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H.R. 5712, CLOSE THE CONTRACTOR FRAUD LOOPHOLE ACT, AND H.R. 5787, FEDERAL REAL PROPERTY DISPOSAL ENHANCEMENT ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION, AND PROCUREMENT

OF THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

ON

H.R. 5712

TO REQUIRE DISCLOSURE BY FEDERAL CONTRACTORS OF CERTAIN VIOLATIONS RELATING TO THE AWARD OR PERFORMANCE OF FEDERAL CONTRACTS

AND ON

H.R. 5787

TO AMEND TITLE 40, UNITED STATES CODE, TO ENHANCE AUTHORITIES WITH REGARD TO REAL PROPERTY THAT HAS YET TO BE REPORTED EXCESS, AND FOR OTHER PURPOSES

APRIL 15, 2008

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H.R. 5712, CLOSE THE CONTRACTOR FRAUD LOOPHOLE ACT, AND H.R. 5787, FEDERAL REAL PROPERTY DISPOSAL ENHANCEMENT ACT

TUESDAY, APRIL 15, 2008

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
ORGANIZATION, AND PROCUREMENT,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:05 p.m. in room 2247, Rayburn House Office Building, Hon. Edolphus Towns (chairman of the subcommittee) presiding.

Present: Representatives Towns, Welch, Davis of Virginia, and Bilbray.

Also present: Representative Moore.

Staff present: Michael McCarthy, staff director; William Jusino and Mark Stevenson, professional staff members; Velvet Johnson, counsel; Kwane Drabo, clerk; Jim Moore and Charles Phillips, minority counsels; and Benjamin Chance, minority professional staff member.

Mr. TOWNS. The committee will come to order.

Welcome to today's legislative hearing on two bills related to contractor ethics and the disposal of Federal surplus property. The first bill we will review is H.R. 5712, the Close the Contractor Fraud Loophole Act, introduced by Representative Peter Welch.

About a month ago Congressman Welch brought to the committee's attention a loophole in a new rule requiring contractors to report fraud and over-billing on Government contracts. For some reason, contracts performed overseas were exempted from that requirement. Well, that didn't make any sense to Congressman Welch because so much contract fraud and waste has been seen on contracts in Iraq and Afghanistan.

So we have been looking into the policy behind that rule and how that exemption got into the rule in the first place. Congressman Welch introduced a bill to close the overseas loophole and another loophole exempting commercial items contracts.

That bill is the topic of our first panel today. The rule in question requires contractors to report internal fraud or overpayment on Government-funded projects rather than wait for its discovery by the Government. The Department of Justice believed such a rule was necessary because few Government contractors voluntarily disclose suspected instances of fraud.

However, the rule exempted contracts to be performed overseas and contracts for commercial items. This makes no sense at all. By exempting overseas contracts, this administration is telling Government contractors that if you are going to commit fraud, go abroad and do it. I am pleased that since Congressman Welch brought attention to this detail and introduced this bill and called for this hearing, it appears that the administration will now revise its proposed rule to include overseas and commercial items contracts in the fraud reporting requirements.

That is a good step, but I think the Welch bill is still necessary to make sure these types of loopholes stay closed, and closed forever.

H.R. 5712 will ensure that taxpayers' dollars are used for the purpose to which they have been appropriated, and not to line the pockets of corrupt individuals or companies. We take that responsibility very seriously. At this time when our national security is of paramount concern, criminals who cheat the Government must be identified, stopped, and punished.

I look forward to hearing from our witnesses.

Our second panel will discuss a bill by Representative Dennis Moore of Kansas to streamlining the sale of surplus Federal land. I will say more about that bill when it is time for the second panel.

[The prepared statement of Hon. Edolphus Towns and the texts of H.R. 5712 and H.R. 5787 follow:]

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C[illegible]MAN

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ONE HUNDRED TENTH CONGRESS

Congress of the United States

House of Representatives

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SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION, AND PROCUREMENT

OVERSIGHT HEARING
Contract Appropriations

Wednesday, April 15, 2008
Room 2247 Rayburn House Office Building

Opening Statement of
Chairman Towns

Welcome to today's legislative hearing on two bills related to contractor ethics and the disposal of Federal surplus property. The first bill we will review is H.R. 5712, the Close the Contractor Fraud Loophole Act, introduced by Rep. Peter Welch.

About a month ago, Congressman Welch brought to the Committee's attention a loophole in a new rule requiring contractors to report fraud and overbilling on government contracts. For some reason, contracts performed overseas were exempted from that requirement.

Well, that didn't make any sense to Congressman Welch, because so much contract fraud and waste has been seen on contracts in Iraq and

Afghanistan. So we have been looking into the policy behind that rule, and how that exemption got in the rule in the first place.

Congressman Welch introduced a bill to close the overseas loophole, and another loophole exempting commercial item contracts. That bill is the topic of the first panel today. The rule in question requires contractors to report internal fraud or overpayment on government-funded projects, rather than wait for its discovery by the government. DOJ believed such a rule was necessary because few government contractors voluntarily disclose suspected instances of fraud. However, the rule exempted contracts to be performed overseas and contracts for commercial items.

This makes no sense at all. By exempting overseas contracts, this Administration is telling government contractors that if you're going to commit fraud, do it abroad.

I am pleased that since Congressman Welch brought attention to this loophole, introduced his bill, and called for this hearing, it appears that the Administration will now revise its proposed rule to include overseas and commercial item contracts in the fraud reporting requirements. That is a good step. But I think the Welch bill is still necessary to make sure these types of loopholes stay closed.

H.R. 5712 will ensure that taxpayer dollars are used for the purpose to which they have been appropriated and not to line the pockets of corrupt individuals or companies.
We take that responsibility seriously. At this time, when our national security is a paramount concern, criminals who cheat the government must be identified, stopped and punished. I look forward to hearing from our witnesses.

Our second panel will discuss a bill by Rep. Dennis Moore of Kansas to streamline the sale of surplus federal land. I think it will fix a problem that we really shouldn't have. A lot of Federal agencies are sitting on property that they aren't using: old buildings, antennas, and plenty of land.

GAO says that agencies have almost $14 billion in land that they do not need, and there's also about $4 billion in land that no one in the government can use. These agencies should dispose of this property. There are better uses for that money.

The problem is that to get the property ready to be sold, there are a lot of upfront costs: you have to do environmental cleanup, demolition, historical preservation, things like that. This would cost the agencies a lot, so they just hold on to the property, especially since they don't keep the proceeds from selling it. The money just goes back into the Treasury. Rep. Moore's bill would allow agencies to keep all of the proceeds from selling the property, and would have GSA take care of the things that have to be done first. The agencies would reimburse GSA for these expenses after the property is sold. I think this bill will go a long way to helping agencies get rid of this unneeded property.

I

110TH CONGRESS
2D SESSION

H. R. 5712

To require disclosure by Federal contractors of certain violations relating to the award or performance of Federal contracts.

IN THE HOUSE OF REPRESENTATIVES

APRIL 3, 2008

Mr. WELCH of Vermont (for himself, Mr. TOWNS, and Mr. WAXMAN) introduced the following bill; which was referred to the Committee on Oversight and Government Reform

---

A BILL

To require disclosure by Federal contractors of certain violations relating to the award or performance of Federal contracts.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Close the Contractor Fraud Loophole Act".

1 **SEC. 2. REQUIREMENT TO NOTIFY INSPECTORS GENERAL**
2 **OF CERTAIN VIOLATIONS RELATED TO CER-**
3 **TAIN FEDERAL CONTRACTS.**

4 (a) NOTIFICATION OF CERTAIN CONTRACT VIOLA-
5 TIONS.—

6 (1) REQUIREMENT.—A covered contractor shall
7 submit written notification to the Office of Inspector
8 General of the Executive agency that awarded the
9 covered contract whenever the contractor has rea-
10 sonable grounds to believe that the contractor, or a
11 principal, employee, agent, or subcontractor of the
12 contractor, has committed a violation of Federal
13 criminal law, or has received a significant overpay-
14 ment, in connection with the award or performance
15 of the covered contract or any subcontract under the
16 contract.

17 (2) CAUSE FOR DEBARMENT OR SUSPENSION.—
18 A knowing violation to notify an Inspector General
19 of a violation or overpayment covered by paragraph
20 (1) shall be a cause for debarment or suspension of
21 the covered contractor.

22 (3) TIMING OF NOTIFICATION.—A notification
23 under paragraph (1) shall be submitted within 14
24 days after the contractor becomes aware of the viola-
25 tion or overpayment.

(4) COPY OF NOTIFICATION.—A copy of any notification under paragraph (1) shall be submitted by the contractor to the contracting officer for the contract.

(b) DEFINITIONS.—In this Act:

(1) The term "covered contract" means any contract in an amount greater than $5,000,000 and more than 120 days in duration, whether performed inside or outside the United States. The term includes a contract for commercial items.

(2) The term "covered contractor" means an entity performing a covered contract awarded by an executive agency.

(3) The term "Executive agency" has the meaning provided in section 105 of title 5, United States Code.

(c) APPLICABILITY.—This Act applies to all work performed under covered contracts, whether the work is performed inside or outside the United States.

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110TH CONGRESS
2D SESSION

H. R. 5787

To amend title 40, United States Code, to enhance authorities with regard to real property that has yet to be reported excess, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

APRIL 14, 2008

Mr. MOORE of Kansas (for himself and Mr. DUNCAN) introduced the following bill; which was referred to the Committee on Oversight and Government Reform

---

A BILL

To amend title 40, United States Code, to enhance authorities with regard to real property that has yet to be reported excess, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Federal Real Property Disposal Enhancement Act of 2008".

SEC. 2. ENHANCED AUTHORITIES WITH REGARD TO PREPARING PROPERTIES TO BE REPORTED AS EXCESS.

Section 572(a)(2) of title 40, United States Code, is amended—

(1) by redesignating subparagraphs (B) and (C) as subparagraphs (C) and (D), respectively; and

(2) by inserting after subparagraph (A) the following new subparagraph:

"(B) ADDITIONAL AUTHORITY.—(i) From the fund described in paragraph (1), subject to clause (iv), the Administrator may obligate an amount to pay, on a reimbursable basis, the direct and indirect costs related to identifying and preparing properties to be reported excess by another agency.

"(ii) The General Services Administration may be reimbursed from the proceeds of the sale of such properties for such costs.

"(iii) After reimbursement of such costs, the balance of the proceeds shall be dispersed pursuant to section 571 of this title.

"(iv) The authority under clause (i) to obligate funds to prepare properties to be reported excess does not include the authority to convey such properties by sale, lease, exchange, or oth-

erwise, including through leaseback arrangements.

"(v) Nothing in this subparagraph is intended to affect subparagraph (D).".

SEC. 3. ENHANCED AUTHORITIES WITH REGARD TO REVERTED REAL PROPERTY.

(a) AUTHORITY TO PAY EXPENSES RELATED TO REVERTED REAL PROPERTY.—Section 572(a)(2)(A) of title 40, United States Code, is amended by adding at the end the following:

"(iv) The direct and indirect costs associated with the reversion, custody, and disposal of reverted real property.".

(b) REQUIREMENTS RELATED TO SALES OF REVERTED PROPERTY UNDER SECTION 550.—Section 550(b)(1) of title 40, United States Code, is amended—

(1) by inserting "(A)" after "(1) IN GENERAL.—"; and

(2) by adding at the end the following: "If the official, in consultation with the Administrator, recommends reversion of the property, the Administrator shall take control of such property, and, subject to subparagraph (B), sell it at fair market value for cash and not by lease, exchange, or leaseback arrangements.

"(B) Prior to sale, the Administrator shall make such property available to State and local governments and certain non-profit institutions or organizations pursuant to this section and sections 553 and 554 of this title.".

(c) REQUIREMENTS RELATED TO SALES OF REVERTED PROPERTY UNDER SECTION 553.—Section 553(e) of title 40, United States Code, is amended—

(1) by inserting "(1)" after "THIS SECTION.—"; and

(2) by adding at the end the following: "If the Administrator determines that reversion of the property is necessary to enforce compliance with the terms of the conveyance, the Administrator shall take control of such property and, subject to paragraph (2), sell it at fair market value for cash and not by lease, exchange, or leaseback arrangements.

"(2) Prior to sale, the Administrator shall make such property available to State and local governments and certain non-profit institutions or organizations pursuant to this section and sections 550 and 554 of this title.".

(d) REQUIREMENTS RELATED TO SALES OF REVERTED PROPERTY UNDER SECTION 554.—Section 554(f) of title 40, United States Code, is amended—

(1) by inserting "(1)" after "THIS SECTION.—"; and

(2) by adding at the end the following: "If the Secretary, in consultation with the Administrator, recommends reversion of the property, the Administrator shall take control of such property and, subject to paragraph (2), sell it at fair market value for cash and not by lease, exchange, or leaseback arrangements.

"(2) Prior to sale, the Administrator shall make such property available to State and local governments and certain non-profit institutions or organizations pursuant to this section and sections 550 and 553 of this title.".

SEC. 4. AGENCY RETENTION OF PROCEEDS.

The text of section 571 of title 40, United States Code, is amended to read as follows:

"(a) DEPOSIT OF PROCEEDS.—Proceeds described in subsection (d) shall be deposited into the appropriate real property account of the agency that had custody and accountability for the real property. Such funds shall be expended only as authorized in annual appropriations Acts and only for activities related to Federal real property asset management and disposal activities, including paying costs incurred by the General Services Administration for any disposal-related activity authorized by this title.

1 "(b) EFFECT ON OTHER SECTIONS.—Nothing in this
2 section is intended to affect section 572(b) or 574 of this
3 title.

4 "(c) DISPOSAL AGENCY FOR REVERTED PROP-
5 ERTY.—For the purposes of this section, the General Serv-
6 ices Administration, as the disposal agency, shall be treat-
7 ed as the agency with custody and accountability for prop-
8 erties which revert to the United States under sections
9 550, 553, and 554 of this title.

10 "(d) PROCEEDS.—The proceeds referred to in sub-
11 section (a) are proceeds under this chapter from a—

12 "(1) transfer of excess property to a federal
13 agency for agency use; or

14 "(2) sale, lease, or other disposition of surplus
15 property.".

○

Mr. TOWNS. At this time I would like to yield time to Congressman Welch, the sponsor of this legislation.

Mr. WELCH. Thank you very much, Mr. Chairman. I want to thank Chairman Towns and I want to thank Chairman Waxman for restoring front and center the responsibility the Congress has to do oversight. That is especially important on the procurement process that has become a much bigger part of how Government spends taxpayers' dollars.

Just a few facts, Mr. Chairman.

In the year 2000, procurement spending was $203 billion. In the first 6 years of the Bush administration that grew to $412 billion, the highest it has ever been in the history of the United States.

Also, non-competitive procurement contracting has also exploded. The use of no-bid contracts and the use of limited competition contracts rose in the year 2000 from $67.5 billion to $206.9 billion in 2006, with the largest increase in a single year being between 2005 and 2006.

Even as that happens, the incidents of documented waste, fraud, and abuse is also exploding. In a report that was done under the supervision of Chairman Waxman, "More Dollars, Less Sense: Worsening Contracting Trends Under the Bush Administration," has documented that in 118 contracts valued at $745 billion that were found by Government auditors to involve very significant waste, fraud, abuse, or mismanagement. This year the report identifies 187 contracts valued at $1.1 trillion that have been plagued by waste, fraud, and abuse. That raises the question as to how we will, as a Congress and as an administration, protect taxpayer dollars from waste, fraud, and abuse.

The subject of this hearing is about a rule that was proposed that originally was going to do the obvious, and that was require contractors who are receiving literally billions of dollars of taxpayer money to report when they become aware of any incidents of fraud. That rule, from its original proposal, did the sensible thing to include that obligation whether the taxpayer money was spent in the United States or abroad, was ultimately promulgated with an exclusion for any expenditures of taxpayer dollars that were spent overseas. Of course, the dominant place where that money is spent is Iraq and, to some extent, in Afghanistan.

The chairman laid out why that is not acceptable, but just a few examples of the really egregious fraud, waste, and mismanagement that has occurred are incidents in Iraq. Mr. Chairman, a few of us were able to go to the Baghdad Police Academy, where the contract wasted millions of taxpayer dollars building a facility that wasn't able to be occupied for its intended purpose. There was literally septic sewage that was leaking from second-story facilities into the first floor.

Folks from the committee went to the Baghdad Police College, which I just mentioned. Another one was the dam at Mosul, where millions of dollars of equipment were just gone missing.

There is item after item that have been documented, Mr. Chairman, in the report by this committee of taxpayer waste, fraud, and abuse which everybody opposes, so this rule that has allowed an exemption to continue can't be sustained.

I thank you Mr. Chairman and yield the balance of my time.

Mr. TOWNS. Thank you very much. I also thank you for the great work that you have done on this legislation.

Let me introduce the members of the panel. Let me begin by introducing the Honorable Paul Denett, Administrator for Federal Procurement Policy, Office of Management and Budget. Thank you for coming.

Mr. Barry Sabin, Deputy Assistant Attorney General for Criminal Division, U.S. Department of Justice. Thank you so much for coming.

Mr. David Drabkin, Acting Chief Acquisition Officer and Senior Procurement Executive, General Services Administration. Thank you so much for coming.

Ms. Colleen Preston, executive vice president of Professional Services Council. Thank you so much for being here.

We will proceed with you, Mr. Denett. Let me just say that each of you have 5 minutes. Of course, we hope that you could sum up in 5 minutes. When the light goes to caution, we want to let you know you need to be sort of like winding up, and then when it gets to red, that means stop. Of course, after that we have a question and answer period.

Before we do that, it is a longstanding policy here that we swear in all of our witnesses.

[Witnesses sworn.]

Mr. TOWNS. Let the record reflect that they all answered in the affirmative.

We will begin with you, Mr. Denett.

STATEMENTS OF PAUL DENETT, ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET; BARRY SABIN, DEPUTY ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE; DAVID DRABKIN, ACTING CHIEF ACQUISITION OFFICER AND SENIOR PROCUREMENT EXECUTIVE, GENERAL SERVICES ADMINISTRATION; AND COLLEEN PRESTON, EXECUTIVE VICE PRESIDENT, PROFESSIONAL SERVICES COUNCIL

STATEMENT OF PAUL DENETT

Mr. DENETT. Thank you, Chairman Towns, Ranking Member Bilbray, and members of the subcommittee. I appreciate the opportunity to appear before you today to discuss recent regulatory actions addressing contractor ethics and disclosure requirements. You have asked for comments on H.R. 5712, the Close the Contractor Fraud Loophole Act. I have prepared written remarks that I would like the subcommittee to enter into the record, and I would like to briefly summarize those comments for you.

Mr. TOWNS. Without objection.

Mr. DENETT. Let me begin by assuring the subcommittee that the administration is committed to an acquisition process with high standards of integrity and effective management controls to reduce fraud, waste, and abuse in Government contracting.

Two recent rulemakings to change the Federal Acquisition Regulation reflect unprecedented steps to strengthen contractor ethics to protect our taxpayers from fraudulent conduct in the award and

performance of Federal contracts and subcontracts. First, the Civilian Defense Acquisition Regulatory Council's finalized FAR changes last November that for the first time establish Government-wide requirements for Federal contractors to have a written code of business ethics.

Second, the Council has issued a proposed rule, also last November, that would require Government contractors to disclose to an agency whenever the contractor has reasonable grounds to believe that a violation of criminal law has occurred in connection with award or performance of a contract or subcontract. The proposed rule would require contractors to establish internal control systems and employee training programs to ensure compliance.

