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Before the Committee on Appropriations

Financial Services and General Government Appropriations

Fiscal Year 2015

113*th* CONGRESS, SECOND SESSION

H.R. 5016

COMMODITY FUTURES TRADING COMMISSION
DEPARTMENT OF THE TREASURY
FEDERAL COMMUNICATIONS COMMISSION
INTERNAL REVENUE SERVICE
PRESIDENT'S FISCAL YEAR 2015 FUNDING REQUEST FOR AND OVERSIGHT OF FEDERAL INFORMATION TECHNOLOGY INVESTMENTS
SECURITIES AND EXCHANGE COMMISSION
SMALL BUSINESS ADMINISTRATION
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Financial Services and General Government Appropriations, 2015 (H.R. 5016)

S. HRG. 113–630

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2015

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON APPROPRIATIONS

UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

ON

H.R. 5016

AN ACT MAKING APPROPRIATIONS FOR FINANCIAL SERVICES AND GENERAL GOVERNMENT FOR THE FISCAL YEAR ENDING SEPTEMBER 30, 2015, AND FOR OTHER PURPOSES

Commodity Futures Trading Commission
Department of the Treasury
Federal Communications Commission
Internal Revenue Service
President's Fiscal Year 2015 Funding Request for and Oversight of Federal Information Technology Investments
Securities and Exchange Commission
Small Business Administration
Treasury Inspector General for Tax Administration

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FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2015

THURSDAY, MARCH 27, 2014

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 10:02 a.m. in room SD–138, Dirksen Senate Office Building, Hon. Tom Udall (chairman) presiding.

Present: Senators Udall, Johanns, and Moran.

FEDERAL COMMUNICATIONS COMMISSION

STATEMENT OF HON. TOM WHEELER, CHAIRMAN

ACCOMPANIED BY: HON. AJIT PAI, COMMISSIONER

OPENING STATEMENT OF SENATOR TOM UDALL

Senator UDALL. Good morning. I am pleased to convene this hearing of the Appropriations Subcommittee on Financial Services and General Government.

First, I want to welcome my ranking member, Senator Mike Johanns. We don't have anybody else here, but we expect a few to show up. But great to be here with you and share this opportunity to learn from our Federal Communications Commission (FCC) members that are here. I also want to——

Senator JOHANNS. Mr. Chairman, sometimes it is about quality, not quantity.

Senator UDALL. Yes, that is right. That is very, very well put. Yes. We have got real quality here. There is no doubt about it.

And I also want to welcome our witnesses. Chairman Tom Wheeler, who recently was confirmed as the new chairman of the FCC. I want to thank you for your service and look forward to your testimony today. And also with us is Commissioner Ajit Pai. Really good to have you with us again and look forward to your testimony as well.

The FCC has been very busy on a number of initiatives, initiatives that are critical to many Americans. And these are initiatives that I strongly support.

The FCC is modernizing the almost $9 billion Universal Service Fund to expand access to vital communications systems for everyone in America.

The United States invented the Internet, but now we lag behind many countries in broadband access. This is especially so in rural parts of New Mexico. So I am pleased to see new broadband and

wireless investments in my home State and on tribal lands. And that is all thanks to universal service reforms.

The FCC is also updating and streamlining the E-Rate program to support Internet access at schools. In New Mexico, E-Rate already makes a big difference, benefiting over 350 schools and libraries and more than 370,000 school children.

There is no doubt, as you both know, that we live in an Internet age. And as Chairman Wheeler has noted, every student in America should have access to state-of-the-art tools for education. E-Rate helps make that possible.

In 2012, Congress authorized the FCC to conduct spectrum auctions to make more spectrum available for mobile broadband use. This fuels innovation in wireless technologies. It helps build FirstNet, our Nation's public safety broadcast network for first responders. And it will generate significant revenue for the U.S. Treasury.

The FCC also has a crucial safety and security role. Our Nation's communications networks do more than just keep us in touch with friends and family. In emergency situations, these networks save lives. This committee explored these issues at a hearing I chaired last fall in how we can improve emergency communications. So I look forward to an update from you about the progress that is being made there.

The FCC request for this fiscal year is—in 2015 funding is $375 million. This is a modest increase from the fiscal year 2014 enacted level. FCC spending is fully offset, as we all know, by regulatory fees and from spectrum auctions.

This committee has an important oversight responsibility, ensuring that the FCC uses that money wisely for the American people. There are two basic questions. What are the resource needs of the FCC, and what are the consequences of the shortfalls?

I have the honor of chairing this subcommittee and serving with Senator Johanns, and I look forward to working with him to advance these critical FCC initiatives. So now I would turn to my ranking member for any opening statement that he would make.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Mr. Chairman, thank you very much for holding the hearing today on the fiscal year 2015 budget request for the FCC.

Let me also say welcome, Chairman Wheeler and Commissioner Pai. We are glad to have you both here.

This is an important hearing as the policies and actions of the FCC reverberate across our economy and impact our Nation's international competitiveness. The hearing is also significant as it is our first this year and serves as the kickoff for the fiscal year 2015 appropriations cycle.

I very much appreciate the work of the chair of the Appropriations Committee, Senator Mikulski, and Ranking Member Shelby and other committee members to try to restore regular order to the congressional appropriations process. However, it is no secret that I opposed the decision last fall to amend the Budget Control Act to escalate Federal discretionary spending back over a $1 trillion.

The changes Congress made to the Budget Control Act simply raise more money to spend more money. I did not object to replacing the sequester cuts, but we should have included targeted cuts that addressed waste or fraud or achieved long-term savings through structural changes. Unfortunately, in my judgment, the agreement reached last year just didn't meet the standard.

Given my concern, I did not support the omnibus appropriations bill for fiscal year 2014 enacted earlier this year. There were numerous provisions in that bill that I supported and would vote for without reservation, but the package was all or nothing, and the good was unfortunately outweighed by the trillion dollar price tag.

Because last year's budget agreement increased the spending caps for fiscal year 2015 as well, I am concerned we are on the same path for this fiscal year.

I was disappointed that the President's budget for fiscal year 2015 proposed $56 billion in new spending this year and $791 billion in spending increases over the next decade, paid for with tax hikes on American families.

With soaring annual deficits and nearly $18 trillion in debt hovering over our economy, our country is in need of serious budgeting that spends responsibly.

As we begin the process of reviewing agency budget requests for fiscal year 2015, I intend to work with my colleagues on the committee to ensure we make the difficult decisions necessary to get our spending under control.

We must also be mindful of the need to clear the way for economic opportunity and for international competitiveness. The FCC plays an important role in ensuring that the United States continues to lead the world in digital innovation and communications infrastructure. Its policies and actions can have an enormous impact on our country's economic growth.

I am eager to hear more today about the Commission's efforts to promote economic growth, reduce regulatory burdens, and promote greater transparency, predictability, and accountability in its regulatory process.

