, is part of the reason for noncompliance in the system the complexity of the entire tax code?

Mr. BURMAN. Absolutely.

Mr. NEAL. Mr. Chairman. Will you yield?

Mr. WICKER. I will be happy to yield.

Mr. NEAL. Mr. Chairman, in 1995 that was one of the promises if you recall, simplifying the tax system. And the words I think at the time were, we are going to "rip the tax code out by its roots."

Mr. WICKER. We are going to have a debate about the Contract With America?

Mr. NEAL. Well, I am only pointing out that the majority at that time said that they were going to do that, they were going to get that done. Here we are 8 years later, and we probably had in Ways and Means two hearings on tax simplification, and we are no closer today to clearing up tax code complexity. What you have said is very accurate.

Mr. WICKER. I would absolutely agree that tax simplification has proved to be a tougher nut to crack than about anything we ought to be doing. It seems like whenever we go back and even try to lower taxes on individuals and businesses to try to encourage economic growth, even that ends up making the system more complex.

I take it that my friend, Mr. Neal, is a member of Ways and Means?

Mr. NEAL. Yes.

Mr. WICKER. I am not. But I hope you will continue to push for tax simplification.

Mr. NEAL. Well, one of the easiest things to do rather than cutting taxes, we perhaps could have simplified the tax code and then we could have figured out where to go with the next proposal.

Mr. WICKER. I eagerly await your legislation on that.

Mr. NEAL. Thank you.

Mr. WICKER. One final question. Have you assessed the cost to the private sector of additional compliance agents? And I realize you might think that it is a defensible cost to the private sector, But when you send out more agents to do audits, and businesses or firms or individuals that are in small business have to hire someone to help them work through the audit, isn't that—clearly that will increase the cost to the business and the private sector?

Mr. BURMAN. I don't think anybody has actually measured that cost. I think there is clearly a trade off. You don't want to have a system where everybody is audited, even though that would be a way to maximize compliance. There has got to be a balance. And my view is just that the balance is out of whack.

We have got 30 billion that we know is owed to the IRS under the current system and we can't collect the money. Clearly we ought to be doing that. I think there are areas where we know that there is high noncompliance, not just the EITC. The IRS ought to be targeting additional resources. The money that people aren't paying there means more tax burdens for everybody else, and that is just not fair.

Mr. WICKER. Well, Dr. Burman, I think you have made some very excellent points in your testimony today. I appreciate it. I would simply suggest that perhaps the Urban Institute might want to at least explore the costs to the private sector in sitting down with all of those auditors and oftentimes proving that, in fact, the taxpayer is honest.

Mr. BURMAN. The ideal thing is, you would like the auditors just to be able to collect information without hassling the taxpayers, to be able to find with a high probability the people who are not compliant, and to leave the compliant people alone.

Mr. WICKER. On behalf of the committee, I want to thank you very much. We have a vote now and there are 6½ minutes left. And so I do thank you, and at this point, I will adjourn the hearing.

[Whereupon, at 1:45 p.m., the committee was adjourned.]

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