You have asked why the rules provide exemptions for overseas contracts and commercial item contracts. I understand that the exemption for overseas contracts is patterned after pre-existing Defense Department regulations dating back to 1988 that exempted overseas contracts from contract clauses requiring hotline posters. These are posters that are placed in the contractor workplace with information on how contractor employees can report suspected fraud and other misconduct.

The exemption for commercial item contracts reflects provisions in the Federal Acquisitions Streamlining Act that require the acquisition of commercial items to resemble customary commercial marketplace practices to the maximum extent practicable.

I am inclined to favor the elimination of these exemptions for the purposes of these rulemakings. My office asked the acquisition law team, which is the team that is responsible for drafting ethics rules, to carefully consider whether exemptions for overseas contracts and commercial items acquisition are necessary.

In response to this request, the Councils sent OMB a draft proposed rule as a followup to the November proposed rule. This rule, which OMB received last week, is currently under interagency review and will be subject to public notice and comment.

You have asked me to discuss H.R. 5712. This bill would, in effect, impose statutory requirements on Federal contractors that are similar to the November proposed rule, except that H.R. 5712 would also apply these requirements to overseas and commercial item contracts. The followup rulemaking and the process I just described will ensure that the concerns underlying this legislation are appropriately addressed. For this reason, I believe the legislation is unnecessary.

In short, the administration is creating stronger Government-wide ethics requirements for government contractors. I am confident, when the deliberations are concluded and regulatory changes are finalized and fully implemented, we will have taken significant steps to have protected the Government and taxpayer from fraud in Government contracting.

This concludes my prepared remarks, and I will be happy to answer any questions that you may have.

[The prepared statement of Mr. Denett follows:]

STATEMENT OF PAUL A. DENETT

ADMINISTRATOR FOR FEDERAL PROCUREMENT POLICY

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,

ORGANIZATION, AND PROCUREMENT

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

UNITED STATES HOUSE OF REPRESENTATIVES

April 15, 2008

Chairman Towns, Ranking Member Bilbray, and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the Administration's regulatory efforts to strengthen contractor ethics and protect the government from fraudulent conduct in the award and performance of federal contracts and subcontracts. You have asked me to address H.R. 5712, the Close the Contractor Fraud Loophole Act, and issues raised in a March 20, 2008 letter from the Committee. In particular, you asked that I address the regulatory exemptions for overseas contracts and commercial item contracts that the civilian and defense acquisition regulatory councils proposed for public comment last November.

Let me begin by assuring the Subcommittee that the Administration is committed to an acquisition process with high standards of integrity and effective management controls to reduce fraud, waste, and abuse in government contracting. The Office of Federal Procurement Policy (OFPP) and procuring agencies have been working closely with the Department of Justice on its Procurement Fraud Task Force to review

regulations and policies for possible improvements to promote early detection, prevention, and prosecution of procurement fraud.

On May 23, 2007, OFPP received a request from Alice Fisher, Assistant Attorney General of Justice's Criminal Division, to consider amending the Federal Acquisition Regulation (FAR) to, among other things, require contractors to notify the government, without delay, when they become aware of a violation of criminal law or contract overpayment. In response, my office asked the Federal Acquisition Regulatory Council (FAR Council) to initiate a case to consider proposed regulatory changes to address Justice's recommendations.

By way of brief background, the FAR Council oversees the FAR. It manages two Councils: the Civilian Agency Acquisition Council (CAAC) and the Defense Acquisition Regulations Council (DARC). These bodies are comprised of agency representatives throughout the Executive Branch and are responsible for issuing changes to the FAR. The CAAC and DARC are assisted by six drafting teams with subject matter expertise in different parts of the FAR. The ethics rules you have asked about were drafted by the FAR Acquisition Law Team.

At the time of the Justice Department request, the FAR Acquisition Law Team was already well on the way to drafting regulatory changes to strengthen ethics requirements for government contractors and subcontractors. In February 2007, three months before the Justice Department request, the CAAC and DARC published proposed changes to the FAR that would, for the first time, establish government-wide requirements for government contractors to have a written code of business ethics and related requirements for posting "fraud hotline" posters to encourage contractor employees to report possible fraudulent contract activity.

In November 2007, the CAAC and DARC finalized the first rulemaking (FAR Case 2006-007). In addition, also in November, the two Councils issued a second proposed rule (FAR Case 2007-006), published in the *Federal Register* on November 14, 2007, that responded to the Justice Department's proposal. Through their issuance of the final rule and the proposed rule, the Councils put into place requirements for contractor ethics codes and, at the same time, gave contractors and other interested members of the public fair notice and an opportunity to comment on the Justice Department's proposed disclosure requirements.

Under the November proposed rule, contractors for the federal government would be required to disclose to an agency whenever the contractor has reasonable grounds to believe that a violation of criminal law has occurred in connection with award or performance of a contract or subcontract. The proposal would also require contractors to establish internal control systems and employee training programs to ensure compliance.

Both the final rule and the proposed rule include exemptions for overseas contracts. These exemptions are patterned after pre-existing Department of Defense regulations, dating back to 1988, that exempted overseas contracts from contract clauses that required "hotline posters" – i.e., posters that are placed in the contractor workplace with information on how contractor employees can report suspected fraud and other misconduct. The November rulemakings also include an exemption for commercial item contracts, in light of provisions in the Federal Acquisition Streamlining Act that require the acquisition of commercial items to resemble customary commercial marketplace practices to the maximum extent practicable.

Following the issuance of the November proposed rule, my office asked the Councils' Acquisition Law Team to carefully consider whether exemptions for overseas contracts and commercial item acquisitions are necessary. In response, the Councils recently sent a draft proposed rule to OMB, which we received on April 8th. This draft proposed rule is a follow-up to the November proposed rule. I am inclined to favor the elimination of exemptions for overseas contracts and commercial item acquisitions for purposes of this rulemaking. The draft proposed rule is currently under interagency review pursuant to Executive Order 12866 and will be subject to public notice and comment. These processes will ensure appropriate consideration of public and agency comments.

You have asked me to discuss H. R. 5712. This bill would, in effect, impose statutory requirements on federal contractors that are similar to the November proposed rule, except that H.R. 5712 would also apply these requirements to overseas and commercial item contracts. As I just mentioned, the Councils recently submitted a draft proposal to OMB for review, and I believe the rulemaking process will ensure that the concerns underlying this legislation will be appropriately addressed, without the need for new legislation.

In sum, the Administration is creating stronger, government-wide ethics requirements for government contractors. I am confident that when deliberations are concluded and regulatory changes are finalized and fully implemented, we will have taken significant steps to protect the government and our taxpayers from fraud in government contracting.

This concludes my prepared remarks. I am happy to answer any questions that you may have.

Mr. TOWNS. Thank you very much, Mr. Denett.

Now we go to you, Mr. Sabin.

STATEMENT OF BARRY SABIN

Mr. SABIN. Thank you, Chairman Towns, Congressman Welch. I appreciate the opportunity to be here today to discuss the Close the Contractor Fraud Loophole Act, H.R. 5712, the efforts of the Department of Justice to combat fraud in Government contracting, and specifically the requirement that Government contractors report fraud in material over-billing.

The Justice Department has a demonstrated and continued commitment to a strong and vigorous enforcement effort in the important area of procurement fraud. The Department of Justice has made the investigation and prosecution of procurement fraud a priority, to include procurement fraud related to the wars and the building efforts in Iraq and Afghanistan.

In October 2006 the Justice Department announced a new national procurement fraud initiative and the creation of the National Procurement Fraud Task Force led by the Justice Department's Deputy Attorney General's Office and Criminal Division to promote the early detection, prevention, and prosecution of procurement and grant fraud associated with increasing contracting activity for national security and other Government programs.

The task force has been enthusiastically embraced by the entire law enforcement community, including the FBI, the Inspector General community, and Defense-related agencies. Overall, we now have more effective resource allocation in procurement fraud investigations, which has resulted in the acceleration of investigations and prosecutions.

This combined effort of task force members has resulted in significant accomplishments, including a number of working committees, specialized training, a public Web site, maybe 300 procurement fraud cases, regional working groups, and more.

Procurement fraud cases, especially those involving the wars in Iraq and Afghanistan, are usually very complex and resource intensive. The cases often involve extra-territorial conduct, as well as domestic conduct, requiring coordination between appropriate law enforcement agencies.

In order to improve coordination and information sharing, we have established a joint operations center based in Washington.

To date, the Justice Department has charged 46 individuals or companies for contract fraud relating to the efforts in Afghanistan, Kuwait, and Iraq. Last week a KBR fuel technician was sentenced to 26 months incarceration in the Eastern District of Virginia following his guilty plea to conspiracy to defraud and accept bribes in connection with a scheme to divert fuel intended for our airfield to the black market in Afghanistan.

Also, last week in the District of Maryland a former senior contract fuel manager pled guilty to conspiracy to defraud the United States, commit wire fraud, and steal trade secrets.

With respect to the proposals to require mandatory disclosure by contractors, on May 23, 2007, in a letter to the Office of Federal Procurement Policy, the Justice Department proposed, on behalf of the task force, some modifications to the Federal Acquisition Regu-

lation, which would require, among other things, that contractors notify the Government whenever they become aware of material overpayment or fraud relating to the award or performance of contract or subcontract rather than wait for the contract overpayment or fraud to be discovered by the Government.

Shortly thereafter, the Councils began the review process, and on November 14, 2007, published proposed rules, substantially incorporating the task force's requested changes of the FAR. The task force's proposal is mild on existing requirements found in other areas of corporate compliance.

In my written statement I will give some of the reasons why the changes were requested, including the data evidencing a decline in voluntary disclosures to a Department of Defense Inspector General.

The proposed rule, as published by the Councils on November 14, 2007, added two exemptions, one to Government contracts performed entirely overseas and the other for commercial contracts that were not included in the original task force's proposal submitted on May 23, 2006.

After the Councils published the proposed rule and sought public comment, the task force considered ways to improve the proposed rule. In response to what the task force believed were some legitimate concerns, we submitted comments on the proposed rule on January 14th of this year, addressing the standard for the schedule of over-payments and criminal violations, cooperation and attorney/client privilege, navigation to disclose potential violations of the False Claims Act, the grounds for suspension and debarment, the time limit for disclosures, and internal investigations by contractors. Law enforcement agencies submitted numerous comments to the councils in support of the task force's proposal.

In our January 14th comments we also address the Council's decision not to include overseas contracts. We asserted that the United States still is a party to these contracts and potentially a victim when over-payments are made or when fraud occurs in connection with those contracts.

We noted that, under these circumstances, the Government still maintains jurisdiction to prosecute the perpetrators of fraud and that these types of contracts, which in many cases support our efforts to fight the global war on terror, need greater contractor vigilance, because they are performed overseas where U.S. Government resources and remedies are more limited.

As the Justice Department has previously stated, the Department welcomes the enactment of new tools to combat fraud committed by contractors within the criminal jurisdiction of the United States. With respect to H.R. 5712, we believe that the rulemaking process should be able to address real concerns adequately by appropriately incorporating the types of changes discussed in our January letter.

The Justice Department and the task force have taken a proactive leadership role in proposing that new ethics rules and fraud and overpayment rules be incorporated into the FAR. Moreover, the Justice Department will continue its efforts to detect, deter, investigate, and prosecute procurement fraud by companies and individuals.

Through these and other efforts, we will ensure that taxpayer moneys are protected, our Nation's security defended, and the investigation and prosecution of procurement fraud remains a Justice Department priority.

I welcome any questions you may have.

[The prepared statement of Mr. Sabin follows:]

Department of Justice

STATEMENT

OF

BARRY M. SABIN
ACTING CHIEF OF STAFF
AND
PRINCIPAL DEPUTY ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION
DEPARTMENT OF JUSTICE

BEFORE THE
SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,
ORGANIZATION, AND PROCUREMENT
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES

ENTITLED
"NEW CONTRACTING AND PROPERTY BILLS"

PRESENTED ON
APRIL 15, 2008

Statement of

Barry M. Sabin
Acting Chief of Staff
and
Principal Deputy Assistant Attorney General
Criminal Division
Department of Justice

Before the
Subcommittee on Government Management,
Organization and Procurement
Committee on Oversight and Government Reform
United States House of Representatives

Entitled
"New Contracting and Property Bills"

April 15, 2008

I. Introduction

Thank you for the opportunity to be here today to discuss both the "Close the Contractor Fraud Loophole Act," H.R. 5712, and the efforts of the Department of Justice to combat fraud in government contracting and specifically the requirement that government contractors report fraud and material overbilling.

As I have previously testified before both the Senate and the House, the Justice Department has a demonstrated and continued commitment to a strong and vigorous enforcement effort in the important area of procurement fraud. The Department of Justice has made the investigation and prosecution of procurement fraud a priority, including procurement fraud related to the wars, and rebuilding efforts, in Iraq and Afghanistan.

Moreover, the Department has developed a track record of success in the procurement fraud area by working with the International Contract Corruption Task Force (ICCTF), including the Army Criminal Investigation Division (Army CID), the Defense Criminal Investigative Service ("DCIS"), the Federal Bureau of Investigation (FBI), the Special Inspector General for Iraq Reconstruction (SIGIR), the U.S. Agency for International Development Office of Inspector General (USAID OIG), as well other Inspectors General (IGs), and traditional law enforcement partners, to investigate and prosecute such procurement fraud.

II. The National Procurement Fraud Task Force

In October 2006, the Justice Department announced a new national procurement fraud initiative and the creation of the National Procurement Fraud Task Force (Task Force) led by the Justice Department's Deputy Attorney General's Office and Criminal Division to promote the early detection, prevention, and prosecution of procurement and grant fraud associated with increasing contracting activity for national security and other government programs. The Department formed the Task Force, among other reasons, to address allegations of fraud in contracting in Iraq, Afghanistan, and Kuwait.

The Justice Department formed the Task Force, in partnership with U.S. Attorney's Offices, the Justice Department's Civil, Antitrust, Environmental and Natural Resources, National Security and Tax Divisions, and other Federal law enforcement agencies, which Alice S. Fisher, Assistant Attorney General for the Criminal Division, chairs. The Executive Director of the Task Force is Steve Linick, a Deputy Chief in the Fraud Section, Criminal Division. More than 35 agencies are participating in the Task Force, including, but not limited, to the FBI, the SIGIR, and the Offices of Inspectors General (IGs) from Department of Defense (DOD), USAID, Central Intelligence Agency, General Services Administration, Department of Justice, Department of Homeland Security, Department of Energy, National Science Foundation, Small Business Administration, Social Security Administration, Veterans Administration, U.S. Postal Inspection Service, Interior, Housing and Urban Development, and Treasury. In addition, all defense-related investigative agencies, DCIS, Naval Criminal Investigative Service, Army-CID, and U.S. Air Force, Office of Special Investigations, are full participants.

The Task Force established a series of objectives relating to procurement fraud, including:

- increasing coordination and strengthened partnerships among all IGs, law enforcement, and the Justice Department to fight procurement fraud more effectively;
- assessing existing government-wide efforts to combat procurement fraud;
- identifying and removing barriers to preventing, detecting, and prosecuting procurement fraud;
- increasing and accelerating civil and criminal prosecutions and administrative actions to recover ill-gotten gains resulting from procurement fraud; and
- encouraging greater private sector participation in the prevention and detection of procurement fraud.

The Task Force has been enthusiastically embraced by the entire law enforcement community, including the FBI, the IGs, and defense-related agencies. Overall, we now have more effective resource allocation in procurement fraud investigations, which has resulted in the

acceleration of investigations and prosecutions. This combined effort of Task Force members has resulted in significant accomplishments, for example:

- The Task Force has created working committees chaired by a high-level member of the IG community or the FBI. These working committees, which consist of representatives from multiple agencies, address common issues such as training, legislation, intelligence, information sharing, private sector outreach, grant fraud, and international procurement fraud.

- There has been significant increase in specialized training for OIG agents, auditors, and prosecutors on the investigation and prosecution of procurement fraud cases.

- The Task Force has established a public website, http://www.usdoj.gov/criminal/npftf, which has assisted suspension and debarment officials by listing in a single location, press releases related to recent procurement and grant fraud cases.

- Since the Task Force was created, more than 300 procurement fraud cases have resulted in criminal charges, convictions, civil actions, or settlements. These cases are summarized on the Task Force's website.

- The Task Force has formed numerous regional working groups, chaired by U.S. Attorneys, to implement the Task Force's goals regionally by working with their local Federal law enforcement counterparts to bring about timely and effective procurement fraud prosecutions.

- The Task Force has encouraged an unprecedented level of collaboration and coordination at all levels of government to combat procurement and grant fraud.

III. Recent Litigation Efforts

Procurement fraud cases, especially those involving the wars in Iraq and Afghanistan, are usually very complex and resource intensive. The cases often involve extraterritorial conduct as well as domestic conduct, requiring coordination between appropriate law enforcement agencies. In order to improve coordination and information sharing, the ICCTF has established a Joint Operations Center (JOC) based in Washington, D.C. The JOC currently serves as the nerve center for the collection and sharing of intelligence regarding corruption and fraud relating to funding for the Global War on Terror (GWOT). The JOC coordinates intelligence-gathering and provides analytic and logistical support for the ICCTF agencies. As a result of this concentration of efforts, the Department has significantly increased the number of prosecutions relating to contract fraud associated with GWOT.

To date, the Department has charged 46 individuals and companies for contract fraud relating to the efforts in Afghanistan, Kuwait, and Iraq. Examples of recent cases are highlighted below:

- On April 9, 2008, Matthew Bittenbender pleaded guilty to conspiracy to defraud the United States, commit wire fraud and steal trade secrets. Previously, charges were filed against Bittenbender and two DOD contractors, Christopher Cartwright and Paul Wilkinson, and their affiliated companies, Czech Republic-based Far East Russia Aircraft Services Inc. (FERAS) and the Isle of Man-based Aerocontrol LTD, for similar conduct to which Bittenbender pleaded guilty. Cartwright, Wilkinson, FERAS, Aerocontrol and Bittenbender were charged with conspiring to steal information relating to fuel supply contracts for DOD aircraft worldwide, including to Bagram Air Force Base in Afghanistan. Bittenbender was a former senior contract fuel manager at Maryland-based Avcard, a company which provides fuel and fuel services to commercial and government aircraft. Bittenbender was charged with taking confidential bid data and other proprietary information related to DOD fuel supply contracts from Avcard, and selling that information to competitors Cartwright, Wilkinson, FERAS and Aerocontrol. In return, Bittenbender was alleged to have received cash payments and a percentage of the profit earned on the resulting DOD fuel supply contracts. Cartwright, Wilkinson, FERAS and Aerocontrol are alleged to have subsequently used that illegally obtained information to bid against Avcard at every location where the companies were bidding head-to-head, thereby subverting DOD's competitive bidding procedures for fuel supply contracts. The trial of this matter against Bittenbender's co-defendants is scheduled to begin in July 2008.

- On February 7, 2008, James Sellman, a fuel technician employed by KBR, pled guilty in the Eastern District of Virginia, to conspiracy to defraud and accept bribes in connection with a scheme to divert fuel intended for Bagram Airfield to the black market in Afghanistan. On January 25, 2008, Wallace Ward, another KBR fuel technician participating in the conspiracy, pled guilty to the same offense. As alleged in the indictment, the scheme involved the diversion in 2006 of over $2 million in lost fuel. The investigation is continuing.