So, again, I thank the two of you for being here. I look forward to your testimony today and to working with you to address the challenges before us and to clear the way for continued U.S. leadership in communications, and I look forward to working with you in the future.

Mr. Chairman, thank you.

Senator UDALL. Thank you very much, Senator Johanns. Really appreciate your opening comments.

And Chairman Wheeler, at this point, I invite you now to present your remarks on behalf of the FCC, followed by Commissioner Pai.

SUMMARY STATEMENT OF HON. TOM WHEELER

Mr. WHEELER. Thank you very much, Mr. Chairman, and Ranking Member Johanns. We appreciate the opportunity to be here.

This is my first time presenting before you. But it is not the first time in my life that I have presented a budget. So let me revert to some of my business experience and try and go to the core of what the issues are.

As you pointed out, Mr. Chairman, we have a reasonable $35 million increase that we are requesting, but it deserves explanation and discussion. You can really think of it in three parts.

About a third of that goes for technology upgrades that produce cost savings and efficiency increases. About a third goes to universal service reform in the form of both expanded enforcement and new rules. And about a third is essentially for two things. One, those mandated costs of inflation—salaries, benefits, et cetera—that happen, as I say, by mandate. And second, the movement of the National Broadband Map from the National Telecommunications and Information Administration (NTIA) to the FCC and our need to pick up that expense.

Let me see if I can unpack each of those. First, let us look at information technology (IT), which is about $13.5 million. Our IT systems are old, inefficient, and insecure. Let me give you a couple of examples.

Forty percent of our IT systems are more than 10 years old. This means that most of them aren't even supported by their vendors anymore, and they are costly to maintain. Worse, we have 207 different systems that are a hodgepodge of incompatible and inefficient. For instance, we cannot build a consumer database that works across the entire agency because we have so many different incompatible systems.

But worst of all, these are insecure systems. I would be happy to explain in a less public setting some of my concerns about that, but let me give you one example. We are still using Windows XP in many of our computers, and it is well known that it is the access point of hackers worldwide. But we don't have the money to get out of it.

UNIVERSAL SERVICE FUND

The second leg of this three-legged stool is Universal Service Fund reform, which is $10.8 million. We have an $8.4 billion program going through big changes with big challenges. The lifeline program has been abused. We will save $160 million this year by stopping some of the duplicate payments and the inappropriate participation that was there. But we are also dealing with companies, not just consumers, and we have had inefficient enforcement.

I said from day one, when I came in, I want heads on pikes. I want to find out who the miscreants are and deal with them. We have insufficient resources to do that.

Our High-Cost Rural Fund, we are shifting from voice to broadband, and we are putting out new trial programs. But our resources in the Wireline Competition Bureau are constrained in many other directions.

And the E-Rate program, as you pointed out, Mr. Chairman, is an 18-year-old program, built around 18-year-old ideas and priorities. We have to change that to reorient it to high-speed broadband. We are in the process of a rulemaking to modernize that right now.

But let me talk a little bit about management. We need more muscular enforcement. I am standing up a strike force on waste, fraud, and abuse in the Universal Service Program. But it doesn't

make sense that on an $8.4 billion program, we have 25 full-time equivalents (FTEs) for enforcement. It is insufficient.

And so, what we ask for here are new employees, and let me be clear—we need investigators. We need auditors. We need financial enforcement folks. We need to expand by 15 the folks that we have in our Enforcement Bureau. That is almost doubling the current FTEs. We need to expand by 10 the folks that we have doing audits in our Office of Managing Director. That is doubling the numbers. We need to expand the Office of Inspector General by 6, and we need to put 14 more in the Wireline Competition Bureau for rules and enforcement appeals and things like this.

And I would just say the last third are things that we are mandated for, for $5.7 million in Consumer Price Index (CPI) and other increases and $4 million for the broadband map.

AUCTIONS

One quick observation. We also, as you know and you pointed out, Mr. Chairman, are responsible for auctions. And while that is paid for out of the auctions themselves, we are asking for an additional $7 million there. We have generated $53 billion from auctions and have spent less than 2 percent of that to run them, a 98 percent return. I think that is a pretty good return on investment for America.

We have had many auctions recently, in the last 5 years or so, that haven't had a very high profile. But in the last 5 years, we have had 10 auctions that have auctioned off more than 16,000 new licenses. And we are now dealing with a mandate that we have from you given in 2012 to conduct the world's first incentive auction, which is literally inventing things as we go.

As you pointed out, Mr. Chairman, the FCC pays its own way. It has no impact on deficit or taxes, and we take our responsibility at the heart of 21st century economies seriously. And that responsibility is multifold.

One, we need to make sure that we are going away from the "regulator knows best" approach. We can't be as smart as the Internet. We need to make sure that we are providing stability for those who invest and create jobs.

And two, we need to make sure that we are fulfilling our responsibility for consumer protection.

And three, we need to make sure that we are fulfilling our responsibility to deliver about two-thirds of our program, about $8.4 billion to assist the development of 21st century communications in rural America.

PREPARED STATEMENT

I appreciate the opportunity to be here and look forward to discussing these issues with you.

[The statement follows:]

PREPARED STATEMENT OF HON. TOM WHEELER

Chairman Udall, Ranking Member Johanns, and members of the subcommittee, I am pleased to appear before you today, alongside my colleague Commissioner Pai, to present the Federal Communications Commission's (FCC's) fiscal year 2015 budget request.

Although I have testified before a number of other congressional committees during my career, this is my first appearance before a Senate Appropriations subcommittee. I see this as an important opportunity to update you on the FCC's activities while providing you with information essential to developing the Commission's funding levels.

When I assumed the Chairmanship of the FCC last November, I was impressed by the Commission's moderate budget levels and the extraordinary work that this agency has accomplished during the past few decades. The Commission has raised more than $53 billion for the Treasury in auctions revenues since 1994—$1.56 billion of that just last month. We are on course to raise billions more in the next few years to fund, among other things, the deployment of an interoperable broadband network for our Nation's first responders, as well as to reduce the deficit. The Commission supports an industry that is essential to our Nation's economy and stimulates ever-higher levels of financial growth. We have repurposed and re-engineered significant amounts of spectrum to fuel these industries—including spectrum that would have been considered almost useless barely a decade ago. During the past 3 years, the Commission has reformed the Universal Service Fund (USF)—a massive undertaking designed to take this 20th century program into the next decades of the 21st century—and now we are building on that reform with a sharpened enforcement focus.

The Commission's activities are entirely funded by those it regulates. In other words, there is a zero relationship between Commission expenditures and the Federal deficit. We have no direct appropriation, and we work hard to raise funds to put money back into the Treasury. In fact, the industries that we regulate contributed $17 million to sequestration since that money was derived from their licensing fees. Auctions revenues cover auctions costs, and the USF funds cover USF program costs.