- On January 23, 2008, Elie Samir Chidiac ("Chidiac") and Raman International Inc. ("Raman") were indicted on conspiracy charges in connection with bribes paid between May 2006 and March 2007 to a contracting officer at Camp Victory in Iraq. Chidiac is the former Iraq site manager for Raman, a military contractor based near Houston, Texas. Raman and Chidiac allegedly paid bribes to induce a DOD contracting officer to steer contracts to Raman. Chidiac is also charged with participating in a second scheme whereby the same contracting officer altered contracting documents to allow him to fraudulently obtain payment -- which he split with the contracting officer -- for work that neither he nor Raman performed. Trial in the case is scheduled for June 9, 2008, in the Western District of Oklahoma.

- On November 20, 2007, Terry Hall, a civilian contractor from Georgia was indicted by a Federal grand jury in the District of Columbia for allegedly soliciting bribes while working at Camp Arifjan, an Army base in Kuwait. Hall operated companies

that had contracts with the U.S. military in Kuwait, including Freedom Consulting and Catering Co., U.S. Eagles Services Corp., and Total Government Allegiance. The indictment charges that Hall's companies received more than $20 million worth of military contracts for providing, among other things, bottled water to the U.S. military in Kuwait.

- On August 22, 2007, U.S. Army Major John Cockerham, his wife Melissa Cockerham, and Cockerham's sister, Carolyn Blake, were indicted in Federal court in San Antonio, Texas, on charges of conspiracy to defraud the United States and to commit bribery, conspiracy to obstruct justice, and for a money laundering conspiracy. Major Cockerham was also charged with three counts of bribery. The scheme ran from late June 2004 through late December 2005, while Major Cockerham was deployed to Camp Arifjan, Kuwait, serving as a contracting officer responsible for soliciting and reviewing bids for DOD contracts in support of operations in the Middle East, including Operation Iraqi Freedom. The contracts were for various goods and services to DOD, including bottled water destined for soldiers serving in Kuwait and Iraq. All three defendants accepted millions of dollars in bribe payments on Major Cockerham's behalf, in return for his awarding contracts to corrupt contractors. Cash bribes paid to the defendants totaled approximately $9.6 million. Trial in this matter is scheduled for October 2008.

IV. The Task Force's Efforts To Increase Private Sector Participation In The Prevention And Detection Of Procurement Fraud

A. The Task Force's Proposal to Require Mandatory Disclosure by Contractors

On May 23, 2007, in a letter to the Office of Federal Procurement Policy, the Justice Department proposed (on behalf of the Task Force), some modifications to the Federal Acquisition Regulation (FAR), which would require, among other things, that contractors notify the government whenever they become aware of a material overpayment or fraud relating to the award or performance of contract or subcontract, rather than wait for the contract overpayment or fraud to be discovered by the government.[1]

Shortly thereafter, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (the "FAR Councils") began their review process, and on November 14, 2007, published a proposed rule substantially incorporating the Task Force's requested changes to the FAR. The Task Force proposal is modeled on existing requirements found in other areas

[1]On May 23, 2007, the Justice Department also submitted comments to the General Services Administration, Regulatory Secretariat, to voice support for then pending FAR Case 2006-007, which would require Government contractors to have a "written code of business ethics and conduct" and an "ethics and compliance program" for its employees. A Final Rule adopting these requirements was published in the Federal Register on November 23, 2007. The effective date of the new FAR provision was on December 24, 2007.

of corporate compliance such as the Sarbanes Oxley Act of 2002, and it expands slightly on the Contractor Standards of Conduct set out by the Department of Defense at DFARS 203.7000. We were careful not to ask contractors to do anything that is not already expected of their counterparts in other industries, and we have avoided imposing any unnecessary burdens on small businesses or creating any expensive paper work requirements. We note also that the National Reconnaissance Office (NRO) through a contract clause recently has begun requiring its contractors to disclose contract fraud and other illegal activities. The NRO reports that this requirement has improved its relationships with its contractors and enhanced its ability to prevent and detect procurement fraud.

The Task Force requested these changes to the FAR for several reasons. First, while we recognize that many government contractors are now required to establish corporate compliance programs, our experience suggests that few have actually responded to the invitation of DOD that they voluntarily disclose suspected instances of fraud. Indeed, the DOD IG reports that during the initial years of the program (FY 1988-1990) there were 147 voluntary disclosures. DOD IG reports that, by contrast, during the last three years (FY 2005-2007), there have been a total of only 20 disclosures, and between FY 2001 and 2007, there have only been a total of 48 disclosures.

Additionally, as you know, the 1980's witnessed significant innovations in the Federal procurement system. Many of those reforms, including corporate compliance programs and corporate self governance, were adopted with industry cooperation, and were later incorporated into evolving regulatory schemes in other business sectors and industries. In fact, the U.S. Sentencing Guidelines' treatment of corporations, adopted in 1991, borrowed heavily from reforms that were first instituted for government contractors in 1986. However, since that time, we are concerned that contractor reform may not have kept pace with reforms in self-governance in industries such as banking, securities, and healthcare.

B. The Exemptions for Overseas and Commercial Contracts

The proposed rule as published by the Councils on November 14, 2007, added two exemptions – one for government contracts performed entirely overseas, and, the other for commercial contracts – that were not included in the original Task Force proposal submitted on May 23, 2007.

After the Councils published the proposed rule and sought public comment, the Task Force considered ways to improve the proposed rule. In response to what the Task Force believed were some legitimate concerns, we submitted comments on the proposed rule on January 14, 2008, addressing the standard for disclosure of overpayments and criminal violations, cooperation and attorney-client privilege, the obligation to disclose potential violations of the False Claims Act, the grounds for suspension and debarment, the time limit for disclosures, and internal investigations by contractors. Law enforcement agencies submitted numerous comments to the FAR Councils in support of the Task Force proposal.

In our January 14 comments, we also addressed the Councils' decision not to include overseas contracts. We asserted that the United States still is a party to these contracts and potentially a victim when overpayments are made or when fraud occurs in connection with the contracts. We noted that under these circumstances, the government still maintains jurisdiction to prosecute the perpetrators of fraud, and that these types of contracts, which in many cases support our efforts to fight the global war on terror, need greater contractor vigilance because they are performed overseas where U.S. government resources and remedies are more limited.

With respect to the commercial contracts exemption, in our initial proposal last May, anticipating an objection by commercial contractors who already are relieved of many FAR requirements, we stated that while there may be reasons for exempting commercial contracts from the compliance program requirements, there was "no reason to exclude those contractors from the reporting requirement."[2]

It is our understanding that the rulemaking process is not complete, and the exemptions for overseas and commercial contracts are being professionally and critically reviewed. We continue to voice our concerns about both exemptions as they are being considered by the Councils.

V. Legislation

As the Justice Department has previously stated, the Department welcomes the enactment of new tools to combat fraud committed by contractors within the criminal jurisdiction of the United States, whether the conduct occurs territorially or extraterritorially. We have investigated and prosecuted, and will continue to thoughtfully and aggressively prosecute, procurement fraud violations. With respect to H.R. 5712, we believe that the rulemaking process should be able to address your concern adequately by appropriately incorporating the types of changes discussed in our January letter.

VI. Conclusion

The Department of Justice and the Task Force have taken a proactive leadership role in proposing that new ethics rules and fraud and overpayment rules be incorporated into the Federal Acquisition Regulation. We will continue to be engaged in the final rulemaking process so that our views are appropriately considered. Moreover, the Justice Department will continue its efforts to detect, deter, investigate and prosecute procurement fraud by companies and individuals. Through these and other efforts, we will ensure that taxpayer monies are protected,

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[2]The Councils elected not to include the Task Force's observations about commercial contracts, and included both the commercial contracts and the overseas exemption in the proposed rule in their November 14, 2007 Federal Register notice (and later in the Final rule on compliance on November 23, 2007). In our January 14, 2008 letter, we chose to defer to the Councils and not to restate our initial concerns about the commercial contracts exemption.

our nation's security defended, and the investigation and prosecution of procurement fraud remains a Justice Department priority.

Mr. TOWNS. Thank you very much, Mr. Sabin.

You may proceed, Mr. Drabkin. Thank you so much.

STATEMENT OF DAVID DRABKIN

Mr. DRABKIN. Chairman Towns, Ranking Member Bilbray, members of the subcommittee, thank you for the invitation to come and talk to you today about the FAR rulemaking process and specifically the "Federal Acquisition and Regulation Case 2007–006, Contractor Compliance Program and Integrity Reporting."

Changes to the FAR undergo a long-established process following the direction of the Congress, the President, or suggestions from agencies or the public. The proposed changes are assigned a case number and are referred to one of the standing teams of the FAR Council. These teams are composed of career civil servants and uniformed members of the armed forces. On occasion, an ad hoc team may be formed to address either an unusually complicated matter or a matter that requires special attention. Ad hoc teams are also composed of career civil servants and uniformed members of the armed forces and are drawn from either existing team members or experts sought from other agencies.

Once a case is assigned to a team, the team develops the language they believe implements the suggested or directed changes based upon their specific expertise and knowledge of the procurement process. If they are making the changes based on statutory Executive direction, discretion in formulating regulatory guidance is limited by the directive they have received. If they are making changes based upon suggestions for the agencies or the public, their discretion is much broader in terms of evaluating the overall consistency of proposed changes with existing policies and practices. There is a FAR guide, and that guide is available on the Web, and I have placed the Web site in my testimony, which I ask, Mr. Chairman, be included in the record.

Mr. TOWNS. Without objection, so ordered.

Mr. DRABKIN. Once the team completes its assigned work, the case is then sent to either the Defense Acquisition Regulatory Council [DARC], or the Civilian Agency Acquisition Council [CAAC], who reviews the team's work. Once both councils have concluded their reviews and made any changes they deem appropriate, the case is submitted to the OMB's Office of Federal Procurement Policy for review and approval, then to OMB's Office of Information and Regulatory Affairs [OIRA], for its review, including an interagency coordination at OIRA's discretion and approval.

Then the final rule is sent to the FAR signatories. Those would be the Director of Procurement at Defense, the Director of Procurement at NASA, and myself at GSA, for their review and approval, and then the case is published in the Federal Register.

Currently, over 50 cases are being processed, both statutory and non-statutory in origin, and the details and the status of all those cases may be found on the Web site set forth in my testimony.

With regard to FAR case 2006–007, it originated from a letter from the Department of Homeland Security as a Katrina hotline poster case. DHS had been asked by Senators Lieberman and Collins to acquire and ensure wide distribution of fraud hotline posters in hurricane relief and reconstruction contracts. The Senators re-

quested that the regulatory action mirror the Department of Defense's contract clause contained in the Defense Acquisition Regulatory Supplement [DFARS], that requires the prominent display of contract information to report fraud, waste, and abuse.

DOD, GSA, and NASA took the initiative to make the ethics coverage in the FARs stronger than DHS or the Senators had requested. The original request by DHS was to take the existing DOD hotline poster regulation and make it Government-wide. The DOD hotline poster clause, which is found at 252.203–7002, was required in solicitations of contracts expected to exceed $5 million, except when performance will take place in a foreign country. It also was not required in commercial item contracts.

The DOD ethics and internal control regulation in the DFARS recommended that a contractor system of management controls should provide for a timely reporting. This was not mandatory on contractors, as there was no clause binding the contractor.

In FAR case 2006–007, originating from DHS, we issued a clause for hotline posters, keeping the overseas and commercial items exemptions in that case. The FAR case went further by making the ethics aspect mandatory and adding on to the hotline poster clause.

The final rule had two clauses, one for the contractor code of business ethics and conduct and another for the display of the hotline poster, itself. The introductory paragraph, which provides an exception if the contract is for the acquisition of commercial items in the part 12 or if it will be performed entirely outside the United States applies to both clauses. The policy states that all the Government contractors must conduct themselves with the highest degree of integrity and honesty and should have a written code of business ethics and conduct.

All contractors should also have an employee business ethics and compliance training program and an internal control system that is suitable to the size of the company to facilitate timely discovery and disclosure of improper conduct in connection with Government contracts, and ensure corrective measures are promptly instituted and carried out.

As this FAR case was progressing, the Department of Justice submitted a public comment asking that FAR case 2006–007 provide more detail on the U.S. citizen guidelines. DOJ did not comment on the exception for contracts for commercial items or contracts performed entirely outside the United States.

At the same time, DOJ submitted a letter to OFBP setting out DOJ's request to open a new FAR case. DOJ requested changes to the FAR to require contractors to establish and maintain internal controls to detect and prevent fraud in their contract and notify contracting officers without delay whenever they become aware of the contract overpayment or fraud, rather than wait for the discovery by the Government.

The emphasis of the DOJ letter and the focus of the DOD and GSA and NASA was on mandatory disclosure rather than on the exemptions. The DOJ request provided that commercial contractors may be excluded from the compliance program requirements. DOJ asked for and received a commitment from OFBP to publish a new proposed rule on an expedited basis. The FAR Council complied

with this request by expediting the drafting, finishing, and approving of a proposed rule.

The new 2007–006, and this can by very confusing, because the other rule is 2006–007, but the new rule, 2007–006 proposed rule did not totally exempt overseas contracts. The proposed rule applied the new debarment and suspension clauses to the overseas contracts. A contractor may be debarred or suspended for knowing failure to timely disclose an overpayment on a Government contract or violations of Federal criminal law in connection with the award and performance of the Government contract or subcontract, which includes violations of any contract, whether domestic or overseas.

The law team has modified the proposed rule and will publish it for public comment and review. Comments received will be considered in drafting the final rule.

Mr. Chairman, Ranking Member Bilbray, the FAR rulemaking process is one of the unheralded great success stories in the Federal Government's procurement practices. It has kept parties and politics out of the business function of Government for decades. I hope that you will join me in congratulating the hundreds of career civil servants and uniformed military members who have, over the years, honed this process and made it work for the American taxpayers and the Federal Government. These individuals are truly the unsung heroes of Government.

Our colleagues in government all over the world study our system with envy and try to emulate it within their own customers and cultures, as allowed.

I would be happy to answer any questions you may have.

[The prepared statement of Mr. Drabkin follows:]

STATEMENT OF

DAVID DRABKIN

ACTING CHIEF ACQUISITION OFFICER

OFFICE OF THE CHIEF ACQUISTION OFFICER

U.S. GENERAL SERIVICES ADMINISTRATION

BEFORE THE

COMMITTEE ON OVERSIGHT AND

GOVERNMENT REFORM

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT,

ORGANIZATION AND PROCUREMENT

U.S. HOUSE OF REPRESENTATIVES

APRIL 15, 2008

Chairman Towns, Ranking Member Bilbray, members of the subcommittee. Thank you for the invitation to come and talk with you today about the FAR rulemaking process and specifically Federal Acquisition Regulation (FAR) Case 2007-006, Contractor Compliance Program and Integrity Reporting.

Changes to the FAR undergo a long established process following the direction of the Congress, the President, or suggestions from agencies or the public. The proposed changes are assigned a case number and then referred to one of the standing teams. On occasion, an ad hoc team may be formed to address either an unusually complicated matter or a matter that requires special attention. Ad Hoc teams are composed of career civil servants and uniformed members of the armed forces and are drawn from either existing team members or experts sought from the various agencies.

Once a case is assigned to a team, the team develops the language they believe implements the suggested/directed changes based upon their specific expertise and knowledge of the procurement process. If they are making the changes based on statutory or executive direction, their discretion in formulating regulatory guidance is limited by the direction received. If they are making changes based upon suggestions from the agencies or public, their discretion is much broader in terms of evaluating the overall consistency of the proposed/suggested changes with existing policies and practices. The FAR Team Guide may be found at: http://www.acq.osd.mil/dpap/dars/far/attachments/FAR%20Operating%20Guide%20Version%203.pdf.

Once the team completes its assigned work, the case is then sent to the DARC and CAAC for review. Once both Councils have completed their reviews and made any changes they deem appropriate, the case is submitted to OMB's Office of Federal Procurement Policy (OFPP) for review and approval, then to OMB's Office of Information and Regulatory Affairs (OIRA) for its review (including interagency coordination at OIRA's discretion) and approval, then the final rule is sent to the FAR signatories for their review and approval, and then the case is published in the Federal Register.

Currently over 50 cases are being processed, from both statutory and non-statutory origins. Detailed status on all the cases may be found at http://www.acq.osd.mil/dpap/dars/opencases/farcasenum/far.pdf.

FAR case (2006-007) originated from a letter from the Department of Homeland Security as a Katrina hotline poster case. DHS had been asked by senators Lieberman and Collins to require and ensure wide distribution of a fraud hotline poster in hurricane relief and reconstruction contracts. The senators requested that the regulatory action mirror the Department of Defense contract clause contained in the Defense Federal Acquisition Supplement (DFARS) that requires the prominent display of contact information to report fraud, waste, and abuse.

DoD, GSA and NASA took the initiative to make the ethics coverage in the FAR stronger than DHS or the senators had requested. The original request by DHS was to take the existing DoD hotline poster regulation and make it government-wide. The DoD hotline poster clause (252.203-7002) was required "in solicitations and contracts expected to exceed $5 million, except when performance will take place in a foreign country." It was also not required in commercial item contracts (see 252.212-7001). The DoD ethics internal control regulation, in the DFARS at 48 CFR 203.7001, recommended that a "contractor's system of management controls should provide for...timely reporting." This was not mandatory on contractors, as there was no clause binding the contractor.

The FAR case (2006-007) originating from DHS issued a clause for hotline posters, keeping the overseas and commercial items exemption. The FAR case went further by making the ethics aspect mandatory and adding it onto the hotline poster clause.

The final rule had two clauses: one for the Contractor Code of Business Ethics and Conduct and another for the Display of Hotline Poster(s). The introductory paragraph, which provides an exception if the contract is for the acquisition of commercial items under Part 12 or will be performed entirely outside the United States, applies to both clauses. The policy states that all Government contractors must conduct themselves with the highest degree of integrity and honesty, and should have a written code of business ethics and conduct. All contractors should also have an employee business ethics and compliance training program and an internal control system that are suitable

to the size of the company, facilitate timely discovery and disclosure of improper conduct in connection with Government contracts, and ensure corrective measures are promptly instituted and carried out.

As this FAR case was progressing, the Department of Justice (DOJ) submitted a public comment asking that FAR case 2006-007 provide more detail on the U.S. Sentencing Guidelines. DOJ did not comment on the exception for contracts for commercial items or contracts performed entirely outside the United States.

At the same time, DOJ submitted a letter to OFPP setting out DOJ's request to open a new FAR case. DOJ requested changes to the FAR to require contractors to establish and maintain internal controls to detect and prevent fraud in their contracts, and to notify contracting officers without delay whenever they become aware of a contract overpayment or fraud rather than wait for its discovery by the Government. The emphasis of the DOJ letter, and the focus of DoD, GSA and NASA, was on mandatory disclosure, rather than on exemptions. The DOJ request provided that commercial contracts may be excluded from the compliance program requirements. DOJ asked for and received a commitment from OFPP to publish a new proposed rule on an expedited basis. The FAR Council complied with this request by expediting the drafting, finishing, and approving a proposed rule.

The new 2007-006 proposed rule did not totally exempt overseas contracts. The proposed rule applied the new debarment and suspension clauses to overseas contracts. A contractor may be debarred/suspended for knowing failure to timely disclose an overpayment on a Government contract, or violations of Federal criminal law in connection with the award or performance of any Government contract or subcontract. This includes violations on any contract, whether domestic or overseas.

The Law Team modified the proposed rule and will republish for public comment and review. Comments received will be considered in the drafting of the final rule

Mr. Chairman, Ranking Member Bilbray, the FAR rulemaking process is one of the unheralded great success stories in the Federal government's procurement process. It has kept partisan politics out of the business function of government for decades. I hope that you will join me in congratulating the hundreds of career civil servants and the uniformed military members who, over the years, have honed this process and made it work for the American taxpayers and the Federal government. These individuals are truly the unsung heroes of Government. Our colleagues in governments all over the world study our system with envy and try to emulate it where their own customs and cultures allow. I would be happy to answer any questions you may have.

Mr. TOWNS. Thank you very much, Mr. Drabkin.

Ms. Preston.

STATEMENT OF COLLEEN PRESTON

Ms. PRESTON. Thank you very much, Mr. Chairman and Congressman Welch. Thank you for the invitation to testify today on behalf of the Professional Services Council.

PSC is the national trade association of the Government services industry. This year PSC and the Contract Services Association of America merged to form a single unified voice representing the full range and diversity of the Government services sector. We now represent over 340 member companies with hundreds of thousands of employees in over 50 States.

We support the efforts of this committee, the Department of Justice's National Procurement Fraud Initiative, the various agencies, and the Office of Federal Procurement Policy in their efforts to ensure that the Government is protected against fraudulent behavior by contractors whether in the United States or abroad, whether commercial suppliers or Government-only contractors.

We all share the goal of reducing unethical behavior. The question is how best do you do that.

Often what sounds like a simple and sensible proposal, when applied in the context of the realities of the contracting process, can end up having significant unintended consequences and costs far beyond its benefits. We believe that is the case with H.R. 5712, and we oppose it in its present form.

Before going further, I would just like to point out that the Government is currently protected against fraudulent behavior by any number of criminal statutes, the False Claims Act, by contract penalties that may be imposed, and by the suspension and debarment process. These protections apply, whether or not a company is providing a commercial item or whether the contract is being performed domestically or overseas.

Our objections to the proposed legislation are based on the following key factors: First, there is no reason to believe that a mandatory reporting requirement will actually result in reduced fraud or additional opportunities for redress by the Government. Indeed, history suggests strongly that voluntary programs properly structured and supported are more effective tools.

Second, we believe that the voluntary disclosure programs that are in existence now are actually a lot more effective than DOJ claims. The data shows that, while the specific DOD voluntary disclosure program has been experiencing a downturn, there are other equally important DOJ programs that are experiencing an increase in voluntary disclosures. They are projecting the exact opposite trend.

Additionally, there are substantial improvements that could be made in the DOD voluntary disclosure program that we believe would strengthen it without requiring mandatory reporting for every error that may be then subject to the criminal investigation.

We also believe that contractors are making many, many voluntary disclosures outside of the formal program, and we think it would be better served if the Department of Justice and others

would explore why that is occurring outside of the current formal program and if that is a problem if they are occurring.

Third, the exemption from reporting for work performed outside the United States was not added, as you have heard today, at the last second, and in no way changes a company's obligations to adhere to U.S. anti-fraud laws and regulations. What we are talking about in H.R. 5712 is a procedural requirement. These are procedural requirements that are often imposed on Government contractors in the United States that our companies understand. That is not the same when you are dealing with foreign companies who do not operate under the same terms and conditions that U.S. companies do.

Fourth, even the Department of Justice in its comments on the proposed Federal acquisition regulation that this legislation seeks to modify acknowledged that the proposed threshold for mandatory reporting, a reasonable grounds to believe, was too vague and would open the door to potential landslide of unnecessary reports, which have little or no relationship to actually fraud.

As they have also acknowledged, it is both unnecessary and inappropriate to apply this to commercial contracts. The idea of getting commercial items is that the Government would buy under the same terms and conditions in the commercial marketplace that every other vendor does. If you go out to buy a computer, for example, you don't dictate to the company what the terms and conditions are of the sale that they are giving to you. In the same regard, if the Government wants access to the best technology in the world in the commercial sector and commercial services, there are many instances where companies will not abide with agreeing to unique, Government-only terms and conditions.

Six, the proposed legislation would place prime contractors in an untenable position. The vagaries of the mandatory reporting threshold places them at great risk, since it requires them to have a degree of insight, and inside knowledge about the business processes of their subcontractors. Might I add that the legislation provides no threshold for reporting at the subcontract level. We believe the better approach would be to mandate that the Department of Justice enter into discussions with contractors to ascertain why the DOD voluntary disclosure program isn't operating as effectively as they believe it should and to require an assessment of the totality of voluntary disclosures that contractors are making before making any further changes.

We support the continued emphasis on education and training rather than penalties to foster that internal self-governance in companies that will encourage employees to come forward to seek advice, and then if they find that there have been errors or problems or infractions to then come forward and report them.

We strongly encourage companies to do this and we are happy to work with the committee and the Department of Justice to assist in developing processes that will further the goal of enhancing ethical contractor behavior.

Thank you. I appreciate the opportunity to testify. I look forward to your questions.

[The prepared statement of Ms. Preston follows:]

STATEMENT OF

COLLEEN A. PRESTON
EXECUTIVE VICE PRESIDENT, POLICY AND OPERATIONS
PROFESSIONAL SERVICES COUNCIL

BEFORE THE SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION, AND PROCUREMENT OF THE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM U.S. HOUSE OF REPRESENTATIVES

"H.R. 5712"

APRIL 15, 2008

Mr. Chairman, Ranking Member Bilbray, members of the subcommittee, thank you for the invitation to testify at today's hearing. I am Colleen Preston, Executive Vice President for Policy and Operations for the Professional Services Council (PSC).

PSC is the national trade association of the government professional and technical services industry. This year, PSC and the Contract Services Association of America (CSA) merged to create a single, unified voice representing the full range and diversity of the government services sector. Solely focused on preserving, improving, and expanding the federal government market for its members, PSC's more than 330 member companies represent small, medium, and large businesses that provide federal agencies with services of all kinds, including information technology, engineering, logistics, facilities management, operations and maintenance, consulting, international development, scientific, social, and environmental services, and more. Together, the association's members employ hundreds of thousands of Americans in all 50 states.

We support the efforts of this Committee, the Department of Justice's National Procurement Fraud Initiative, the various agencies and Office of Federal Procurement Policy to ensure the government is protected against fraudulent behavior by contractors, whether in the United States or abroad, whether commercial suppliers or government-only contractors.

We all share the goal of reducing unethical behavior. The question is how to best do that.

H.R. 5712 would require contractors to submit a written notification to the agency Inspector General whenever they have reasonable grounds to believe that an employee, agent, or subcontractor has committed a violation of federal criminal law or received a substantial overpayment. It then makes a contractor subject to debarment or suspension for failure to report. These rules would apply to commercial item purchases and overseas contracts with a value in excess of $5 million, as well as to all subcontracts, irrespective of value.

Often, what sounds like a simple and sensible proposal, when applied in the context of the realities of the contracting process, can end up having significant unintended consequences, and costs far beyond its benefits. We believe that is the case with H.R. 5712, and we oppose it in its present form.

Before going further, I would like to point out that the government is currently protected against fraudulent behavior by any number of criminal statutes, including the False Claims Act, by contract penalties it may impose, and by the Suspension and Debarment process. These protections apply whether the contractor is providing a commercial item, or whether the contract is performed domestically or overseas.

Our objections to the proposed legislation are based on the following key factors:

First, there is no reason to believe that a mandatory reporting program will actually result in reduced fraud or additional opportunities for redress by the government. Indeed, history suggests strongly that voluntary programs, properly structured and supported, are far more effective tools.

Second, we believe that voluntary disclosure programs are actually proving far more effective than the Department of Justice (DOJ) claims. In fact, the data show that while the specific DoD Voluntary Disclosure program DoJ referenced may have experienced a downturn, other equally important voluntary disclosure programs have demonstrated quite the opposite trend. Additionally, there are substantial improvements that could be made to the current voluntary disclosure program that we believe would strengthen the program without requiring that every error become the subject of a criminal investigation.

Third, the exemption from reporting for work performed outside of the United States was not added at the last second, as some suggest, and in no way changes a company's obligation to adhere to U.S. anti-fraud laws and regulations. Instead, it is consistent with longstanding U.S. policy and practice in this area which recognizes the difficulties and practical limitations inherent in trying to impose U.S. procedural requirements on firms constituted under the laws and regulations of other nations. This proposed legislation could make it impossible for the U.S. government to contract with entities in nations around the world where our policy is rightly to foster local economic growth by relying on local contractors. It would place similar challenges on the backs of prime contractors operating on behalf of the U.S. government overseas and who are required by contract to subcontract with substantial numbers of host nation companies.

Fourth, even the Department of Justice, in its comments on the proposed Federal Acquisition Regulation that this legislation seeks to codify, acknowledged that the proposed threshold for mandatory reporting – "reasonable grounds to believe" -- was too vague and would open the door to a potential landslide of unnecessary reports which have little or no relationship to actual fraud.

Fifth, as the Department of Justice has also acknowledged, it is both unnecessary and inappropriate to impose this type of mandatory disclosure requirement on contracts for the procurement of commercial items, since doing so violates the very reasons commercial procurement procedures exist. Again, because commercial companies, like any other company, are subject to all of the government's anti-fraud statutes and regulations, the mandatory PROCESS requirements imposed by the rule are unnecessary.

Sixth, the proposed legislation would place prime contractors in an untenable position. The vagaries of the mandatory reporting threshold places them at great risk since it also requires them to have a degree of insight and knowledge about the business *processes and practices of subcontractors at all levels---even those with whom the prime contractor has no privity of contract.*

We believe the better approach would be to mandate that DOJ enter into discussions with contractors to ascertain why the DoD Voluntary Disclosure program may not be operating

as effectively as DOJ would like, and to require an assessment of the totality of voluntary disclosures made by government contractors before making further changes. We support the continued emphasis on education and training rather than penalties to foster that internal self-governance in companies that will encourage employees and others to seek guidance before taking action. And, we strongly encourage companies to voluntarily report to the appropriate government official when errors are made. We will be happy to work with the committee and the Department of Justice to assist in developing processes that will further the goal of enhancing ethical contractor behavior.

Mandatory Reporting Rather than Voluntary Disclosure Is Not a Better Means to Encourage Ethical Contractor Behavior

We are concerned that the requirement in H.R. 5712 that calls for a contractor to report to the agency IG whenever the contractor has "reasonable grounds" to believe an employee, agent or subcontractor committed a violation of federal criminal law or has received a significant overpayment, is a step in the wrong direction, because it would not encourage contractors to disclose overpayments and potentially fraudulent conduct, or ensure that their employees, agents and subcontractors act ethically in the first place.

This mandatory reporting requirement is similar to a Department of Justice (DOJ) proposal now out for public comment as a proposed change to the Federal Acquisition Regulations. DOJ proposed this new reporting requirement because, despite the number of government contractors who have established corporate compliance programs, they assert that "few have actually responded to the invitation of the Department of Defense (DOD) that they report or voluntarily disclose suspected instances of fraud."[1]
While DOJ perceived there has been a lack of sufficient numbers of voluntary disclosure, by defense contractors in particular, they looked only at the number of disclosures pursuant to one specific program. They did nothing to ascertain whether contractors were instead using less formal disclosure mechanisms or reporting under other voluntary disclosure programs (which have had an increase in participation), or whether there had been a reduction in reporting because many companies had instituted effective compliance programs that were in fact reducing fraudulent behavior. They did no analysis to determine why contractors weren't using the formal DoD Voluntary Disclosure program before recommending that the only way to encourage disclosure is to make it mandatory.

As stated in the January 12, 2008 comments on the proposed regulations provided by the Council of Defense and Space Industry Associations (CODSIA)[2] of which PSC is a member, making disclosure mandatory rather than voluntary is a major departure from the long-standing and proven federal policies that encourage voluntary disclosures. Since 1986, DoD's Voluntary Disclosure Program—which DoJ helped sponsor and has continuously supported—has recognized that the *voluntary* participation of defense

[1] Department of Justice Letter to the Administrator of the Office of Federal Procurement Policy, OMB, May 23, 2007.

[2] CODSIA Case No. 01-08, Comments on FAR Case 2006-007.

contractors is essential to achieving greater disclosure of wrongdoing. *Voluntary* disclosure rewards contractors that adopt effective internal controls, shoulder the burden of timely investigating evidence of fraud, and voluntarily cooperate with investigative authorities toward efficient resolution of issues that may or may not constitute violations of federal criminal law. The program has preserved attorney-client and work product privileges and given federal authorities an effective way to recognize, and indeed reward contractors that act responsibly.

By all objective measures, the formal DoD Voluntary Disclosure Program has served the public interest well and yielded substantial monetary recoveries for the government. There are also any number of other voluntary disclosure programs that are highly successful and touted by the DoJ for their success, for example:

- Under the DoJ's Antitrust Corporate Leniency Policy, the number of voluntary disclosures has increased dramatically, making the policy "the Division's most effective generator of international cartel cases and ... the Department's most successful leniency program;[3]
- The number of voluntary disclosures to the State Department Directorate of Defense Trade Controls, which enforces the export control rules increased from 216 in 1999 to 394 in 2004, according to the GAO;[4] and,

- There was a spike in voluntary disclosures of violations of the Foreign Corrupt Practices Act after DoJ adopted a policy of rewarding contractor disclosure and cooperation.

Clearly, if structured correctly, voluntary disclosure programs work!

In addition to the fact that there may be fewer formal DoD Program voluntary disclosures because so many companies have implemented successful integrity programs, we believe there have been many more informal voluntary disclosures – primarily direct to contracting officials, where they are appropriately being resolved as contract matters and the contractor is given the opportunity to take corrective action to ensure the conduct does not occur again. These disclosures most often involve routine billing or other administrative errors that are best resolved at the contract level rather than being immediately elevated to a criminal investigation, as would be the case under the proposed regulation and statute.

CODSIA and PSC also believe that the formal DoD Voluntary Disclosure program is not utilized to a greater degree because of a number of factors that inhibit disclosures. For example, the average time to close a DoD Voluntary Disclosure case is almost 3 years, and there are inadequate protections afforded relative to the use of disclosure reports in other

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[3] See e.g., "An Overview of Recent Developments in the Antitrust Division's Criminal Enforcement Program," presented by Scott D. Hammond (January 10, 2005) (available at http://www.usdoj.gov/atr/public/speeches/207226.pdf).

[4] See Defense Trade: Arms Export Control System in the Post-9/11 Environment (GAO 05-234; February 16, 2005) at 64, available at: http://www.gao.gov/new.items/d05234.pdf .

civil or criminal actions. If these existing weaknesses were addressed, we believe contractors would be more likely to utilize the formal, DoD voluntary program.

There are already powerful incentives to voluntarily disclose fraudulent conduct without additional legislative punishments. First, the U.S. Sentencing Guidelines provide for dramatically reduced penalties for convicted organizations that voluntarily report and cooperate with government investigations. Second, disclosure to the government minimizes exposure to a *qui tam* suit and treble damages under the civil False Claims Act – once the government knows of the facts upon which the alleged fraud is based, no one outside of the government can bring suit. Finally, current regulations provide that, in considering debarment of a company, the debarring official must consider mitigating factors, including whether the contractor timely disclosed the conduct in question, fully investigated such conduct, and disclosed the results of that investigation to the government.

The best way to encourage ethical contractor behavior is to retain a voluntary disclosure process. In the 1980's, the President's Blue Ribbon Commission on Defense Management ("Packard Commission") composed of leaders in industry and commerce, concluded that additional federal rules and regulations that had been adopted in an attempt to foster appropriate government contract behavior had actually resulted in a decrease in individual and corporate ethical responsibility. Rather than striving for responsible decision-making and ethical behavior, companies were focused on complying with the rules and regulations. The Commission concluded that: "The process by which a contractor recognizes and distinguishes responsibility for compliance from a mere façade of compliance is self-governance." It is this culture that ensures that when a problem occurs, "the organization will respond promptly and responsibly to pin down the root cause and take appropriate corrective and disciplinary action."[5]

There are numerous practical problems associated with a mandatory reporting requirement.

"Reasonable Grounds" and Employees Being Trained in the Law

Instituting a mandatory reporting requirement, with the threat of debarment or suspension for not reporting soon enough, will force companies to report precipitously – before they have had an opportunity to do a complete and thorough investigation into whether or not an allegation has any merit. In other words, the proposed legislation creates an extremely vague threshold which will either require the reporting of every individual error even before the company has real insight to determine whether a criminal violation may really have occurred or require that company management literally become legal experts, since they will be charged with interpreting such vague language. Even the Dept. of Justice, in its January 14, 2008 letter to the General Services Administration (GSA), acknowledged that their proposed threshold was too vague and open-ended and thus recommended a modest tightening of the definition. We believe DoJ's proposed modification leaves far too

[5] Letter from the Defense Industry Initiative on Business Ethics and Conduct on FAR Case 2007-008; Contractor Compliance and Integrity Reporting, January 14, 2008.

much uncertainty and far too little flexibility for the company to conduct a reasonable internal investigation, but it is at least an acknowledgment of the dangers of "the reasonable grounds" standard for reporting.

For example, Sally and John, who work on an assembly line at a defense contractor have a nasty falling out over the weekend and Sally breaks up with John, who had accused her of seeing other men. John is particularly upset, and while chatting with his boss in the break room the following week tells him that he saw Sally having lunch with a person he believes is their government contracting officer and that Sally picked up the check. It would appear that Sally may have violated the federal Procurement Integrity law. The boss doesn't know that John is a jilted suitor and has no reason to suspect John's version of the event. The question is, should the boss first call Sally in and ask her version of the events? Should he report the alleged incident through the company's internal ethics hotline, to his supervisor, or to the company's legal office? Or must the boss immediately report this incident to the agency Inspector General, or to the government contracting officer's supervisor? Do we want to require that everyone in a company have sufficient criminal law training to know if an activity might be criminal? Is the statement of a single witness "reasonable grounds" to believe that a violation of federal criminal law occurred? Does it make a difference in determining whether "reasonable grounds" exist to know that John was just jilted by Sally?

We don't know, and virtually every previous attempt to institute similar mandatory reporting requirements in regulation has raised the same questions about the vagueness of the standard that would trigger the requirement to report. Again, it is these practical implications of implementing what sounds like a good idea that cause us grave concern.

Overpayments

It becomes even trickier when you are talking about reporting "significant overpayments." Accounting under any large contract is incredibly complex. It's not as if you looked at your bank statement and all of sudden saw a deposit of $10,000 from the Social Security Administration and you weren't eligible to receive Social Security. In most cases numerous people are involved in billing and receipt. Billing systems are also highly automated. Despite that, mistakes can and will be made by both the government and contractors.

The Federal Acquisition Regulations (FAR) already require that, when an overpayment occurs, the contractor inform the contracting officer and that provisions for repayment be made, contrary to the Department of Justice's statements.[6]

Reporting to the Inspector General Rather than the Contracting Officer Only

If every incident were reported to the agency IG rather than to the contracting officer as a first step, the IG would be inundated with allegations that in many cases have no merit, or are not related to criminal wrongdoing, but rather a mistake or error on an employee's part. Many of these situations could easily be resolved if the company were able to do an internal investigation without the fear that some government official might after the fact conclude, because of the statute's vague language, that they should have reported the

[6] See, 66 FR 65353, December 18, 2001 and 68 F.R. 56667, October 1, 2003.

incident sooner. In addition, particularly in the payment area, it is critical that the contractor's system be reviewed to attempt to ensure that similar mistakes are not made in the future. Moreover, it would be travesty if every billing error were turned into a criminal investigation.

In it's recently released *2007 National Business Ethics Survey*, the Ethics Resource Center found that an overwhelming 90% of employees preferred to discuss possible issues with people they had a pre-existing relationship with – primarily supervisors, higher management, and other responsible persons, such as ethics officers. Perhaps even more important is that employees seek guidance at an early stage before misconduct occurs. It is in everyone's best interest for the contractor to have an effective ethics program, with the ability to do a thorough investigation internally before it makes a report to the government.