The FCC's fiscal year 2015 budget request is $375,380,313, including $11,090,000 specifically allocated to the Office of Inspector General. Our auctions cap request is $106,200,000. Adopting this request will allow us to follow through on important priorities identified by your committee and our authorizers: the continued reform of USF programs to combat waste, fraud, and abuse and enhanced enforcement to put teeth into those reforms; as well as internal agency reform designed to make our processes responsive to consumers and the industry in a cost-effective fashion. Importantly, the auctions funds will support spectrum auctions identified in the 2012 Spectrum Act, which will make additional spectrum worth tens of billions of dollars available for commercial licensed services as well as providing nationwide spectrum for unlicensed use, and will support FirstNet.

Although it is important to keep costs down in the current budget environment, let me give you a snapshot of the Commission's recent budget restraints. The FCC's spending levels decreased after fiscal year 2009 from $341 million to $335 million, and hovered just at that mark for 2 years, finally hitting $339 million during the next 3 years—with $17 million of that number going toward sequestration in fiscal year 2013. During fiscal year 2013, the FCC cut its programming to the bone and worked hard to find cost savings, often delaying lifecycle replacements and improvements for facilities and equipment. In fiscal year 2011, the FCC had 1,776 employees. Today, we are down to 1,725, which is a 30-year low in full-time equivalents (FTEs). The number of FCC contracting personnel also has steadily decreased from a high of 959 in fiscal year 2009 to a current level of 470.

These cost reductions had real consequences. We have been unable to replace our Office of Engineering's Equipment Authorization System, and at this year's Consumer Electronics Show, I heard complaints about how sequestration's impact had slowed the approval of new products before last year's holiday shopping season. Cuts in employees left us chronically understaffed in enforcement, for example, so that our work to police pirate radio activities suffered—a big concern among some broadcasters—as we focused all available resources on public safety and homeland security activities. Likewise, we never replaced or upgraded our enforcement equipment. In fact, we have more than 200 relic information technology (IT) systems that are costing the agency more to service than they would to replace over the long term.

An effective and well-resourced FCC is critical, because we oversee the networks that power our information economy. The Commission's policies to unleash spectrum, promote competition, and provide regulatory certainty can help spur innovation and investment in a vital sector that drives economic growth and job creation. And the information and communications technology sector continues to be one of the leading lights of our economy and a key to our global competitiveness. For example:

—American firms account for 84 percent of global profits in the computer hardware and software industries.
—In 2010, the Information and Communication Technology (ICT) sector accounted for 24 percent of real gross domestic product (GDP) growth.
—Each year, the ICT sector generates more than $300 billion in free goods and services that are not captured by GDP statistics.
—The mobile apps economy, which didn't exist at the start of 2008, has created more than 750,000 U.S. jobs.
—Since 2009, more than $250 billion has been invested by private companies to expand, extend and upgrade broadband networks, which exceeds investment by the major oil and gas or auto companies.
—Annual investment in U.S. wireless networks grew more than 40 percent between 2009 and 2012.
—Venture capital financing of "Internet-specific" businesses has doubled in the past 4 years, from $3.5 billion in 2009 to $7.1 billion in 2013.

During the next year, the FCC will be hard at work on activities that will deliver significant benefits to consumers, businesses and our economy. We will be developing and licensing spectrum resources to spur innovation in new communications devices; upgrading, enhancing and securing our internal systems to better serve consumers and the industries that rely on us; and modernizing and enforcing our USF programs. That is really what the Commission's fiscal year 2015 budget is designed to support—another boom year of communications services for the American consumer and another year of growth for the industries that we support.

During that same year, the FCC, like the technology and telecommunications industries, needs to adapt to keep pace with the exploding marketplace. The FCC needs the basic tools to sustain and encourage industry growth; to protect licensees; and ensure the reliability and safety of the systems that we use. We need to do so in a way that fosters solid management practices that support, sustain and enhance the industries that we regulate.

One of the primary reasons that I initiated a process reform review upon assuming the FCC Chairmanship was because of my commitment to create an agency that is highly efficient, as well as responsive to the needs of all Americans. Instituting reform at this level will require the expenditure of resources that support essential programmatic changes. To support these efforts, the Commission is requesting a total of 1,790 FTEs for fiscal year 2015, which includes an additional 10 FTEs for Information Technology (IT) programming and 45 FTEs for USF modernization and oversight. These numbers are projections over the current low number of FTEs, and they represent an increase of only 14 FTEs over fiscal year 2011 levels.

The FCC carefully considered the need to hire additional employees prior to submitting its fiscal year 2015 budget request. We have far fewer personnel in IT than comparable agencies, and, as I mentioned earlier, we have more than 200 incompatible, aging computer systems that, because they cannot talk to one another, act to increase the cost of doing business. We must overhaul, upgrade, secure and replace IT systems that are antiquated relics—costly to maintain and harmful to agency productivity. The Process Reform report that I commissioned draws a direct line between inefficient and unreliable IT systems and sluggish administrative and regulatory activities. Certainly, the FCC, of all agencies, must be able to communicate effectively inside and outside the Commission. The failure to invest in IT now will keep us from achieving many of the reform goals that Congress has set—from transparency to timeliness.

Our other major spending target is USF modernization and oversight. The need here is urgent and resource-intensive. I intend to place a heavy—but not heavy-handed—emphasis on modernization and enforcement to ensure that USF adheres to Congress' vision and provides essential access to telecommunications services to all Americans—whether they live in a remote area of Alaska, in one of our American territories, or on an Indian reservation in North Dakota. On that note, I would emphasize that closing the infrastructure gaps in Indian country is an agency-wide priority, and I am committed to greater consultation with tribal leaders to promote broadband deployment and adoption in their communities.

We envision hiring a broad range of USF specialists with the regulatory, enforcement, economic, legal, accounting and auditing skills necessary to provide oversight of the USF programs in multiple offices and bureaus. Although our budget estimates for fiscal year 2015 indicate that most hires for USF would be targeted in the Wireline Competition Bureau (WCB), our new Managing Director currently is reviewing and revising the individual bureau staffing levels in accordance with the Commission's mission objectives. While the final recommendation has not yet been made, the USF employees will likely be distributed among WCB, the Enforcement Bureau (EB), Office of Inspector General (OIG), and the Office of the Managing Di-

rector (OMD). Every time I read or hear a news story about someone who tries to game the USF system, I recommit myself to the goal of dedicating qualified staff to reducing fraud.

Our requested auctions spending bump will support current auctions activities as well as the complex process of developing the Incentive Auction Program. Since 1994, the auctions expenses have been approximately 2 percent of our total auctions revenues. The Commission operated the auctions program for 10 years under a cap without inflationary adjustments, only receiving an increase in fiscal year 2013 to fund the start-up for the Incentive Auctions program.