If an employee thinks that their company could lose the contract they're working on, or be debarred or suspended and not have any government contract if they report a violation, or that they themselves will be investigated by an Inspector General - they are going to be less likely to disclose, not more. The better course of action in many cases is to be able to resolve disputes in an administrative fashion – to take appropriate action against an offending employee, make monetary restitution to the government, and work to ensure that the behavior will be prevented in the future. That is the key – not punishment! But once a matter is reported to the IG as a potential criminal fraud matter, under the Contract Disputes Act the contracting officer is no longer authorized to settle the matter – only DOJ is. As a result, even the most routine disclosures, made to the IG out of an abundance of caution and fear of violating the reporting requirement and being debarred or suspended, will take years to resolve.

Failure to mandatory report basis for debarment or suspension
The government already has the right to suspend or debar a contractor to avoid having to contract with an unscrupulous contractor. Suspension and debarment is not designed and should not be used as an additional penalty for behavior that is already the subject of criminal or civil penalties. Voluntary reporting of the offending behavior is already an element to be considered in mitigation by the debarment or suspension authority when determining whether debarment or suspension is appropriate. Making failure to report a basis for debarment or suspension on its own is effectively forcing a contractor to incriminate itself in order to avoid being banned from what may be its only market. In addition, the practical issues arise again – what if an employee - even a manager or supervisor commits fraud? They are likely to do everything in their power to conceal the crime from anyone else in the company. Will that failure to report on themselves give rise to a debarment or suspension of a company, effecting potentially thousands of innocent co-workers?

Exclusions from Coverage for Commercial Items and Overseas Contracts

The exclusion for application of the proposed regulations to contracts performed entirely outside the United States and when the contract is for the acquisition of a commercial item

is identical to the scope of coverage in the FAR Contractor Code of Business Ethics and Conduct final rule published on November 23, 2007, and the previous Defense Federal Acquisition Regulation on which it was based. That regulation has been in existence since 1988 with the exclusion for overseas contracts. The exemption for Commercial Items resulted from the directive in the Federal Acquisition Streamlining Act to minimize the number of government-unique requirements imposed on commercial suppliers so that the government would have access to commercial technology and innovations in the commercial sector.

Exclusion for Contracts Performed Entirely Outside the United States
We have made it a policy in Iraq, Africa, the Middle East, and virtually anywhere in the world that we provide assistance, to utilize local companies to the maximum extent possible - whether as prime contractors or subcontractors to U.S. companies. The exclusion for contracts performed entirely outside the United States is based on the fact that while all contractors, anywhere in the world are subject to U.S. criminal fraud prosecution for their activities on U.S. contracts, it is unreasonable and impractical to expect foreign firms to be able to comply with the unique procedural requirements the U.S. government imposes on its government contractors. A local cement provider in Kuwait, or a family-run plumbing contractor in Iraq, cannot be expected to be aware of and to effectively institute an ethics or reporting program that would comply with U.S. standards. Of course, those firms are entirely liable for adherence to U.S. anti-fraud laws of all kinds, but the companies are constituted under their own country's laws and standards. How can we expect these companies to understand American rules of jurisprudence such as "a reasonable grounds to believe" when we can't define them sufficiently ourselves?

Similarly, the flow-down requirements of the proposed legislation are also problematic. Simply put, it is even more unreasonable and impractical to expect prime contractors to know the details of the internal business operations and practices of all of the subcontractors involved on a project, particularly those at lower tiers with which the prime contractor has little or no relationship. It is equally unreasonable to hold prime contractors responsible for reporting potential violations based on a standard that is so vague, whether the subcontractors are performing in the United States or abroad.

Exclusion for Commercial Items
The general exclusion of commercial items from regulations that dictate specific internal company policies and procedures is a result of the directive in the Federal Acquisition Streamlining Act to minimize the number of government-unique requirements imposed on commercial suppliers so that the government would have access to commercial technology and innovations in the commercial sector. The issue is not whether laws precluding fraud and requirements to return overpayments apply to contractors providing commercial products – they do. Rather, the issue is whether companies from whom the government buys, just like any commercial purchaser, should be forced to accept government-unique contract terms and conditions. Even DOJ, in its January 14, 2008 letter providing comments on FAR Case 2007-006, supported the exclusion of the mandatory business ethics, compliance and reporting clause for commercial items contracts.

The government must have access to the best technology and services offered in the commercial marketplace. Numerous policies over the years have instituted a requirement to use commercial products before paying to develop government-unique products or services. While there are certain government-unique clauses included in commercial contracts, including the current regulatory requirement to report to the contracting officer if the contractor believes a violation of law has occurred, it is unrealistic to assume that companies that sell all over the world are willing to accept the risk of a "black mark" such as might occur under H.R. 5712 to protect what is typically a tiny share of their market. Remember also that there are already significant incentives to report fraud or other criminal behavior.

Conclusion

Abandoning well-established principles of self-governance and voluntary disclosure in favor of mandatory disclosure as proposed by H.R. 5712 will result in less disclosure of potentially fraudulent activity and less opportunity for contractors to work with the government to improve their ethics practices and procedures. Mandatory disclosure raises numerous legal issues, including the protection from self-incrimination that companies are able to resolve in a voluntary disclosure environment. Contractors that would knowingly violate criminal laws are not going to be persuaded to stop because another law says they must now report when they do violate the law. Instead, mandatory disclosure and the additional provisions of H.R. 5712 add additional risk that contractors who are trying to behave in an ethical manner will get tripped up in and incur additional penalties, if not total banning from government contracts.

We agree that stopping unethical behavior is the right goal, the only question is, how best to do that. We believe the better approach would be to mandate that DOJ enter into discussions with contractors to ascertain why the DoD Voluntary Disclosure program may not be operating as effectively as DOJ would like, and to require an assessment of the totality of voluntary disclosures made by government contractors before making further changes. We support the continued emphasis on education and training rather than penalties to foster that internal self-governance in companies that will encourage employees and others to seek guidance before taking action. And, we strongly encourage companies to voluntarily report to the appropriate government official when errors are made. We will be happy to work with the committee and the Department of Justice to assist in developing processes that will further the goal of enhancing ethical contractor behavior.

On behalf of the Professional Services Council, I appreciate the opportunity to provide our comments on the important issues before the subcommittee and I look forward to any questions you may have. We also look forward to working with the subcommittee as you continue your deliberations on this legislation.

STATEMENT REQUIRED BY HOUSE RULES

In compliance with House Rules and the request of the Committee, in the current fiscal year or in the two previous fiscal years, neither I nor the Professional Services Council, a non-profit 501(c)(6) corporation, has received any federal grant, sub-grant, contract or subcontract from any federal agency.

BIOGRAPHY

Colleen A. Preston joined PSC as Executive Vice President for Policy & Operations during the association's merger with the Contract Services Association. Prior to accepting her position at CSA, Ms. Preston was a consultant focusing on the federal acquisition process and business process reengineering.

From 1993-1997, she held the newly created position of Deputy Under Secretary of Defense for Acquisition Reform, where she led a small team that provided the catalyst for reengineering and improving the Department of Defense acquisition process through internal process, regulatory and legislative (Federal Acquisition Streamlining Act and the Federal Acquisition Reform Act) changes.

For six months prior to becoming deputy undersecretary, Preston was the Special Assistant to the Secretary of Defense for Legal Matters, advising the Secretary of Defense on all legal issues coming before him and handling the legal, ethical and financial issues arising out of the appointment and Senate confirmation of the Department of Defense Presidential appointees.

Before her stint at DoD, she served for 10 years as the primary legal advisor on acquisition policy issues for the Committee on Armed Services, U.S. House of Representatives, beginning with her assignment with the Investigations Subcommittee and ending as General Counsel to the full committee. She was instrumental in the development of numerous acquisition improvement measures, such as the Competition in Contracting Act, the Small Business and Federal Competition Enhancement Act, acquisition provisions of the Goldwater-Nichols Act, and the Defense Acquisition Workforce Improvement Act.

She came to the committee staff after 4 years as an attorney/advisor in the Office of the General Counsel, Secretary of the Air Force, where in addition to providing legal guidance on acquisition issues, including bid protests, she acted as counsel to the Air Force Contract Adjustment, and Debarment and Suspension Boards.

Ms. Preston received both her Bachelor of Arts in Political Science and her Juris Doctor with Honors from the University of Florida, where she was a Law Review Student Works Editor. She received her Masters of Law, with emphasis on government contracting, from Georgetown University.

She is the recipient of numerous awards, including the National Contract Management Association (NCMA) Herbert Roback Award, the Department of Defense Distinguished Civilian Service Medal, the Defense Acquisition University Alumni Association David C. Acker Award, and a four-time recipient of the Federal Computer Week Federal 100 Award. She is a member of the Florida Bar and a Fellow, NCMA.

Mr. TOWNS. Thank you very much. I thank all of you for your testimony.

Let me begin with you, Ms. Preston. So you are saying that H.R. 5712 is not necessary?

Ms. PRESTON. We are saying that we believe that better approach is—yes, the short answer would be that it is unnecessary. We believe that through the regulatory process we have had the opportunity to explain a lot of the concerns that have come about as a result of the Department of Justice's proposal, and that, if you look at the behavior of companies and employees in those companies, you are much more likely to get not only reporting if there is unethical behavior, but also cures to make sure that act or problem doesn't occur again if you have a voluntary program.

Mr. TOWNS. Mr. Sabin, what do you say to that?

Mr. SABIN. With respect to the legislation?

Mr. TOWNS. Yes.

Mr. SABIN. The Department of Justice and the task force proceeded through the regulatory route. We thought that would be an appropriate means and an appropriate mechanism for addressing the concerns. We wanted to instill strong ethics, business corporate compliance, and the like, and we felt that working through the interagency process, that the regulatory mechanism, as articulated by Mr. Denett, is an appropriate vehicle by which to do that.

In terms of the legislation proposed by Congressman Welch in recent days, we don't have a formal Department of Justice views letter or position with respect to that piece of legislation. So, our initial preference is to proceed through the regulatory mechanism before going through the legislative process.

Looking at the actual bill, we would be happy to sit down with staff, with you, but we can, at least on initial observation, see some deficiencies, both technical, definitional, and the like, to work through if the legislation proceeds. But, I don't come before you today with a Department of Justice views based upon the recency of the proposed legislation.

Mr. TOWNS. All right. Mr. Denett, don't you think that something needs to be done? I mean, I think it was Mr. Sabin who talked about 46 cases. And let me just say to you that I know there are a lot of others. So, don't you think we need to do something?

Mr. SABIN. Well, Congressman, we are doing something. The things that we have out now are unprecedented. We are advancing the ethical behavior with contractors more than has ever been done, so we are pleased by that. We are requiring them to have ethics training, internal reporting mechanisms. We are requiring them to inform us when they have done criminal activity. So to me this is major initiatives that have gone forth in the last several months.

The fact that we are now giving serious thought to getting rid of the exemption for overseas and commercial, that is a significant change from what we proposed a short while ago.

So in order for us to fully vet that and get comments from everyone—the American Bar, various companies, associations—we think that they are owed the opportunity, since that is in the works, to have a chance to vet their views so that we know everybody's view

on this before a final decision is made. I think to legislate without that input is not a wise choice.

Mr. TOWNS. Well, you know, let me just go back to you again, Ms. Preston, because you are saying that voluntary is fine, voluntary disclosure. You say that is fine, voluntary?

Ms. PRESTON. Yes, Mr. Chairman.

Mr. TOWNS. Right, and, Mr. Sabin, you are saying mandatory is what we need?

Mr. SABIN. We believe that in this context, in the procurement fraud context, it has not been working. The data does not reflect that voluntary disclosures to, for example, the Department of Defense Inspector General has declined, especially in recent years. Indeed, we are not aware, over the past 2 years, of any disclosures, voluntary disclosures, from the top 15 contractors relating to fraud and material over-billing.

So in that realm, with the increased spending that is occurring in national security and the like, we believe that and our recommendations were to have a mandatory disclosure obligation.

Some of the voluntary disclosure programs that are referenced either in Ms. Preston's written statement or in her remarks this morning, we believe are sort of misplaced with respect to the application in this reign. For example, the antitrust program that is referenced in her statement in the Department of Justice that provides amnesty is one in which it is for the company reporting about other companies, as opposed to the particular company that is disclosing, which would be in the procurement fraud context about either conduct that occurs within that corporate structure. So, to apply other voluntary disclosure programs, which can work in other contexts, to this one we believe is misplaced.

Ms. PRESTON. Mr. Chairman, as Mr. Sabin said, there are other programs that have worked very well and are working, and the reporting under those voluntary programs is increasing.

If I understand what he is saying is basically that because they haven't had a voluntary report from the top 15 contractors, there is an assumption that there is fraud that has been unreported. Most of those companies belong to and are probably signatories to the Defense Ethics Initiative and other things. They have instituted strong, strong ethics programs with reporting.

Many of the reasons that people do not report, as we are told, under the DOD voluntary disclosure program is that once they do, it becomes a criminal process that takes up to two to 3 years to resolve. Most of the times, the companies will report to a contracting officer if there is not fraudulent conduct. And, it turns out that if it can be handled through an administrative process, they will do it that way, and that is much preferable to them to be able to resolve the situation, to punish the employee, to figure out why it happened in the first place, and to work out a system with the Government so that they can improve the program that they do have and make sure it doesn't happen again.

So, I think to say that just because they haven't had a report from 15 companies doesn't mean that the program is not working. All we are asking is, sit down with us, figure out why the program isn't working. Let's see if we can make it work by getting rid of

some of the impediments that are causing people not to report under it.

Mr. TOWNS. My time has expired, so I yield now to Congressman Bilbray.

Mr. BILBRAY. Justice Department, I assume, has made some suggestions on some numbers changes in the rulemaking, right?

Mr. SABIN. Yes, we have.

Mr. BILBRAY. Including the suspension language. Do you intend to add any other language or have any other recommendations specifically to the rulemaking?

Mr. SABIN. We had on January 14th provided a number of detailed recommendations and suggested language with respect to 2007–006. To the extent that, as Mr. Denett indicated, additional materials would be circulated, either in interagency process or published for additional comment, we would actively engage in that to ensure that the task force's views and the Justice Department's views are provided.

Mr. BILBRAY. Are you comfortable with how FAR has vetted this with stakeholders such as Ms. Preston?

Mr. SABIN. Yes. I believe the notice and comment period provided for extensive opportunity for specifics to be addressed, that there were a number received by both Inspector Generals, law enforcement community, as well as law firms and others in private industry, and we have had dialog with a number of those to ensure that we are trying to be surgical, reasonable, and thoughtful in how to establish what, I think, we all share common ground on, which is a rigorous business and ethics compliance code.

Mr. BILBRAY. With the progress we have made on the rulemaking, do you think this legislation is essentially needed or advisable?

Mr. SABIN. Our position has been that in the first instance the rulemaking should proceed forward rather than the legislative this year.

Mr. BILBRAY. Your point is the rulemaking should move forward and then, we will see what we should do with legislation?

Mr. SABIN. That is where we are. We do not have further Justice Department views on the particular legislation.

Mr. BILBRAY. OK. Thank you, Mr. Chairman. I yield back. Can I yield to the chairman, please?

Mr. DAVIS OF VIRGINIA. Closing loopholes always sounds good, but when the loophole just turns out to be an exemption inadvertently transported into a proposed rulemaking, this bill applies a blunt instrument process to a process that requires delicate surgery.

This bill provides that a known failure to report violations is a criminal law when it is related to a Federal contract. It would be a cause of debarment or suspension for all concerned, including those holding contracts performed overseas or contracts for commercial items.

That is exactly the coverage currently contained in much more lengthy proposed regulation. What's all the fuss about? The proposed rule does include an exemption for overseas and commercial contracts, but the exemption applies only to the establishment of internal ethics and programs and control systems.

The enforcement of debarment and suspension for failure to report would apply to all contractors, even without this bill. While it may or may not be good policy to apply all or some of the internal programs to overseas or commercial contractors, the frenzy accompanying the bill hardly seems justified.

This does not make a significant change to the substance of the proposed rule, but it does leap from the statutorily designated process for writing acquisition regulations and in statute a novel reporting scheme yet to be completely vetted.

The concept of mandatory reporting by contractors of possible criminal violations based on reasonable grounds is unprecedented and controversial. The rule is the subject of more than 70 comments, and only two of those commentators are present today. We expected many of the firms subject to the rule to express serious concerns. They argue a company could well face the loss of the ability to do business with the Government based on highly technical interpretations of what constitutes a criminal law violation.

I admit that debarment and suspension are to protect the Government, not to punish companies. That has always been the underlying policy. None of the witnesses today, including the Department of Justice, support this bill, and they urge justifiable statutorily mandated regulatory process to take its course.

We understand the new proposed rules to be issued any day now, which will, among other things, correct the exemptions and internal ethics awareness and control programs and call for another round of comments.

In stark contrast to open and very deliberate and open process, today is the first and the only hearing on this bill. Tomorrow at 9:30 a.m. members of the full committee will be asked to consider and approve this proposal, which appears designed to close more political holes than legal ones.

Thank you. Thank you, Mr. Chairman.

[The prepared statement of Hon. Tom Davis follows:]

HENRY A. WAXMAN, CALIFORNIA
CHAIRMAN

TOM DAVIS, VIRGINIA
RANKING MINORITY MEMBER

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STATEMENT REP. TOM DAVIS
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HEARING ON H.R. 5712
APRIL 15, 2008

"Closing loopholes" always sounds good. But when the loophole in question turns out to be an exemption inadvertently transported into a proposed rulemaking, this bill applies a blunt instrument to a process that requires delicate surgery.

H.R. 5712 would provide that a knowing failure to report violations of criminal law and overpayments related to a federal contract can be a cause of debarment or suspension for all firms, including those holding contracts performed overseas and contracts for commercial items. This is exactly the coverage currently contained in a much maligned proposed regulation. What, then, is all the fuss about? The proposed rule does include an exemption for overseas and commercial contracts – but the exemption applies *only* to the establishment of internal ethics awareness programs and control systems. The enforcement of debarment and suspension for failure to report would *apply to all contractors even without this bill.* While it may or may not be good policy to apply all or some of the internal programs to overseas or commercial contractors, the frenzy accompanying this bill hardly seems justified.

H.R. 5712 does not make a significant change to the substance of the proposed rule. Nevertheless, it would leapfrog the statutorily designated process for writing acquisition regulations and encase in statute a novel reporting scheme yet to be completely vetted. The concept of mandatory reporting by contractors of possible criminal violations based on "reasonable grounds" is unprecedented and controversial. The rule was the subject of more the 70 comments. As expected, many of the firms subject to the rule expressed serious and legitimate concerns about the proposal. They argued a company could well face the loss of the ability to do business with the government based on highly technical interpretations of what constitutes a "criminal law" violation.

It appears none of the witnesses appearing today, including the Department of Justice, support this bill and they urge us to allow the statutorily-mandated regulatory process to take its course. We understand a new proposed rule is to be issued any day now which will, among other things, "correct" the exemptions to the internal ethics awareness and control programs and call for another round of comments.

In stark contrast to that open and deliberative process, today is the first – and only - hearing on this bill. Tomorrow at 9:30 am, Members of the full Committee will be asked to consider and approve this proposal, which appears designed to close more political holes that legal ones.

Mr. TOWNS. Thank you.

On that note I yield to the author of the bill, Mr. Welch.

Mr. WELCH. Thank you, Mr. Chairman. There are really two very simple questions. One, how is it that the original rule was proposed that would require reporting for domestic contracts but not for foreign contracts? And then the second is the need for the statutory protection to give the benefit of protection to the taxpayer.

Mr. Denett, I am going to ask you a little bit about this. The original rule that was proposed had a requirement for fraud reporting if it was a domestic contract, correct?

Mr. DENETT. Yes.

Mr. WELCH. And it did not include a requirement for reporting if that taxpayer dollar was spent abroad, correct?

Mr. DENETT. Well, the work group of career people that worked on it, when they looked at the fact that Defense Department had exempted overseas for earlier requirements, such as these posters, they decided not to include overseas in it.

Mr. WELCH. OK. Let me ask you this: in your mind, does a taxpayer dollar spent abroad deserve any less protection from waste, fraud, or mismanagement than a taxpayer dollar that is spent here in the United States?

Mr. DENETT. Well, as I stated in my opening remarks, I am inclined to remove the exemption, but I am not comfortable——

Mr. WELCH. I'm asking a simple question: does the taxpayer dollar abroad deserve the same degree of protection as a taxpayer dollar spent here at home?

Mr. DENETT. All our tax dollars, regardless of location——

Mr. WELCH. All right. We all agree on that, I take it. All right? So isn't it your job, among other things, at OMB to take appropriate action, including rulemaking, to protect all taxpayer dollars, regardless of where those taxpayer dollars are being spent?

Mr. DENETT. That is, in fact, what we are doing.

Mr. WELCH. And now, you have proposed this rule, and you are now suggesting that you want to amend it so that it does incorporate suggestions that were made to you by the Department of Justice to include foreign contracts, correct?

Mr. DENETT. That is correct.

Mr. WELCH. All right. I want to know, if you can explain it, how it is in this rulemaking process where you sent out for comment the rule that had this exception for foreign contracts—you sent it to Homeland Security, the SBA, the Department of Labor, Veterans Affairs, Defense, Housing and Urban Development, Transportation, Agriculture, Health and Human Services, State, Interior, Treasury, and so on, 18 different agencies. None of them comment, with the exception of Justice, about the oversight of leaving outside the protection of taxpayer dollars that were spent abroad?

Mr. DENETT. That is what I am told.

Mr. WELCH. All right. We have, thanks to documents that have been provided, a couple of e-mails that were sent out probably to 50 to 80 people who had an opportunity to comment, and with the exception of one comment from the Social Security Administration, nobody in this extensive process that you go through flagged this failure to include subject to the rule foreign contracts?

Mr. DENETT. That is correct. The focus was on creating ethics standards for the first time ever, requiring mandatory——

Mr. WELCH. Wait a minute. The focus is on protecting taxpayer dollars. How did we get from here to there? You did have a comment from the Social Security Administration, of all places, that stated very explicitly under this proposed rule contracts performed by a U.S. company on foreign soil would be exempt. Did you respond to that comment by the Social Security Administration?

Mr. DENETT. I did not. I don't know if GSA, who had members on there——

Mr. WELCH. So the answer is no. Why did you take the advice offered by the Department of Justice?

Mr. DENETT. As I said earlier, our focus was on making major improvements, which in fact we did. This group of career civil servants that labored over this for many weeks put forth to us something that did not include overseas contracting.

Mr. WELCH. Mr. Drabkin, what about the GSA? We went through this extensive process, e-mails and comments from people all across Government, and no one, with the exception of somebody from Social Security Administration, flagged this separation between domestic and foreign?

Mr. DRABKIN. Yes, sir. What happened at the CAAC meeting when the rule was discussed, a Social Security representative—and I was informed of this today, not when I spoke with your staff members on Friday—but the Social Security member to the CAAC did raise the issue. There was a brief discussion, and that same member withdrew the issue and the rule went forward. At the time——

Mr. WELCH. This is the first——

Mr. DRABKIN. If I may, Mr. Welch——

Mr. WELCH. No. You have answered it.

Mr. DRABKIN. No, sir, I haven't.

Mr. WELCH. You actually haven't is right, but do you support change in the rule so that it includes foreign contracts as well as domestic contracts?

Mr. DRABKIN. Sir, I support the process, and the process we are going through now, and I support taking public comments. Since I am one of three people that get to vote on the rule and sign it, it would be inappropriate for me in advance of that process being complete to tell you where I sit, although Mr. Denett has made it clear to us what the administration's policy is, and we generally follow the administration's policy at this point.

Mr. WELCH. Fair enough. Thank you.

Ms. Preston, you represent the Professional Services Council. It is over 300 contractors.

Ms. PRESTON. Yes, sir.

Mr. WELCH. And your boss, I think, was on record as saying that they do not want this rule; is that correct?

Ms. PRESTON. Yes, sir, that is correct.

Mr. WELCH. I listened to your testimony, and, frankly, I think we are talking about, in some respects, two different things. This rule and this legislation does not require any of your member companies to become private Inspector Generals. This requires them to report when they have knowledge about waste, fraud, or abuse. I mean,

what are you so afraid of if, let's say, Bechtel and the $150 million that went to $160 million and $169 million contract in building the Basrah Children's Hospital, if they become aware of fraud why wouldn't we have an expectation, on behalf of the taxpayers, that they would report that?

Ms. PRESTON. The reason that there is concern is because of the standard and creating a standard for when it is. That——

Mr. WELCH. I hate to interrupt, but I don't have much time. That goes to the terms and conditions and perhaps the language of the statute or the rule, but why would any of your contracting entities that you work for—Blackwater, Triple Canopy, KBR—companies that have received billions of dollars in taxpayer dollars, why would they have any reservation about sharing with the Government knowledge that they have when they have it that taxpayers are being ripped off?

Ms. PRESTON. There isn't any question that they would share that information if they knew it. The question is: how is it drafted in terms of particularly the legislation, and what are the risks that they incur? So they——

Mr. WELCH. So you don't want any statutory either rulemaking obligation. You want them to have voluntary capacity to do this, so when in doubt they make the final decision?

Ms. PRESTON. Because if they voluntarily can report, then they will report when they understand something. It is the practicalities of what happens. So if you are the contractor—and many of these contracts, as you said, are over in Iraq—you are the contractor who has five levels of subcontractors. The subcontractor that is doing the plumbing on that building, they probably——

Mr. WELCH. Or not doing the plumbing on that building.

Ms. PRESTON. The prime contractor is not in privity of contract with that subcontractor and may not have——

Mr. WELCH. I don't have much time, so——

Ms. PRESTON. Say one of those employees——

Mr. WELCH. I yield the balance of my time. I'm sorry.

Ms. PRESTON. Say one of those employees overhears one of the Iraqi nationals saying to a friend, I just got someone to work for me at $10 an hour and I was able to charge the Government or charge my prime contractor $15 an hour. An employee of the prime contractor hears that. Does he then immediately report that as being a case of fraud? He doesn't know if the person was bluffing. He doesn't know whether or not there has been a violation of law. He doesn't know if that is unethical behavior. He doesn't really know what happened.

The concern is that if he doesn't immediately report it and it later turns out to be some type of fraudulent or unethical behavior, that company could be debarred, the whole company, for something that someone overheard in a conversation out on the——

Mr. WELCH. Mr. Sabin, would you debar that company?

Mr. SABIN. It would look to the specific facts and circumstances relating to the matter. We have limited resources, and we would use our enforcement and investigative resources appropriately. I think we could have common ground at what could be appropriate standards and manners in which disclosures could be made subject to internal investigation by the company to root out the particular

facts so that expeditiously the referral was made in a thoughtful and proper manner.

Mr. WELCH. Thank you.

Thank you, Mr. Chairman.

Mr. TOWNS. I now yield to the gentleman from Virginia, Mr. Davis.

Mr. DAVIS OF VIRGINIA. We seem to have different philosophies here. My philosophy in Government contracting is: you want to get the best deal for the taxpayer, and to do that, you want as many bidders in the process or as many companies and ideas coming in as possible.

What I hear coming from some other Members is, we want to reduce this. We want to debar people. We want to put up restrictions so you have fewer people, and that means less competition, which at the end of the day means we end up paying more and getting less.

Ms. Preston, you have a long record in this, going back to when I was a Government contracts attorney back in the 1980's. You remember the procurement integrity certifications and everything that came out. You note that many commercial companies would be unwilling to accept the risk level that is levied upon them by the mandatory self-reporting requirements in this bill. Do you think the self-reporting regime will cause such companies to walk away from the Federal market, or parts of it?

Ms. PRESTON. I do believe that there are many companies now who sell commercial products to the Government who are very concerned that——

Mr. DAVIS OF VIRGINIA. The downside is raised so much.

Ms. PRESTON. That the costs of doing business with the Government are increasing, and every single provision that gets added on, there will come a time when there is the straw that breaks the camel's back.

Mr. DAVIS OF VIRGINIA. Is there a high cost of compliance with the proposed self-reporting regime, and is this high cost or is this a very marginal cost for a company as you look at it?

Ms. PRESTON. No. I believe that when you put on the threat of debarment, suspension in the way this legislation is drafted, that it will cause companies to increase dramatically some of the costs of doing business, but it is the risk that is the biggest factor. It is the unknown that really causes people concern.

Mr. DAVIS OF VIRGINIA. We did a hearing a couple of years ago that noted some of the largest companies in America still refuse to do business with the Federal Government. They will work through intermediaries, re-sellers, and the like, but they are very nervous for a number of reasons. Some of it is the liability, some was protection of IP, some of it is separate accounting systems. We tried through time to try to attract these companies—many of them are very large—into the Federal marketplace so we can get better deals for taxpayers instead of having to go through re-sellers.

But this is just another, it seems to me, lower of the unintended consequence of trying to protect consumers. In point of fact, it may drive away competitors.

Ms. PRESTON. Exactly. We believe that it will. We believe that the voluntary process works well. It is an incentive to companies.

Companies have tremendous incentives to report. One is if they do they avoid the potential of a suit. They get leniency under the U.S. sentencing guidelines. That has been a dramatic factor in incentivizing companies to voluntarily report.

We think that process is working well and allows them to operate within the context of the ethics programs that they have established within their companies.

Mr. DAVIS OF VIRGINIA. Mr. Drabkin, let me ask, do you have any reason or any evidence that the alleged loophole for the contracts performed overseas or for commercial items was nefariously slipped in the proposed rule at the 11th hour to try to give contractors a free ride to defraud taxpayers?

Mr. DRABKIN. No, sir. Quite frankly, I am offended that the suggestion was made without a scintilla of evidence that suggested that was the case. In fact, for many months prior to this hearing there have been suggestions floating around that somehow someone influenced one of these career civil servants to put that in. That is absolutely not true.

The truth of the matter is they made a drafting error. They copied and cut and pasted language from 2006–007. They put it into 2007–006. They didn't give any great thought to whether or not the exemption made sense or not. They were in a hurry and they processed a rule. Quite frankly, sir, the suggestion that has been made by some folks around town that these folks did wrong is just horrible. It is an offense.

Mr. DAVIS OF VIRGINIA. In point of fact, in procurement in general, whether it is contract managers, procurement officials, we are having a hard time recruiting good people into this business, aren't we?

Mr. DRABKIN. Sir, we are not meeting what anybody calls a recruitment goal. We are barely staying even. We add additional requirements each day to what a contracting officer does, and then we impugn their honor and their integrity without a scintilla of evidence, not a single bit of evidence. Why would they do this? Ask yourself why would they sign up to do this. You don't pay them any extra. They're not the ones that get to go and travel. They are not the ones that get to go to big, giant institutions for education. They work 60 to 80 hours a week to get the job done. They don't ask for overtime, and we impugn their honor and integrity because we—well, I had better stop.

Mr. DAVIS OF VIRGINIA. I represent 5,400 Federal employees and a number of contractors, as well, and most of them are very hard working and try to do their job, and once in a while you make a mistake, as we do, I might add, up here. We make a lot of them. Hence, we have a $9 trillion deficit.

Thank you very much.

Mr. TOWNS. Thank you very much.

At this time I will go a second round.

Ms. Preston, what do you feel could be done to fix this legislation? What do you feel, or is it a fact that you just feel that we should not be involved in the process at all?

Ms. PRESTON. Well, I don't believe the legislation is necessary at this time. I think the regulatory process is working well. We have concerns about the regulations the way they have been drafted,

and particularly the new exclusions. We will get the opportunity to comment on those, as well.

But, certainly we think that, at least in the regulatory process, you have an opportunity to have every voice heard and to explore further the particular impact of changes that we don't necessarily get in the legislative process.

Mr. TOWNS. Right. You know, it is interesting, though, that most people just oppose legislation, period. Sarbanes-Oxley, I will never forget in terms of people coming up and opposing it and opposing it and opposing it, and at the same time they were saying there were some problems. So if we have some problems, how do we fix the problems?

Now, I think with Mr. Sabin, who indicated that those 46 cases—anyway, I think, going back to the money, I think there was $102 billion we spent over the last 5 years to help rebuild Iraq and Afghanistan, and, of course, they cover at least $14 million in contract bribes. Well, even with this structure we are finding bribes. So, I think that there are some serious problems, and I think that we cannot sit back and just sort of ignore the problem. I think something needs to be done.

Now, if H.R. 5712 is not the answer, then I think we should talk about what needs to be done, but to say that legislation is not necessary, I can't quite accept that. I think that it is too serious to just sort of pass off the fact that making a decision to volunteer the information they give to you. I don't think that we can really move forward with that in mind, with the fact that the kind of money that is being spent and knowing—and everybody sitting at that table knows there are some problems. Nobody said there are no problems.

Ms. PRESTON. And, Mr. Chairman, we certainly do not advocate any of the activity that is going on that is unethical in any form whatsoever. The fact that it is being found and prosecuted is, I think, a good news story that people are finding out about what is happening and prosecuting those people who have acted unethically. That should definitely happen.

What we are talking about here is not whether or not people will be prosecuted for fraudulent behavior; it is a question of a reporting mechanism to—what people believe is the tool to make sure that we do, in fact, find out about whether or not there is fraud. That is the issue. It is not whether or not people are being prosecuted or not; it is how you get there.

We are saying that you are more likely to get companies to self-report if you don't hit them with punishment and other things in addition to the penalties that already are associated with whatever activity occurred. That is the only question is how you get there.

Mr. TOWNS. Well, I think that we need to help them get there, and I think that H.R. 5712 sort of helps them to get there.

You know, I think that we need to do something, and if this is not the answer I want to hear something from you other than, "continue to trust them." That is what I really say, because, you know, we are spending a lot of money. That is $102 billion. That is B as in Boy. That is a lot of money.

Ms. PRESTON. I certainly agree, Mr. Chairman, and I am not asking to trust them. I am pointing out that there are incentives al-

ready in place that are much more powerful than a mandatory reporting requirement, which has many pitfalls associated with it; that there are so many more incentives that would cause a company to report a violation if they found one.

If you are knowingly violating the law, you are not likely to self-report. The chances are if somebody is embezzling in one of your companies, they are not going to tell anybody else. They are not going to self-report. They are not going to report themselves. If someone else finds out about it, they are much more likely to report it in a system where they know the company won't be punished in a way that hits them instead of the offending person.

If it is your colleague next door and you find out that they are embezzling, you want that colleague punished. You want them thrown out of the company. You want them prosecuted, but you don't want yourself and the rest of your fellow colleagues hurt, like you would be if you were debarred or suspended.

Mr. TOWNS. Let me say that it does not appear to me that the Federal contractors are being asked to do anything that is not already expected for their counterparts in other industries. To me, it doesn't appear to be any different. I guess I need to yield to the author of it, but it seemed to me that when I look at Sarbanes-Oxley and others, you know that we are asking the same thing really. I don't understand the resistance here.

Yes, sir, Mr. Sabin?

Mr. SABIN. I think Ms. Preston's points—we share some common ground there with respect to the desire that sentencing guidelines provide a foundation by which risk is taken out of the equation for corporations in terms of their reporting. I think we share common ground that we want to increase incentives so that corporate individuals, both employees and management, understand the consequences and understand the process. Process is important, as well as substance. So we get to, as she indicated, the mechanism by which that can occur so that we can achieve, both in terms of corporate culture as well as other appropriate goals and objectives, including law enforcement, that goal.

I think the flaw in her analysis is that the present system is working in terms of that kind of information flowing either to the contracting officer or to the Inspectors General, because the indication that was received when we looked at this matter through our interagency process is that those referrals were not coming, even though there has been an extraordinary increase in terms of Government spending, and that the idea is that there needs to be thoughtful prosecutional discretion that it not linger in terms of the investigation or the prosecution, that we make real-time decisions, but that the referrals and that information could assist the Government in greater means of addressing a problem we believe exists, and that we believe that additional enforcement efforts, as appropriate—there may be declinations. There may be matters that are inappropriate for Federal prosecution.

Again, we are not seeking to go very wide in that. It has to be fraud in connection with the contract or subcontract. It has to be material over-billing, not just routine contract administration. So, our objective is to make sure that those enforcement efforts are thoughtful and productive so that there is a culture, both in the

corporate community as well as in their interaction between private and public sector.

Mr. TOWNS. I yield to Congressman Bilbray.

Mr. BILBRAY. Thank you.

As followup on that, doesn't the DOD contractors have the ability to go to the Defense Contractor Management Agencies, the Inspector General for the DOD? Now, does the Inspector General report to these other agencies so that they can be informed that reports have shown up there?

Mr. SABIN. If I understand the question, there is a referral process from DOD IG to prosecutorial enforcement, as well as an interagency process so that we are vetting so that there isn't overlap between what DOD is doing and another Inspector General. So there is, as they say in Washington, deconfliction occurring with respect to the investigative matter.

Mr. BILBRAY. The fact that DOD has this different system, is it possible that those reports are going over there and not double backing, not being reported?

Mr. SABIN. The information that we received in the task force is that those referrals are not occurring, whether in DOD or elsewhere.

Mr. BILBRAY. OK. Now, you deferred to the FAR. Why do you defer to the FAR?

Mr. SABIN. On certain matters they certainly have the expertise and the Justice Department doesn't profess to be experts in all nuances of Government contracting. All they are primarily is the enforcement. But our task force members, many of whom are steeped in the specifics, recommended that this was an appropriate vehicle by which to address a problem that needed addressing.

Mr. BILBRAY. Now, the FAR sort of indicated that this was sort of a clerical error that had created a loophole here?

Mr. DRABKIN. The exception language was a drafting error, and we now have a draft proposed rule without that language in it for the comment process. I didn't get a chance to explain it fully, but we can't add new requirements to a rule after we have gone out for public comment without going out for public comment again, and so we have to go back through the proposed process. And actually, we have more in this proposed rule than is in Mr. Welch's legislation, including some additional recommendations from the Department of Justice, which have been incorporated in the proposed rule and is currently being cleared within the Government. But, we have provided copies to members of your staff so you can see what is in there.

Mr. BILBRAY. So Mr. Welch's legislation is actually addressing a concern you have; it is just that you are saying we created the problem with a clerical error, we are now going through the process, as mandated by Federal law, to not only address this but to address other related items or more extensive coverage within the system where the problem originally occurred, rather than doing it through the legislative process?

Mr. DRABKIN. I want to be clear, because I don't want there to be any mistake. We did not knowingly, thinkingly, put in the exception.

Mr. BILBRAY. OK.

Mr. DRABKIN. We have taken that exception out in the proposed rule. Even though it was mentioned by the Social Security Administration person at the CAAC meeting, it got no real thought. It wasn't examined. It was never raised, and it never went any further.

We understand as a result of the comment process, which Congress told us to use when it set up the procurement rulemaking process in title 41—we have gone through that process. It has worked. It has identified this issue and a number of others, which are really important to making this work and work well.