The Commission welcomed the statutory authority to initiate and operate Incentive Auctions because of its benefits to consumers and stakeholders, as well as the Treasury. We are grateful that you recognized the need to ensure that this program is properly funded and that you provided us with the necessary resources to move ahead with our work, even as other programs were facing sequestration. The importance of this auction to the public safety community and the boost it will provide for nationwide interoperable communications will benefit all Americans. We also see this auction as a significant financial opportunity for many broadcasters—it will enhance the ability of broadcasters retaining their spectrum to continue providing the public with diverse, local, free over-the-air television service.

At the same time, the reclaimed spectrum will promote economic growth and enhance America's global competitiveness. More spectrum means more speed, capacity and ubiquity of mobile broadband services such as 4G LTE and Wi-Fi networks. These benefits will be magnified by another auction scheduled for the next year, AWS–3, which will provide access to reclaimed Federal spectrum.

I appreciate this subcommittee's attention to the Commission's funding needs during the next fiscal year, and I look forward to working with you to fulfill our statutory mission efficiently and effectively. Thank you.

Senator UDALL. Thank you very much for your testimony.

And Commissioner Pai, good to see you here, and please proceed with your testimony.

SUMMARY STATEMENT OF HON. AJIT PAI

Mr. PAI. Thank you, Mr. Chairman.

Chairman Udall, Ranking Member Johanns, Senator Moran, thank you for inviting me to testify this morning on the work of the Federal Communications Commission.

This morning, I would like to focus my opening remarks on two critical issues: Reforming the Universal Service Fund (USF) and modernizing the agency's processes.

First, USF. The Communications Act makes an important promise in the very first sentence: Congress created the FCC "to make available, so far as possible, to all the people of the United States" communication services.

We at the FCC take this promise seriously. And that is one reason why the Commission reoriented USF support away from telephone service and toward next-generation broadband networks in 2011.

And, of course, not every reform of the Universal Service Transformation Order has worked out as intended. Chairman Wheeler and I were not yet at the Commission when that order was adopted. So we can take a fresh look and reexamine whether any aspects of that order have actually deterred rural investment and harmed rural consumers.

Fortunately, it appears the Commission will soon cross one such aspect off the books—the Quantile Regression Analysis, or QRA, benchmarks. For over a year, I and many others have warned that the QRA benchmarks have increased regulatory uncertainty, chilled the investment climate, and impeded the deployment of broadband to rural Americans.

That said, the benchmarks were unanimously adopted. So it was no small matter when Chairman Wheeler announced a change of course in December. I applaud him for that decision. Ending regulatory uncertainty was the right thing to do, especially given that the QRA benchmarks did not save the Fund a single dollar.

There is another aspect of the Universal Service Transformation Order I hope the Commission will reexamine soon, and that is the so-called rate floor. The rate floor was designed to reduce "excessive subsidies for basic phone service." But it doesn't do that. Instead, it increases the rates rural consumers pay without reducing the subsidies that carriers receive.

Specifically, the rate floor offers certain rural telephone companies Federal universal service dollars to increase consumers' phone bills. And these rate hikes are not minimal. Today, the rate floor is $14 per month, but it is set to go up soon to $20.46 on July 1, increasing rates for over 1 million rural consumers. That is a 46 percent jump for some consumers, many of whom are still waiting for the economic recovery to arrive.

And for small carriers in these areas, it may mean more serious financial problems. Rate shock could send customers off their networks entirely, which means further uncertainty about the economics of rural investment.

My view is that we should not add to the challenges our fellow citizens face in rural America. Instead, we should freeze the rate floor indefinitely and reexamine this policy. We followed that path with respect to the QRA benchmarks under the Chairman's leadership, and I hope we do so here, too.

Second, process reform. This is important because it affects every area of the Commission's work. On the legislative front, a bipartisan supermajority of the U.S. House of Representatives passed recently the FCC Process Reform Act of 2013. The House also passed the FCC Consolidated Reporting Act of 2013 back in September by a vote of 415 to 0. Together, these bills would eliminate outdated mandates on the agency, streamline our operations, and make it more accountable to the public. I hope these bills become laws soon.

However, the FCC cannot and should not wait for Congress to act. There is much that we can do on our own. All too often, proceedings at the FCC drag on needlessly for many years. I am encouraged that Chairman Wheeler from the get-go has said that process reform is a priority, and many of the reforms proposed in last month's staff report on this topic are a good starting point.

For instance, we should establish more deadlines and set an internal schedule for meeting those deadlines. We should also become more transparent to the public and to Congress about the work we do, and we can do that by creating an FCC dashboard on our Web site that collects in one place key performance metrics, such as how long it takes us to process consumer complaints.

And Chairman Udall, I support your call to make our consumer complaint database searchable and user friendly. You are absolutely right that this idea, which is included in the FCC Process Reform Act I just mentioned, would benefit consumers. I believe it should be a part of our dashboard. For if we make it easier for others to hold us accountable for our performance, I am confident that all of us would act with more dispatch.

PREPARED STATEMENT

Finally, I should note that while all commissioners are asked to vote on a budget proposed by the Chairman and submitted to the Office of Management and Budget, I have not been asked to participate in the development of the agency's budget request. But with that context in mind, I will do my best to respond to any questions you might have on that score or on any of the policy priorities that the FCC is tackling.

Thank you once again, Mr. Chairman, Ranking Member Johanns, and I look forward to our exchange.

[The statement follows:]

PREPARED STATEMENT OF HON. AJIT PAI

Chairman Udall, Ranking Member Johanns, and members of the subcommittee, it is a privilege to appear before you today. Thank you for inviting me to testify on the work of the Federal Communications Commission (FCC).

We have been busy, and today I'd like to share with you my views on several important issues that we are confronting, namely: freeing up spectrum for commercial use, reforming the Universal Service Fund's high-cost and E-Rate programs, removing regulatory barriers to infrastructure investment, adjusting our rules to the changing media marketplace, ensuring Americans can always reach help when they dial 911, and reforming the agency's processes.

Spectrum.—Given this subcommittee's focus on appropriations, it is worth noting that the FCC is one of few agencies that can generate a profit for the Federal Government. By auctioning off spectrum, the Commission has raised tens of billions of dollars for the Treasury over the last two decades. Between 2005 and 2008, for example, the Commission's spectrum auctions raised over $33 billion that was used for deficit reduction, and the FCC's auctions program was a net contributor to the Treasury each and every year.

But the Commission's auction program has not always turned a profit. From January 2009 through December 2013, the Commission raised a paltry $72 million in auction revenue, or about two-tenths of 1 percent of the amount raised in the prior 4 years. Indeed, when you account for the Commission's spending on auctions, our auctions program has actually lost money during the last 5 years. This is bad news not just for the Treasury but also for American consumers, whose demands for additional bandwidth have increased as their use of tablets and smartphones has spiked over this same period of time.

That is why, since joining the Commission, I have concentrated on trying to accelerate the allocation of spectrum for mobile broadband and to rejuvenate the Commission's auction program. And I am pleased to report that we recently have made real progress on both of these fronts. Just last month, the Commission completed its first major spectrum auction in 6 years by auctioning off the H Block, 10 MHz of long-fallow spectrum once thought to be virtually worthless, to the tune of $1.564 billion. Former Chairwoman Clyburn deserves credit for pushing that auction through, as does Chairman Wheeler for finishing the job.