I think it is fair to say there is not a member of the FAR Council that is not concerned with procurement fraud, with people stealing from the Government or the taxpayers, particularly in a time of war, but generally as a whole—I am probably the only person in this room who has actually been a fraud counsel and ran a fraud program as part of the Defense Contract Management Agency—none of us like fraud. We all want to address it. How we address it is a process we go through. We are going through that process. We certainly don't disagree with Mr. Welch that we should have a process, but we are going through the process——

Mr. BILBRAY. Title 41, what year did we implement title 41?

Mr. DRABKIN. The rulemaking process in title 41 was part of the OFPP Act, and I believe it was passed in 1970.

Mr. BILBRAY. OK. Now, your position is that it is not with title 41, it is not with the legislation, the enabling legislation. The problem was basically in the rulemaking itself, and you are going back and revisiting that within the rulemaking process?

Mr. DRABKIN. Yes, sir, and we have made that clear to the staff. As I said, we have provided you with copies of——

Mr. BILBRAY. But the intention of the gentleman's legislation—this is the vehicle you are using, saying the problem was not in the original legislation, it was in a process of rulemaking, and so that is why you feel you should keep it in the rulemaking process to correct it?

Mr. DRABKIN. Yes, sir, and it also gives us greater flexibility. If we discover we have made a mistake in implementing it, we can fix it faster than the legislative process normally is able to respond. That is not a criticism, it is just a reflection of the way Government works.

Mr. BILBRAY. Thank you very much.

Mr. Chairman, I just think that—remember, we are legislators. We are taking the vehicles that we have available to us. Obviously, with the rulemaking the way it is, they are looking at directing the same issue from their jurisdiction because they say it came out of their camp.

I yield back, Mr. Chairman.

Mr. TOWNS. Thank you very much.

Mr. WELCH. Thank you very much, Mr. Chairman.

You know, I am hearing two things that are contradictory. We are hearing that we don't really need legislation because the rule is being fixed, but I don't think it is a coincidence that there was no action toward fixing the rule until the chairman held a hearing and we introduced legislation. Also, nobody on the panel is committing to when that final rule is going to be published and imple-

mented, so it raises significant questions, certainly on my part, as to whether, if we drop the pressure, the ball is going to be dropped.

The other issue that is really of concern to me, Mr. Drabkin, you know, I have absolutely no doubt about the quality and integrity of the folks that work for our entire Federal Government.

Mr. DRABKIN. Thank you, sir.

Mr. WELCH. They work hard. They don't get paid. But, what we have here since 2000 is an explosion in these contracts, including foreign contracts, including no-bid contracts, and the contracting procurement process has gone from $200 billion to $400 billion. And, I bet your department and OMB haven't received a comparable increase in personnel that they need to review contracts.

Mr. DRABKIN. Sir, the number of contracting specialists in the Government in 1990 was 33,000 doing $150 billion worth of work. Today it is 28,000 doing $450 billion worth of work. The problem is we don't have enough people.

Mr. WELCH. That is my point. What you have said, with all due respect, is that the fix wasn't in. This wasn't a conspiracy, it was a mistake.

Mr. DRABKIN. Yes, sir.

Mr. WELCH. Well, that is not reassuring for taxpayers, and we need a remedy. On the other hand, while your numbers to do your job have been declining, the membership in the professional contractors or services, Ms. Preston's group, has been increasing, and there has been some suggestion here by my friend from Virginia that it is getting to be a hassle to do work with the Government. But, there is a lot of contractors that are doing just fine. We had Blackwater in here who testified they have done $1 billion worth of contracts and have made at least 10 percent of profit. That is not a bad take.

Mr. DRABKIN. Sir, our concern isn't with Blackwater. In terms of access to the market, it is not with being able to access Blackwater; it is being able to access the IT companies who don't do business with the Government, who have solutions we would like to buy but who don't want to sell to us because of our terms and conditions and the fact that we have turned contracting into a criminal matter, not a contractual business matter. Although that is no excuse for cheating the Government and no one should ever be allowed to do it.

Mr. WELCH. It is something that is very simple here where we protect the taxpayer dollars when they are spent abroad as well as at home. There has been an acknowledgement on the part of three of the four panelists that there, at least, has to be a rule, some debate about whether you need legislation. I absolutely want to give the benefit of the additional protection to the taxpayer, particularly when the agencies that are reviewing these contracts are getting squeezed on the personnel required to protect the taxpayers.

I have some confidence that Justice can use appropriate discretion so that it will be used wisely and well on behalf of the goal of protecting the taxpayers. I reject the position of the contractees, the ones who have been paid $400 billion and above, that they don't want "the burden" of having to accept as part of the benefit of $400 billion in taxpayer dollars the obligation to share in a time-

ly way with the Government their knowledge that taxpayers are being ripped off.

I yield the balance of my time.

Mr. TOWNS. Thank you very much.

Let me thank all of you for your testimony. Of course, we look forward to working with you, because I think we agree on one thing: something needs to be done. It is not perfect. I think we all agree on that. Of course, I think we can try to move from there. So thank you so much, all of you, for your testimony.

Yes, Mr. Denett?

Mr. DENETT. Chairman Towns, we will expedite this proposed rule. I heard Congressman Welch say he's concerned that we might drop the ball. We won't drop the ball. It is a high priority to us. We will move it. We will get it out soon. I hope you give us the opportunity to get input from all interested parties. We do not need this legislation. Give us a turn at bat. You will be pleased with the outcome.

Mr. TOWNS. Well, we thank you very much for your comment. Of course, as you know, it takes things a while to move around here, so we will be watching you as we continue to move, because it doesn't happen overnight around here. It really doesn't. I wish it did a lot of times.

Thank you so much, Mr. Denett, Mr. Sabin, Mr. Drabkin, and Ms. Preston. I thank all of you.

I would like to welcome our second panel to H.R. 5787, the Moore-Duncan Property Bill. I think it will fix the problem that we should not have. A lot of Federal agencies are sitting on property that they aren't using, old buildings, antennas, and plenty of land. GAO says that agencies have almost $14 billion in land that they do not need, and there is also about $4 billion in land that no one in the Government can use. These agencies should dispose of the property. There are better uses for the money.

The problem is that to get the property ready to be sold there are a lot of up-front costs. You have to do environmental cleanup, demolition, historical preservation, things like that. This would cost the agencies a lot, so they just hold on to the property, especially since they don't keep the proceeds from selling it. The money just goes back into the Treasury.

Representative Moore from Kansas' bill will allow agencies to keep all of the proceeds from selling the property and would give GSA funds to take care of the things that have to be done first. The agencies would reimburse GSA for those expenses after the property is sold.

I think the bill will go a long way to helping agencies get rid of this unneeded property.

As with the first panel, it is our committee policy that all witnesses are sworn in.

Before we do that, let me yield for an opening statement by Ranking Member Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman.

Mr. Chairman, I think that this is an issue that both sides can work on. I think that one of the sides that really is not talked enough about in Washington is the mistakes that have been made in the past and try to build onto it. There are a few of you that

might have been around during the so-called savings and loan debacle. I just know for one, as somebody that saw the way the Federal Government handled that issue, that the real crisis in that situation was not that the savings and loans had problems, but that the Federal Government inherited huge amounts of real estate assets, and then basically sold it for 10 or 20 cents on the dollar.

The taxpayer was literally ripped off, not by somebody violating the law, but by agencies not having an incentive to get every dollar of value out of real estate assets. There is where the real loss of the savings and loan was. And one way to be able to point that out is you look around through the tax codes of how many people made a fortune off of buying up the RTC property and then selling it and managing the property in an appropriate way and how much successes were built on the backbone of us losing huge amount of resources in real estate.

So I am encouraged to go through the hearing, take a look at the bill as recently introduced, and hopefully we can work on this.

I think that assets unused are assets wasted, and so let's see how well we can work this.

The challenge is for any bureaucracy to be responsive and address this issue in a way that will maximize the benefit for the taxpayer.

With that, I appreciate the hearing, Mr. Chairman.

Mr. TOWNS. Thank you very much.

I would like to ask unanimous consent that Congressman Dennis Moore be allowed to sit in on this hearing. Of course, it is his legislation.

At this time I would like to yield to Congressman Moore.

Mr. MOORE. Mr. Chairman and Mr. Bilbray, thank you very much for the opportunity to be here to join the subcommittee today for this hearing to discuss new legislation, H.R. 5787, that I have introduced with Mr. Duncan of Tennessee that would help address the disincentives that are currently keeping some Federal agencies from disposing of assets and property they no longer need.

Last June, the OMB released a report, which found there is currently a backlog of more than 21,000 excess and surplus Federal properties worth a total of $18 billion. Holding on to these properties has serious implications for the a motion taxpayer, as it costs Federal agencies billions of dollars each year to maintain secure properties that are under-utilized or simply not needed.

Investigations by the GAO have also pointed out that the administrative requirements and cost preparing the property for transfer or sale continue to hamper some agencies' efforts to address their backlog of unneeded properties.

Because it can be difficult for agencies to secure the resources they need to prepare a property for disposal, these costs serve as a disincentive, because it makes more sense in the short term for them to simply hold on to a property, particularly if they do not expect to receive the proceeds of a transfer or sale.

Fortunately, over the past several years the administration and Federal agencies have made progress toward strategically managing Federal real property by establishing asset management plans, standardizing data reporting, and adopting performance measures, but I believe there are common sense steps that we can take now

to ensure that all Federal agencies have the proper incentives to dispose of property they no longer need.

H.R. 5787, the Federal Real Property Disposal Enhancement Act, is designed to do that. First, the legislation would move to help agencies deal with the administrative requirements and costs of preparing under-utilized properties for transfer or sale by allowing the GSA, in cooperation with agencies, to use its resources and expertise to cover these up-front costs and help agencies ensure that title records, property descriptions, and environmental clearances are in order. GSA would then be reimbursed for all the costs it incurs from the proceeds that agencies receive from the transfer or sale of these properties.

The legislation would also provide agencies with another incentive to reduce their inventory of unneeded properties by allowing them to keep all the proceeds received from the sale of surplus properties, which they could then use for future disposal and asset management activities.

Over half of all land-holding agencies, including the three largest land-holding agencies in our Government—Department of Defense, GSA, and the Veterans Administration—already have this authority to retain proceeds, and it has been shown to be a tremendous incentive for some agencies to dispose of property they no longer need.

As we are all aware, the Federal Government faces huge fiscal challenges, which is why we must increase our efforts both to manage our existing assets more effectively and to significantly reduce the inventory of under-utilized Federal properties. We should no longer waste precious taxpayer funds on maintaining and holding properties that are not needed by our Government.

Again, Mr. Chairman, thank you for the invitation to join the subcommittee today. I look forward to hearing from the witnesses. Thank you, sir.

[The prepared statement of Hon. Dennis Moore follows:]

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Opening Statement of Congressman Dennis Moore on H.R. 5787, the Federal Real Property Disposal Enhancement Act

April 15, 2008 Subcommittee on Government Management, Organization, and Procurement Hearing

Mr. Chairman, thank you for the opportunity to join the subcommittee for today's hearing to discuss new legislation, that I have introduced with Mr. Duncan of Tennessee, that would help to address the disincentives that are currently keeping some federal agencies from disposing of assets and property they no longer need.

Last June the Office of Management and Budget (OMB) released a report which found that there is currently a backlog of more than 21,000 excess and surplus federal properties worth a total of $18 billion. Holding onto these properties has serious implications for the American taxpayer, as it costs federal agencies billions of dollars per year to maintain and secure properties that are underutilized or simply unneeded.

Investigations by the Government Accountability Office (GAO) have also pointed out that the administrative requirements and costs of preparing a property for transfer or sale continue to hamper some agencies' efforts to address their backlog of unneeded properties. Because it can be difficult for agencies to secure the resources that they need to prepare a property for disposal, these costs serve as a disincentive because it makes more sense, in the short-term, for them to simply hold onto a property, particularly if they do not expect to receive the proceeds of a transfer or sale.

Fortunately, over the past several years the administration and federal agencies have made progress toward strategically managing federal real property by establishing asset management plans, standardizing data reporting, and adopting performance measures.

But I believe that there are common-sense steps we can take now to ensure that all federal agencies have the proper incentives to dispose of property they no longer need.
The legislation that Mr. Duncan and I have introduced, the Federal Real Property Disposal Enhancement Act, is designed to do just this.

First, the legislation would move to help agencies deal with the administrative requirements and costs of preparing underutilized properties for transfer or sale by allowing the General Services Administration, in cooperation with agencies, to use its resources and expertise to cover these up-front costs and help agencies ensure that title records, property descriptions, and environmental clearances are in order. GSA would then be reimbursed for the costs it incurs from the proceeds that agencies receive from the transfer or sale of such properties.

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The legislation would also provide agencies with another incentive to reduce their inventory of unneeded properties by allowing them to keep all the proceeds received from the sale of surplus properties, which they could then use for future disposal and asset management activities. Over half of all landholding agencies, including the three largest landholding agencies - Department of Defense, GSA, and the Veterans Administration - already have this authority to retain proceeds, and it has been shown to be a tremendous incentive for some agencies to dispose of property they no longer need.

As we are all aware, the federal government faces huge fiscal challenges, which is why we must increase our efforts both to manage our existing assets more effectively and to significantly reduce the inventory of underutilized federal properties. We should no longer waste precious taxpayer funds on maintaining and holding properties that are not needed.

Again, I'd like to thank Chairman Towns for the invitation to join the subcommittee today and I look forward to hearing from the witnesses. Thank you.

Mr. TOWNS. Thank you very much.

It is a longstanding policy that we swear in our witnesses, so please stand and raise your right hands.

[Witnesses sworn.]

Mr. TOWNS. Let the record reflect that they answered affirmatively.

Danny Werfel is the Acting Comptroller of the Office of Federal Financial Management at OMB, so we ask that you go first.

STATEMENTS OF DANNY WERFEL, ACTING COMPTROLLER, FEDERAL FINANCIAL MANAGEMENT, OFFICE OF MANAGEMENT AND BUDGET; AND STAN KACZMARCZYK, ACTING DEPUTY ASSOCIATE ADMINISTRATOR, OFFICE OF GOVERNMENT-WIDE POLICY, GENERAL SERVICES ADMINISTRATION

STATEMENT OF DANNY WERFEL

Mr. WERFEL. I would like to begin by thanking Chairman Towns, Ranking Member Bilbray, Representative Moore, and other members of this subcommittee for having the hearing today and inviting me to speak.

The Federal Government is achieving measurable results as we work to meet the President's goals of right-sizing the Federal real property inventory. In 2004, before the President launched the real property initiative, the Federal Government lacked a comprehensive inventory of its real property holdings and could not effectively identify which assets to target for investment or disposal. Today we have a comprehensive inventory of more than 1.1 million individual assets with a replacement value exceeding $1.5 trillion.

Agencies are using performance measures, such as whether the property is mission critical, the utilization rate of that property, the cost and condition of that property, to identify assets in need of investment and those unneeded assets suitable for disposal.

Agencies have disposed of more than $7 billion in unneeded Federal real property since 2004, and we are moving toward the President's goal of disposing $15 billion in unneeded assets by the year 2015.

While we are proud of these accomplishments, there is more work to be done. Our inventory shows many surplus assets remaining on our books. As long as these assets remain on our books, agencies are investing resources to maintain them. Of note, our most recent report to Congress shows over 21,000 surplus and excess assets on the Federal inventory.

Also importantly, our inventory shows that we have mission critical assets with a backlog of repairs and maintenance. These backlogs degrade our facilities over time and cause us to spend more on maintenance and repairs in the long run. One of the anecdotal examples we would like to give is that a roof repair may cost $7,000 today to address, but if we don't do that and wait, it could cost us $7 million in the near future to go ahead and replace that roof.

As reported by GSA in their written testimony for this hearing, six of our largest property-holding agencies have backlogs that exceed $16 billion.

Federal agencies need additional tools and resources to address these ongoing challenges. Agency efforts to manage and dispose of real property are governed predominately by the Real Property Act of 1949. Two critical updates to this legislation are needed: first, allowing agencies to retain a portion of the net proceeds of sale of unneeded assets and requiring those proceeds be reinvested to help fund disposal activities and fund our maintenance backlog; and, second, expediting the disposition process for our targeted assets.

I would like to talk briefly about these two reform proposals.

First of all, retention of proceeds. Many agencies do not have the authority to retain proceeds, and such proceeds can be converted into significant savings for taxpayers. Let me explain how: First, proceeds can be used to cover up-front costs associated with the disposing of unneeded assets. As these assets are removed from the inventory, the costs to maintain them are avoided. Second, proceeds can be used to address repair and maintenance backlogs, avoiding the inevitable higher costs incurred by agencies when these backlogs are not addressed timely.

On to the issue of expedited disposals. The disposition process that we operate under today is lengthy and complex. Our goal is to streamline that process so that parties interested in an asset for a possible no-cost conveyance have greater visibility and more timely access to the assets, and properties that are not a good fit for a no-cost conveyance can be quickly demolished or sold at market so that agencies can more immediately terminate the ongoing maintenance costs associated with these assets.

Both of these reforms were proposed as part of a pilot program in the 2009 President's budget. We believe that enactment of this pilot would both facilitate the disposal of surplus property in the short term and help inform Congress and the executive branch on our longer-term, permanent reform approaches.

While the administration prefers to enact these two reforms, retention of proceeds and expedited disposals, together, we are open to working with Congress to consider alternative paths. Ultimately, we believe that reform in both of these areas is essential and necessary for agencies to improve the management of their real property portfolio.

After my written testimony for this hearing was submitted, OMB completed its review of the draft property bill provided to us by staff from this committee. I understand that bill has now been introduced yesterday and is H.R. 5787. We appreciate you and your staff's willingness to consult with us on the draft bill, and we respectfully offer the following observations for your consideration.

The draft bill would allow agencies to retain 100 percent of the sale's proceeds, a very positive step that we applaud; however, the draft bill contains additional language that such proceeds "shall only be expended as authorized in annual appropriations acts."

If we understand the impact of this particular language correctly, proceeds will only be expended for agency real property needs if congressional appropriators prioritize such funding within their existing spending caps, which are sometimes referred to as 302-B allocations. In this regard, Federal agencies will face the same challenges they face today; that is, dollars needed for real property will

be directly competing with dollars needed for other discretionary priorities.

The intent of the administration's real property proposal was not only to allow agencies to retain proceeds from property disposal, but to also provide agencies with the incentive for increased flexibility to reinvest those proceeds in the properties that have the highest priorities.

I thank you again for the opportunity to testify today, and I look forward to answering your questions.

[The prepared statement of Mr. Werfel follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

Testimony of Daniel I. Werfel
Deputy Controller
Office of Management and Budget

before the

Subcommittee on Government Management, Organization, and Procurement
House Committee on Oversight and Government Reform

April 15, 2008

The Federal Government is achieving measurable results in meeting the President's goal to improve the management of Federal real property assets and fulfill the requirements outlined in Executive Order (EO) 13327, Federal Real Property Asset Management. When the Executive Order was signed in 2004, the Federal Government lacked a comprehensive inventory of its real property holdings and could not effectively identify which assets to target for investment or disposal. Today, due to the concerted efforts of Federal agencies and their Senior Real Property Officers:

- We have a comprehensive database of the Federal Government's real estate that collects inventory and performance data on more than 1.1 million assets with a replacement value exceeding $1.5 trillion.
- For the third consecutive year, all agencies reported asset level inventory and performance data to the government-wide database. Agencies are actively using performance data to support management decisions, such as identifying assets in need of investment and unneeded assets suitable for disposal.
- Agencies have disposed of more than $7 billion in unneeded Federal real property since 2004, and are moving towards the President's goal of disposing of $15 billion in unneeded assets by 2015.[1]

We have taken important steps in meeting the President's objective for agencies to manage their real property portfolios at the right size, cost and condition to most effectively serve program missions and goals. However, Federal agencies need additional tools and resources to further improve the management of real property assets. Currently, agency efforts to manage and dispose of real property are governed predominantly by the Property Act of 1949 (codified in Title 40), which no longer addresses the real property needs that exist today.

To that end, two areas that should be critical components for real property reform include: (1) allowing agencies to retain a portion of the net proceeds of sale for activities related to

[1] The President's initiative to dispose of unneeded property does not apply to Federal lands held for environmental purposes (e.g., parks, refuges, forests, public lands). Instead, disposal efforts are targeted only on surplus administrative assets (e.g., office buildings, warehouses, laboratories).

Federal real property capital improvements and disposal activities, and (2) expediting the disposition process for targeted assets. Both of these reforms were proposed as part of a pilot program in the 2009 President's budget, with similar pilots introduced in Bills in both the House and Senate. We believe that the enactment of the President's proposed pilot would both facilitate the disposal of surplus property in the short-term and help inform Congress and the Executive Branch on long-term or permanent reform approaches.

Retention of Proceeds. The laws that currently govern the Federal real property disposition process have created an unintended disincentive for many Federal agencies to dispose of unneeded assets. Many agencies do not have authority to retain proceeds from the sale of real property assets, nor do they receive reimbursement for costs incurred to sell a property, such as advertising and cleanup. Consequently, agencies often lack the resources needed to sell or dispose of properties and are unable to avoid annual costs that are incurred when properties are maintained past their point of usefulness. Allowing agencies to be reimbursed for selling costs and to retain sale proceeds would provide agencies with the funds necessary to cover upfront costs associated with disposing of unneeded assets.

In addition, sale proceeds from the disposal of unneeded assets could fund existing maintenance and repair backlogs at mission critical facilities throughout the Federal inventory. Delayed funding of this backlog both degrades the infrastructure of Federal facilities and increases the overall, long-term costs of maintaining Federal properties. Thus, sale proceeds can be converted into significant savings for taxpayers by both eliminating maintenance costs in the case of surplus assets and significantly reducing such costs for mission critical assets.

Expedited Disposals. The process that Federal agencies are required to follow when disposing of unneeded assets is complex and lengthy. The objective for the expedited disposal pilot is twofold: (1) to ensure that all interested parties (e.g., Federal, State and local governments as well as homeless organizations) have visibility into and access to suitable properties eligible for conveyance; and (2) to ensure that properties eligible for sale that do not fit into the first category can be immediately demolished or go direct to market for sale so agencies can avoid paying additional and unnecessary operating costs.

While the Administration prefers to enact these two reforms (retention of proceeds and expedited disposals) together, we are open to working with the Congress to consider alternative paths. Ultimately, we believe that reforming both areas is essential and necessary for agencies to improve the management of their real property portfolios.

Conclusion. The Federal real property results achieved over the last four years demonstrate the importance of transparency, collaboration, leadership, and accountability in effectively managing the Federal Government's real property assets. Each year since the President signed EO 13327, Federal agencies have improved real property data and enhanced their real property decision-making processes, resulting in the disposal of $7 billion in unneeded assets. It is imperative for the Congress and the Executive Branch to work together to enact the necessary reforms that will provide agencies with the tools and resources needed to sustain and build on these results.

We congratulate this Subcommittee for its attention and dedication to improving the management of Federal real property assets. We look forward to working with you and other Members of Congress to implement the strategies identified above. At this time, I would be pleased to answer any questions that you have.

Mr. TOWNS. Thank you very much, Mr. Werfel.
Mr. Kaczmarczyk.

STATEMENT OF STAN KACZMARCZYK

Mr. KACZMARCZYK. Chairman Towns, Ranking Member Bilbray, and members of the subcommittee. I am Stan Kaczmarczyk, Principal Deputy Associate Administrator for the General Services Administration's Office of Government-wide Policy. I am pleased to appear before you today to discuss GSA's policy support for and operational success in real property asset management.

President Bush signed Executive Order 1327, Federal Real Property Asset Management, on February 4, 2004. From the outset, GSA has fully supported and participated in the implementation of the Executive order. GSA has taken a prominent role on the Federal Real Property Council established by the Executive order. As one of the Federal Government's many land-holding agencies, GSA was proud to be recognized by the administration for achieving and maintaining green status on the PMS scorecard, the first agency to attain that status.

In support of the Council, the Office of Government-wide Policy developed and maintains the Federal Real Property Profile, a centralized real property data base that compiles data on more than 1.1 million real property assets with a total replacement value of more than $1.5 trillion. The FRPP collects 24 major data elements, including 4 key performance measures.

Since 2004, using existing authorities, Federal agencies have reported through the FRPP, as Danny mentioned, the disposal of more than $7 billion of surplus real property.

One of the significant asset management challenges confronting the Federal Government is the lack of incentives to dispose of unneeded real property. For example, some agencies are unable to retain and reinvest the proceeds from the sale of surplus assets. With a limited amount of financial resources, too often the real property inventory becomes a secondary priority. This creates a backlog of repair needs and deferred maintenance. As Danny mentioned, in 2007 the Government Accountability Office found that six land-holding agencies reported a backlog for repair and maintenance that totaled over $16 billion. If agencies could retain and reinvest the proceeds from the sale of surplus real property assets, the funds could be used to help addresses this significant backlog.

In 2005 GSA received the authority to retain all proceeds from sales of its surplus properties. Since enactment of this authority, GSA has disposed of 42 surplus real property assets, with the total sales amount of $155 million. We believe that providing all Federal land-holding agencies with the authority to retain net proceeds of sale will provide an incentive for sound asset management decisionmaking.

The administration's fiscal year 2009 budget includes proposed legislation that would allow agencies, those not previously authorized to retain proceeds, the ability to retain 20 percent of proceeds from the sale of unneeded assets.

Another disincentive to sound real property asset management is that some agencies retain unneeded real properties because they cannot afford the up-front costs of disposal. A general provision in

the administration's fiscal year 2009 budget recommends authorizing GSA to pay for and provide up-front redeployment services to other agencies to help them decide whether to retain and reuse the property or to place the asset in the disposal process.

Federal agencies, under the leadership of the Federal Real Property Council, have taken the initial steps to promote the efficient and economical use of Federal real property resources and to increase agency accountability, but without funds necessary to reinvest in or dispose of these assets, they will continue to deteriorate as part of the Federal inventory.

We ask that you consider our legislative proposals to improve the real property asset management.

Mr. Chairman, this concludes my statement. I will be pleased to respond to any questions.

[The prepared statement of Mr. Kaczmarczyk follows:]

STATEMENT OF

STAN KACZMARCZYK

PRINCIPAL DEPUTY ASSOCIATE ADMINISTRATOR

OFFICE OF GOVERNMENTWIDE POLICY

U.S. GENERAL SERVICES ADMINISTRATION

BEFORE THE

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

SUBCOMMITTEE ON GOVERNMENT MANAGEMENT, ORGANIZATION, AND PROCUREMENT

U.S. HOUSE OF REPRESENTATIVES

APRIL 15, 2008

Chairman Townes and Members of the Subcommittee, I am Stan Kaczmarczyk, Principal Deputy Associate Administrator of the General Services Administration's (GSA's) Office of Governmentwide Policy (OGP). I am pleased to appear before you today to discuss GSA's policy support for and operational success in real property asset management, consistent with the aims of H.R. 3049, as introduced.

Improving the management of the federal real property portfolio is a priority of this Administration. When President Bush signed Executive Order 13327, Federal Real Property Asset Management, on February 4, 2004, he charged federal agencies to manage their real property portfolios at the right size, cost, and condition to serve most effectively program missions and goals.

From the outset, GSA has fully supported and participated in the implementation of Executive Order 13327. GSA has taken a prominent role on the Federal Real Property Council (FRPC) under the leadership of the Public Buildings Service. Commissioner David Winstead is GSA's Senior Real Property Officer and Chair of the FRPC's Asset Management Plans Committee. As one of the Federal Government's many landholding agencies, GSA was proud to be recognized by the Administration for achieving and maintaining "Green" status on the PMA scorecard – the first agency to attain that coveted status.

In support of the entire FRPC, OGP developed and maintains the Federal Real Property Profile (FRPP), a centralized real property database that compiles data on more than 1.1 million real property assets with a total replacement value of more than $1.5 trillion. We analyze the data and issue reports, including the annual publicly-available Federal Real Property Report. The FRPP collects 24 major data elements, including 4 key performance measures:

- Mission Dependency
- Utilization
- Condition Index, and
- Annual Operating Costs.

OGP also developed and provides to all agencies a software tool that systematically analyzes these performance measures and allows agencies to assess the performance of their real estate inventories. This performance assessment tool stratifies assets that are underutilized and poor financial performers, allowing agencies to make strategic decisions about these assets.

Since 2004, using existing authorities, federal agencies have reported the disposal of more than $7 billion of surplus real property. With these results, and a consistent increase in disposals each year, we anticipate meeting the Administration's targets of cumulatively disposing of $9 billion of unneeded assets by 2009, and $15 billion of unneeded assets by 2015.

One of the significant challenges confronting the Federal Government's efforts to dispose of unneeded assets is that federal landholding agencies lack significant incentives to dispose of unneeded real property. The short-term budget analysis favors retention of unneeded real properties because of the up-front costs needed to achieve long-term savings. To that end, the Administration has proposed legislation that would allow GSA to provide "redeployment services" to other agencies to help them decide whether to retain and re-use the property or to place the asset in the disposal process. GSA would compile the real estate and environmental due diligence necessary to report property excess, and ensure that transactions meet both statutory and market requirements.

A General Provision in the Administration's FY '09 Budget recommends authorizing GSA to use amounts in its surplus property fund to pay for these services up-front for executive agencies, and to either (1) recoup the cost of these redeployment services from the proceeds of the eventual sale of the property, (2) seek reimbursement from the landholding agency, or (3) fund the cost directly from the surplus property fund.

Another disincentive to sound real property asset management is the general inability of agencies to retain and reinvest the proceeds from the sale of surplus assets. With a limited amount of financial resources, too often the real property inventory becomes a secondary priority. This creates a backlog of repair needs and deferred maintenance, which only exacerbates the problem of underperforming assets. In the 2007 update to the Government Accountability Office (GAO) High Risk Report, the GAO found that 6 landholding agencies reported a backlog for repair and maintenance that totaled over $16 billion. If agencies could retain and reinvest the proceeds from the sale of surplus real property assets, the funds could be used to help address this significant backlog of work needed by assets for which agencies do have a continuing need.

In 2005, GSA received the authority to retain the proceeds from sales of its surplus properties. Since enactment of this authority, GSA has disposed of approximately 42 PBS surplus real property assets with a total sales amount of $155 million. GSA currently has and under the new bill would continue to have 100 percent retention of sales of its surplus properties. The recovery of this embedded equity has enabled GSA to apply those funds into other important real property needs, in addition to the savings realized from the avoided cost of upkeep of the properties. We believe that providing all Federal landholding agencies with the authority to retain net proceeds of sale will provide the requisite incentive for sound asset management decision-making within the context of the Guiding Principles established by the FRPC.

To this end, the Administration's FY'09 Budget also includes proposed legislation that would allow those agencies not previously authorized to retain proceeds the ability to retain twenty (20%) of proceeds from the sale of unneeded assets. The remaining eighty (80%) would be returned to the Treasury. Retention of disposal proceeds is beneficial and would allow agencies to reinvest these funds back into their inventories, thus further reducing the backlog of deferred repairs and maintenance.

The retained proceeds could be used to repair major building systems, which would significantly extend the useful life of assets and improve operational performance. Agencies could also use the retained proceeds to complete the necessary due diligence required to dispose of even more unneeded surplus real property assets. Without this authority, agencies will have fewer reinvestment options to consider, which may result in a determination to dispose of property that may otherwise be needed in furtherance of their mission. Moreover, agencies may be reluctant to dispose of underperforming property, since they may have to incur significant up-front costs and expenses to identify and dispose of unneeded property. These costs should be offset by the long-term savings in property holding costs that result from the disposal, but without a source of funds from which to pay these disposal costs and expenses, agencies may not have the discretion to make such decisions.

Federal agencies, under the leadership of the FRPC, have taken the initial steps to promote the efficient and economical use of federal real property resources and to increase agency accountability. The FRPP and its associated performance assessment tool have allowed agencies to identify underutilized and underperforming assets that are candidates for reinvestment or disposal. But without the funds necessary to reinvest in or dispose of these assets, they will continue to deteriorate as part of the federal inventory. We ask that you provide federal agencies the authority to retain proceeds from the sale of surplus property to address the needs of these underperforming and unneeded assets.

Mr. Chairman, this concludes my statement. I would be pleased to respond to any questions you or the other members of the committee may wish to ask.

Mr. TOWNS. Thank you very much. I want to thank you Mr. Werfel and Mr. Kaczmarczyk for your testimony.

At this time I would like to yield to the ranking member, Mr. Bilbray.

Mr. BILBRAY. Thank you, Mr. Chairman.

Just quickly, the fact is we also don't talk about the fact that if we put this back into the private sector, the local government benefits from the tax base—not that the Speaker would have appreciated us taking the Presidio in San Francisco and putting it back on the market, which you can imagine the resources we could have gotten for that.

You made a recommendation, though, and I would ask the author of the bill to consider the fact that allowing the assets to go back into either the support for maintenance or the purchase of new—and keep it within that maintenance and that property management side, and I think that the authors should keep a real open mind to keep that from getting lost. I don't think the intention was for this to get buried. That was the whole reason to try to make the maximum on this.

That is one recommendation we could make up there, and I think that we can followup on that working with the author and trying to focus the staff. It may not be 100 percent, it may be 85, like we do with drug asset seizures for the local government, but at least focus the resources over on to that maintenance aspect of where we are getting this.

I think there is a way to work this out. I think the bill being drafted yesterday just gives us a foundation to work with, and I appreciate the positive recommendations from both of you.

Mr. TOWNS. I would like to yield to the authors of the legislation, Mr. Duncan and Mr. Moore.

Mr. MOORE. Thank you, Mr. Chairman. As I mentioned before in my statement, in June 2007 OMB reported there is currently a backlog of more than 21,000 Federal assets and properties worth $18 billion. Does OMB have an estimate of how much Federal agencies are spending each year to hold and maintain excess and surplus properties they no longer need?

Mr. WERFEL. We do. It is $130 million per year.

Mr. MOORE. That is $130 million?

Mr. WERFEL. Yes, sir.

Mr. MOORE. All right. You also have an estimate for how many more Federal properties are unneeded or under-utilized but are not yet characterized as excess?

Mr. WERFEL. That we don't have. I think what you are talking about, Mr. Kaczmarczyk has it.

Mr. MOORE. As you mention in your testimony, OMB has been supportive of proposals to create a pilot program that would allow agencies to take excess properties directly to sale, essentially allowing them to avoid the required screenings for transfer to another Federal agency, homeless use, and public benefit conveyance. It seems this proposal is based on the premise that the screening requirements are the primary factor keeping agencies from disposing of property they no longer need. Does OMB have any evidence that this is, indeed, the case?

Mr. WERFEL. What we have discussed in the Federal community through the Federal Real Property Council are the major obstacles that we confront in disposing real property, and two themes emerged. One is the agencies look at the process, which takes about 240 days to go through, to go through all the various public benefit conveyance steps that are necessary, and that is, in many cases, a deterrent to having the agencies push their properties through for sale.

In addition, as has been mentioned several times, there are up-front costs associated with getting a property ready for sale. It can be as simple as moving a large dirt pile from the property before they get it ready for sale, but removing that dirt pile could cost a couple of thousand dollars that the agency doesn't have.

So really seeing both these obstacles, the length of time, the 240 days for public benefit conveyances on average, and the proceed issue both present obstacles for agencies.

Mr. MOORE. Thank you.

Are you aware of the legislation by Senators Carper and Coburn that would create a pilot program that would allow agencies that disposed of properties through the pilot to keep only 20 percent of the proceeds of their sales? Are you aware of that?

Mr. WERFEL. We are aware of it. It is very similar to a pilot proposal that has been in the President's budget for the last few years.

Mr. MOORE. My question then is if most agencies can already keep 100 percent of the proceeds, what incentive would they have to take part in the pilot program?

Mr. WERFEL. Representative Moore, one clarification about your question. First, it is my understanding that a minority of our agencies currently have the authority to retain proceeds. For example, Veterans Affairs and the State Department have such authorities, but many of our agencies, such as Transportation, Department of Homeland Security, and many other agencies, including the Defense Department for their non-BRAC properties, do not have such authority.

So the 20 percent retention would be a much better improvement than what they face today, and that 20 percent proceeds could help. I used the dirt pile example—help the agencies remove that just for the environment work that is necessary. We believe that 20 percent would have a big impact.

Clearly, 100 percent would go a much further way. It would not only allow you to do the up-front cost to get the property ready for disposal, which, relatively speaking, would be smaller in amount than addressing our real property maintenance backlog. So, when you start getting up into the 100 percent range, now you are talking about the opportunity to really make investments into our infrastructure that not only will improve the condition of our facilities, but, as I mentioned, will be a positive return on investigation for taxpayers because the sooner you repair those facilities the less expensive the life cycle cost of those facilities are.

Mr. MOORE. May I ask some very brief questions of the gentleman from GSA, Mr. Chairman?

Mr. TOWNS. Sure.

Mr. MOORE. Could you describe the trend in the disposal of GSA properties that we have seen since the agency was given the au-

thorization to retain the proceeds of its sales in 2004? Has the agency seen a significant increase in the number of properties disposed of since this authorization was given?

Mr. KACZMARCZYK. The authorization applies to GSA properties.

Mr. MOORE. Right.

Mr. KACZMARCZYK. I don't know if I would say there has been a significant increase, but it has certainly been a boon to us in being able to retain the proceeds and to reinvest them.

There has been an increase in recent years, but it has basically been as a result of a tiering process that was put in by GSA, but we restructured our portfolio to three tiers. The ones that we really have a continuing need for that are our top priority investments, ones that could reach that category with some additional investment, and then a third tier that we really should get rid of, we have no use for. That has been the real driver for the increase in disposals.

Mr. MOORE. Does GSA have any evidence that the screening requirements for homeless use and public benefit conveyance are keeping agencies from disposing a property they no longer need?

Mr. KACZMARCZYK. I wouldn't say evidence. I agree with Danny that it is a real concern that comes up in the Federal Real Property Council, which is all the Federal land-holding agencies getting together to try to increase or improve asset management. I am of the mind that if you should get rid of it, you should get rid of it, especially if it is costing you money to maintain it, even if it takes time to go through the proper channels.

Mr. MOORE. Last question, Mr. Chairman.

Do you feel that another important factor is that it is often difficult for agencies to secure the resources they need to fund disposal efforts, and that not all agencies are allowed to keep the proceeds from sales they do complete? Is that a concern?

Mr. KACZMARCZYK. Yes, that is definitely a concern, and the legislation would be a big help in that area.

Mr. MOORE. Thank you, witnesses. Thank you, Mr. Chairman.

Mr. TOWNS. Let me thank you for sponsoring the legislation, and, of course, let me thank both of you for your testimony. Thank you very much.

On that note, the committee is adjourned.

[Whereupon, at 4 p.m., the subcommittee was adjourned.]

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