But our work isn't finished. In the Middle Class Tax Relief and Job Creation Act of 2012, often called the Spectrum Act, Congress entrusted the Commission with holding a number of spectrum auctions, all with the twin goals of getting new spectrum into the commercial marketplace and raising at least $27.95 billion for national priorities.

What are those national priorities? In short, they are deficit reduction and public safety—two things I'm sure every member of this subcommittee holds as priorities. Regarding the former, our incentive auctions hold the promise of raising more than $20 billion for deficit reduction. Indeed, Congress counted on us raising this money when it passed the Spectrum Act, so if the Commission fails to follow through, we will be responsible for increasing the budget deficit.

As for public safety, successful spectrum auctions will provide money for key public safety priorities, such as the First Responder Network Authority's (FirstNet's) build-out of a nationwide, interoperable public safety broadband network. That $7 billion build-out makes good on the recommendation of the 9/11 Commission that first responders need interoperable communications systems in times of disaster. The Spectrum Act also set aside up to $135 million for State and local public safety officials, up to $300 million to advance the research and development of wireless public safety communications, and up to $115 million for the deployment of next-

generation 911 (NG911). Under the law, all of this funding will be realized only if the net revenues of our wireless auctions are at least $27.95 billion.

Given these important national priorities, we need to aim high. The H Block auction was a first step toward those goals, but a chunk of the money raised there will pay for running our auctions program. We still have about $27 billion to go.

The next step towards raising these needed funds will be the auctioning of Federal spectrum as required by the Spectrum Act. Most important to that effort are two bands of spectrum, 1755–1780 MHz paired with 2155–2180 MHz, that will hopefully become part of a new Advanced Wireless Service-3 (AWS–3) service. These bands are already internationally harmonized for commercial use, which means deployment will be swifter and cheaper than other options. That also means carriers are likely to bid more for this spectrum, which can lead to greater net revenues for the national priorities I described above.

Note that I said "hopefully." Under the Commercial Spectrum Enhancement Act, the Commission can only assign commercial licenses for this spectrum if the revenues from the auction exceed 110 percent of the costs of relocating Federal users out of that spectrum and coordinating with those that remain. And the best way to make sure that we hit that mark and push that spectrum out into the marketplace is to invite all carriers to participate in the auction and offer a band plan that incentivizes the carriers to bid up the spectrum without restraint.

One further note on this band: I regret that we will not be bringing all of this spectrum to the marketplace free and clear from interference by incumbent Federal users. Clearing 1755–1780 MHz of Federal users would be the best way to maximize the value of spectrum, both at auction and for consumers. That's what we did 10 years ago when we created the AWS–1 band that is so important to mobile broadband today, and that's why the Spectrum Act puts a thumb on the scale for clearing and allows sharing only if clearing is "not feasible because of technical or cost constraints." But it appears that the decision has been made that clearing is not feasible at this point. I therefore hope that the Government will do its part for the public, publishing specific and detailed transition plans as early as possible and coordinating with carriers quickly so that this spectrum can be put to use soon.

After this auction of Federal spectrum in the fall, the broadcast incentive auction will be the Commission's best opportunity to push a large amount of spectrum well-suited for mobile broadband into the commercial marketplace and raise the billions we need. With this auction, television broadcasters will have the opportunity to relinquish their spectrum that wireless carriers will then have the opportunity to purchase, with the bid-ask spread (i.e., the net revenues) going to the Treasury once the Commission has paid for the relocation expenses of broadcasters remaining in business.

As the Commission moves forward on incentive auctions, I believe that five principles should guide our work. *First,* we must be faithful to the statute. It is our job to implement the Spectrum Act, not to rewrite it to conform to our policy preferences. *Second,* we must respect the laws of physics. Our band plan and approach to repacking must work from an engineering perspective. *Third,* we must be fair to all stakeholders. This is especially important because the incentive auction will fail unless both broadcasters and wireless carriers choose to participate. *Fourth,* we must keep our rules as simple as possible. The broadcast incentive auction is inherently complicated; unnecessary complexities are likely to deter participation. And *fifth,* we need to complete this proceeding in a reasonable timeframe. Prolonged uncertainty is not good for anyone.

My greatest worry regarding the incentive auction, at this point, is about participation. In order for the incentive auction to be successful, we will need robust participation by broadcasters and wireless carriers alike. But right now, I am concerned that the Commission will make unwise policy choices that will deter participation in both the reverse and forward auctions. My position on the reverse auction is simple. Prices paid to broadcasters should be determined by the market. The Commission should not set them by administrative fiat. The Commission should not deter broadcaster participation through a complicated "scoring" scheme that tries to prejudge the compensation television station owners should receive. Any attempt to restrict payments to broadcasters will prove to be penny-wise and pound-foolish. Indeed, without sufficient broadcaster participation, the entire incentive auction will fail.

And on the forward auction, the Commission should not limit carriers' ability to participate, such as by setting a spectrum cap or narrowing the spectrum screen despite the significant competition that exists in the wireless market. The inevitable effect of such a policy would be less spectrum for mobile broadband, less funding for national priorities, a higher budget deficit, and an increased chance of a failed auction. With a $27.95 billion target, we cannot let this auction fail.

Finally, there's one last piece of spectrum I'm excited to discuss: the 5 GHz band. Although we are not planning to auction this spectrum, it can—and I believe will—be of substantial value to the American economy. The 5 GHz band is tailor-made for the next generation of Wi-Fi. Its propagation characteristics minimize interference in the band and the wide, contiguous blocks of 5 GHz spectrum allow for extremely fast connections, with throughput reaching 1 gigabit per second. The technical standard to accomplish this, 802.11ac, already exists, and devices implementing it are already being built. All of this means we can rapidly realize these benefits: more robust and ubiquitous wireless coverage for consumers; more manageable networks for providers; a new test bed for innovative application developers; and other benefits we can't even conceive today.

Following the instructions set forth by Congress in the Spectrum Act, the Commission launched a rulemaking last year to make up to 195 MHz of additional spectrum in the 5 GHz band available for unlicensed use. We also proposed to allow greater utilization of those segments of the 5 GHz band already available for unlicensed use. Last summer, I urged the FCC to move forward with its 5 GHz proceeding in stages, addressing the easier questions (such as how to modify the service rules for the UNII–1 band) before moving on to the hard ones.

And at the end of this month the Commission will be taking action. Although I cannot comment on specifics, I can say that I am pleased that we will be making the band attractive for commercial Wi-Fi while safeguarding incumbent users. That means better, faster devices for consumers, which is all the more important given the growing congestion in the 2.4 GHz band (which consumers right now commonly rely upon for Wi-Fi access).

Universal Service Fund.—Another big ticket item in the Commission's budget is the Universal Service Fund, which disbursed over $8.36 billion last year. The Fund contains four separate programs, three of which are capped. The high-cost program has a yearly budget of $4.5 billion, which is used to keep rural telephone rates "affordable" and deploy broadband to areas where the competitive market would not otherwise go. The E-Rate program, which supports schools and libraries, had a $2.38 billion cap last year, which is adjusted each year for inflation. And the rural healthcare program is capped at $400 million, but spending totaled only $157 million last year. The only uncapped program is the Lifeline program, which disbursed $1.79 billion last year, more than double the $817 million disbursed in 2008. In addition to these disbursements, the Fund spent $109 million in 2013 on administrative costs (not including the costs of Commission staff overseeing the program), with the majority ($65.6 million) dedicated to administering the E-Rate program. My testimony will focus on the high-cost program and the E-Rate program.

High-Cost.—The Communications Act of 1934 makes an important promise in its very first sentence: Congress created the Federal Communications Commission to "make available, so far as possible, to all the people of the United States . . . a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges." We at the FCC take this promise seriously. That is one reason why the Commission adopted the 2011 *Universal Service Transformation Order,* which reoriented the Fund away from supporting telephone service and toward supporting next-generation, broadband-capable networks.

Fortunately, it looks like the Commission will soon be crossing one obstacle to rural investment off its books: the quantile regression analysis (QRA) benchmarks. For over a year, I and many others have warned that the QRA benchmarks have increased regulatory uncertainty, chilled the investment climate, and impeded the deployment of broadband to rural Americans. That said, the benchmarks have been the law for over 2 years so it was no small matter when Chairman Wheeler announced a change of course in December. Ending regulatory uncertainty is the right thing to do, especially given that the QRA benchmarks did not save the Fund one dollar. I am hopeful that ending the QRA benchmarks means that bringing next-generation technologies to our Nation's rural citizens will be a priority during Chairman Wheeler's tenure, and I look forward to continue working with him to make that happen.

But sometimes it seems that every step forward for rural America is accompanied by a step back. I am concerned about another aspect of the Universal Service Transformation Order that is likely to have serious and unfortunate consequences for rural consumers: the so-called "rate floor," which was adopted before Chairman Wheeler or I arrived at the Commission. The rate floor was designed to reduce "excessive subsidies for basic phone service," but in fact it increases the State-set rates rural consumers pay without reducing the subsidies that carriers receive. Specifically, the rate floor offers certain rural telephone companies Federal universal service dollars to increase customers' phone bills. So if a company increases its rates by a dollar, it'll receive an extra dollar for per line from the Fund.

And these rate hikes are not de minimis. Today, the rate floor is $14 per month, but it is set to go up to $20.46 on July 1 under the terms of the Universal Service Transformation Order. That's a 46 percent jump for rural consumers, many of whom are still waiting for the economic recovery to arrive. And for small carriers, it may mean more serious financial problems. Such a rate shock could send customers off the network entirely, which means further uncertainty about the economics of investing in rural America. We should not be adding to the challenges our fellow citizens face in rural America. Instead, I hope the Commission will soon freeze the rate floor indefinitely and reexamine this policy.

There are other steps that we must take to follow up on the promise of universal service. For example, we have yet to implement phase II of the Connect America Fund, which is the FCC's primary vehicle for delivering broadband to the millions of rural Americans without it. The second phase was supposed to commence at the beginning of 2013 but it looks like it won't start until 2015 at the earliest. Given that the Wireline Competition Bureau has been doing yeoman's work to complete the model necessary for that effort—and given the urgent need for broadband in the country—we should aim to make sure that effort does not fall further behind. That means setting out the competitive bidding process that will occur in areas where price-cap carriers decline Connect America Fund support sooner rather than later because no part of rural America should miss the broadband revolution while waiting for the regulatory dust to settle.

Similarly, it is time for the Commission to start moving forward with a Connect America Fund for rate-of-return carriers. In constructing that fund, we must recognize that broadband operators in rural America today face unique challenges. Rural carriers must carefully plan their infrastructure over a 10- or 20-year time scale if they are to recover their costs. Indeed, Congress embedded this principle into section 254 of the act, including a statutory command that universal service support be "predictable." What is more, line loss in rural America is real. As such, we must recognize that direct support for broadband-capable facilities, within the existing budget, is critical.

E-Rate.—I am hopeful that, in the next few months, we will bring about real reform of that program. Established at the direction of Congress 18 years ago, the E-Rate program is intended to bring advanced communications services to schools and libraries across America.

In many ways, the E-Rate program has been a success. Internet access in public schools has almost tripled, and speeds have grown alongside availability. For example, a 2010 FCC survey showed that 22 percent of respondents were "completely" satisfied and another 58 percent were "mostly" satisfied with the bandwidth they're getting. And just last year, 87 percent of educators responding to an independent survey reported that "access to adequate bandwidth is available for robust communication, administrative and instructional needs" in "all" or "most" classrooms on a school campus.

But like all Federal programs, E-Rate has had its share of difficulties. For applicants, the funding process from start to finish can stretch for years. To navigate arcane steps like Form 470 competitive bidding, Form 471 Program Integrity Assurance review, and the Form 500 commitment adjustment process, schools must enlist specialized E-Rate consultants, draining scarce dollars away from students and technology.

For parents, the process is so opaque that they cannot know ahead of time how much funding their child's school might receive and cannot track whether it is actually spent on enriching the education of their kids.

For school boards, E-Rate's "priority" system (under which things like paging and Blackberry services for administrators get prioritized over connecting a classroom to the Internet) distorts their spending decisions since some services are discounted by up to 90 percent while others may or may not receive any discount in a given funding year.

For Government watchdogs, there's plenty of waste and abuse to worry about. For example, one Brooklyn school has gotten millions of E-Rate dollars over the years including money for Internet access services—even though the students are not allowed to use the Internet.

And for everyone with a phone line, and who hence contributes to the program, it's hard to tell what bang we're getting for our universal service buck—there is no meaningful transparency with respect to E-Rate spending and no real information on the impact of that spending.

There is a better way—one which would focus the E-Rate program on children. To create a student-centered E-Rate program, we need to fundamentally rethink how we structure the program. That means starting each school and library with an upfront allocation of funding so they know how much they can spend and can

plan accordingly (a concept a subcommittee like this one should appreciate). That means establishing a meaningful matching requirement so that schools and libraries have a strong incentive not to waste money. That means cutting the red tape so that the initial application is just one page and there's only one other form needed before funds are disbursed. That means targeting funding at next-generation technologies like broadband and Wi-Fi while still letting local schools set their own priorities. And that means publishing all funding and spending decisions on an easily accessible, central Web site so that every parent, every journalist, every Government watchdog, every American can see just how E-Rate funds are being spent.

The student-centered E-Rate program I have outlined (a summary is appended to this testimony) would fulfill E-Rate's statutory mission of bringing advanced services to schools and libraries across the country. It would reduce waste, fraud, and abuse in the program and increase transparency and accountability. By streamlining the rules, we would also reduce the need for administrative overhead, saving the Government millions more. And it would free an extra $1 billion for next-generation services in its first year ($600 million of which is currently spent each year on basic telephone service and other outdated technologies), all without collecting an extra dime from the American people.

Given the potential savings at hand, I do not support increasing the program's budget at this time, and I am pleased that Chairman Wheeler appears to be on the same page. For example, last week he said that "[s]imply sending more money to the E-Rate program to keep doing business as it has been for the last 18 years is not a sustainable strategy." I concur. Indeed, under no circumstances should we increase the size of the E-Rate program without finding corresponding new savings elsewhere in the Universal Service Fund. We cannot ask Americans to pay even more in their monthly phone bills, especially when median household income in this country is lower than it was in 2007.

If we are willing to make the "hard decisions," as Chairman Wheeler has put it, I believe that real reform of the E-Rate program can become a reality. A student-centered E-Rate program—that's what teachers and librarians need, and that's what America's students and parents are counting on us to deliver.

Infrastructure Investment.—Removing regulatory barriers to the deployment of infrastructure is another Commission priority. To give entrepreneurs, investors, and innovators the regulatory certainty they need to invest in next-generation infrastructure, we need to make sure that we are not saddling them with last-generation rules. That means hastening the Internet protocol (IP) Transition and facilitating wireless infrastructure deployment.

IP Transition.—Almost every segment of the communications industry is competing to offer newer, faster, and better broadband services. Telecommunications carriers are upgrading DSL with IP-based technology and fiber. Cable operators have deployed DOCSIS 3.0 to increase bandwidth 10-fold. Satellite providers are offering 12 megabit packages in parts of the country that never dreamed of such speeds. And millions of Americans—many of whom don't subscribe to fixed broadband service at home—now have access to the Internet on the go using the mobile spectrum the Commission auctioned back in 2006 and 2008. Indeed, according to the State Broadband Initiative of the National Telecommunications and Information Administration, 98.8 percent of Americans had access to high-speed broadband as of December 2012. The common thread knitting all of these changes together is the Internet protocol (IP), a near-universal way to route and transmit data.

What are the results of all this competition? More choices for consumers, and major challenges to old business models. Thirty years ago, most American consumers had access to one network largely run by one carrier, Ma Bell. Today, Americans are fleeing the copper network. 33.6 million Americans dropped their copper landlines over the past 4 years. About one in seven households with plain old telephone service over the public-switched telephone network (PSTN) dropped their service last year alone. And competition is rampant: 99.6 percent of Americans can choose from at least three wireline competitors, and 92 percent can choose from *10 or more.* The evidence also shows that consumers are in fact exercising that choice: Interconnected voice over Internet protocol (VoIP) providers added 14.6 million subscriptions over the last 4 years. Essentially, voice is becoming just another application riding over the Internet.

Over a year ago, I called on the Commission to move forward with an All-IP Pilot Program, one that would give forward-looking companies a path to turn off their old time division multiplexing (TDM) electronics in a discrete set of wire centers and migrate customers to an all-IP platform. Why? Because we cannot continue requiring service providers to invest in both old networks and new networks forever. Every dollar that is spent maintaining the networks of yesterday is a dollar that

can't be invested in building and upgrading the networks of tomorrow. Our goal should be to maximize investment in IP infrastructure so that high-speed broadband extends to every corner of our country.

I am pleased that, under Chairman Wheeler's leadership, the Commission adopted an order establishing an Al-IP Pilot Program consistent with the four guidelines I set forth last year. *First,* carrier participation should be voluntary—and the order announced that "no provider will be forced to participate in an experiment." *Second,* trials should reflect the geographic and demographic diversity of our Nation— and the order sought "experiments that cover areas with different population densities and demographics, different topologies, and/or different seasonal and meteorological conditions." *Third,* no one can be left behind—and the order declared that "no consumer [may] lose[ ] access to service or critical functionalities" and that residential and business customers must receive "clear, timely, and sufficient notice of any service-based experiment." And *fourth,* we must be able to evaluate an all-IP trial with empirical data—and the order sought "experiments that collect and provide to the Commission data on key attributes of IP-based services." With these core principles in place, I am optimistic that the trials will be a success.

I am especially happy that the All-IP Pilot Program is moving forward on a unanimous, bipartisan basis. As I said last year, this isn't an issue that divides the left from the right or Republicans from Democrats. Accordingly, the order reflects our consensus that companies should have the opportunity to go all-IP. What is more, the order demonstrates that reaching an agreement does not mean compromising your values. I look forward to continuing our collaborations as we assess the proposed trials that are already coming in.

Of course, preparing for the IP Transition does not end with conducting an All-IP Pilot Program. We also need to take a hard look our regulations in light of the coming transition, if for no other reason than that the private sector needs flexibility to make investment decisions based on consumer demand, not outdated regulatory mandates. Accordingly, I believe four principles should shape our approach to the overall transition.

First, we must ensure that vital consumer protections remain in place. For example, when consumers dial 911, they need to reach emergency personnel; it shouldn't matter whether they are using the (public switched telephone network (PSTN), a VoIP application, or a wireless phone. The same goes for consumer privacy protections and antifraud measures like our slamming rules. *Second,* we must not import the broken, burdensome economic regulations of the PSTN into an all-IP world. No tariffs. No arcane cost studies. And no hidden subsidies that distort competition to benefit companies, not consumers. We must also repeal the old-world regulations such as retail tariffing that no longer make sense in a competitive all-IP world. While they remain on the books, wholesale expansion to IP may just be too tempting. *Third,* we must retain the ability to combat discrete market failures and protect consumers from anticompetitive harm. *Fourth,* we must respect the limits of the Communications Act and not overstep our authority. If the law does not give us the authority to act, we must turn back to Congress for guidance rather than venturing forth on our own.

Wireless Infrastructure.—Along with ending the economic regulations that deter wireline infrastructure investment and delay the deployment of next-generation networks, we need to address the business and technical challenges of deploying wireless broadband. Building a wireless network is expensive enough, but numerous Federal, State, and municipal regulations can make further deployment difficult or even prohibitive. To be sure, some oversight is necessary to ensure sound engineering and safety and to respect environmental, historical, and cultural concerns. But many procedures simply frustrate, rather than facilitate, deployment. That ultimately harms consumers who are denied better and cheaper wireless services.

I am therefore pleased that the Commission moved forward last September with a Notice of Proposed Rulemaking seeking comment on a variety of ideas for reducing regulatory barriers to the construction of wireless infrastructure. In particular, I'd like to highlight three of them in my testimony this morning.

First, we should make clear that local moratoria on the approval of new wireless infrastructure violate Federal law. The FCC has already put in place a shot clock for localities to address tower siting permits and other building applications. Prohibiting moratoria would address the tactic some localities have used to evade those deadlines by adopting an indefinite "time out" on the approval of wireless infrastructure.

Second, we should modernize our rules to exempt distributed antenna systems (DAS) and small cells from our environmental processing requirements, except for rules involving radio frequency emissions. Given their small size and appearance—some small cell equipment can fit in the palm of your hand, for instance—there is

no reason to subject DAS and small cells to the same environmental review process as a 200-foot tower. We should similarly update our historic preservation rules, which add yet more regulatory requirements, in order to facilitate the deployment of DAS and small cells. It bears noting that the greater the deployment of wireless infrastructure like this, the less reliance carriers (and hence consumers) must place on larger, "macro" cell sites and the less power networks and devices will consume.

Third, we should address what happens when a local government doesn't comply with our shot clock. Currently, if a city does not process an application within 150 days, the only remedy is to file a lawsuit. This increases delay and diverts investments away from networks. To fix this problem, we should supplement our shot clocks with a backstop: If a locality doesn't act on a wireless facilities application by the end of the time limit, the application should be deemed granted. (As a legal matter, I believe the FCC has this authority following the Supreme Court's decision last May in *City of Arlington, Texas* v. *FCC*.)

There are also other steps that the Commission can take to hasten the deployment of wireless infrastructure. For example, we have sought comment on clarifying the scope and meaning of section 6409(a) of the Spectrum Act, which prohibits State and local governments from denying certain collocation requests. I hope that we make appropriate clarifications in the near term. And we are looking for ways to expedite the deployment of infrastructure to implement positive train control, as required by the Rail Safety Improvement Act of 2008. I support moving forward on all these fronts swiftly; the American public deserves no less.

Net Neutrality.—Given the amount of work the Commission must do to remove regulatory barriers to infrastructure investment, I hope that we do not divert our attention to promulgating rules that may in fact erect new barriers. I am of course talking about "net neutrality," which has apparently returned to the FCC's agenda after the courts ruled—for the second time in 4 years—that the FCC exceeded its authority in attempting to regulate the network management practices of Internet service providers.

Without delving too far into the subject, let me say this. For over a decade, the Nation's broadband infrastructure has been governed by four Internet Freedoms, set forth by then-FCC Chairman Michael Powell. *First,* consumers should have their choice of legal content. *Second,* consumers should be able to run applications of their choice. *Third,* consumers should be permitted to attach any devices they choose to the connection in their homes. And *fourth,* consumers should receive meaningful information regarding their service plans. Although our Nation's broadband marketplace is dynamic and rapidly evolving, these four freedoms have remained vibrant throughout—they are in a sense the pillars, the foundation of the market—and they have long received bipartisan support.

With those principles already entrenched, the FCC should stay its hand and refrain from any further attempt to micromanage how broadband providers run their networks. Such restraint is the best way to ensure that the market—and hence consumers—dictate the future of the Internet. This, in turn, will encourage innovation throughout the entire Internet ecosystem and incentivize the continued deployment of high-speed, quality broadband service. Our goal should be to connect all Americans with smart networks, not to enact rules that require networks to be dumb pipes. So let's recognize net neutrality for what it is: an unnecessary distraction from the pressing need to end regulatory barriers that stand in the way of ubiquitous broadband.

Media Marketplace.—The media landscape has undergone revolutionary change in the last few decades. But the FCC's rules have not kept pace with the realities of the marketplace. Accordingly, since joining the Commission, I have advocated updating our regulations on a variety of fronts while at the same time preserving the Commission's commitment to the core values of competition, diversity, and localism. Today I will focus on two aspects of our work: reviewing our media ownership rules and revitalizing the AM radio band.

Media Ownership.—The Commission is required by law to review its media ownership regulations every 4 years. This cycle's review began in September 2009 as we announced a series of workshops to begin gathering information from various stakeholders. Now, more than 4 years later, our review is still not complete. The time has come for us to launch our next review, but we have not yet finished the last one. This is unacceptable and shows a troubling disregard for our legal obligations. We should bring the current quadrennial review to a close at the Commission's March 31 meeting.

We should make sensible reforms to our rules so that they reflect the marketplace realities of 2014 rather than those of 1975. For example, I supported then-Chairman Julius Genachowski's proposal to eliminate the newspaper-radio and radio-television cross-ownership rules. I also believe that the time has come to eliminate the news-

paper-television cross-ownership rule. In this day and age, if you want to operate a newspaper, we should be thanking you, not placing regulatory barriers in your path. I am a realist and understand that whatever reforms we end up implementing will not go as far as I might prefer. But I do believe that we should be able to find common ground and move forward with some sensible reforms.

Unfortunately, it appears that the Commission is set on tightening our media ownership rules in a piecemeal fashion rather than engage in the holistic review that Congress envisioned. Most disturbing is a proposal to make Joint Sales Agreements (JSAs) attributable under our local television ownership rule. As broadcasters' share of the advertising market has shrunk in the digital age, television stations must be able to enter into innovative, pro-competitive arrangements in order to operate efficiently.

JSAs allow stations to save costs and to provide the services that we should want television broadcasters to offer, particularly in our Nation's mid-sized and small media markets. In my home State, for example, a JSA between two Wichita stations enabled the Entravision station, a Univision affiliate, to introduce the only Spanish-language local news in Kansas. Across the border in Joplin, Missouri, a JSA between Nexstar and Mission Broadcasting not only led to expanded news programming in that market but also nearly $3.5 million in capital investment. Some of that money was spent upgrading the stations' Doppler Radio system, which probably saved lives when a devastating tornado destroyed much of Joplin in 2011.

JSAs are also an important tool for enabling minority ownership of television broadcasters. Although the Commission has not studied the link between joint sales agreements and ownership diversity, my office's own review estimated that 43 percent of female-owned and 75 percent of African-American-owned full-power commercial television stations currently are parties to JSAs. For example, WLOO serves the Jackson, Mississippi market and is owned by Tougaloo College, a historically African-American college. WLOO is also party to a JSA with another Mississippi station, WDBD, which, in the words of WLOO's general manager, "has permitted WLOO to become a real success story, enabling a new, minority station owner to reinvigorate this station and expand its local services." Without the JSA, WLOO reports that it would have to stop creating locally-produced programming so that it could redirect that money to hiring a small sales staff, and its general manager is worried that it may not have the funding to survive an equipment failure.

For stations in smaller markets like Wichita, Joplin, and Jackson, the choice isn't between JSAs or having both television stations operating vibrantly on an independent basis. Rather, the real choice is between JSAs and having at most one television station continue to provide news programming while the other does not. Indeed, the economics suggest that there likely will be fewer television stations, period.

Another piecemeal change to our media ownership rules was teed up in September with a notice of proposed rulemaking (NPRM) proposing to eliminate the ultra high frequency (UHF) discount portion of our national television ownership rule. Given the transition from analog to digital television, there is a strong case for ending the UHF discount; UHF signals are not inferior to very high frequency (VHF) signals in the digital world. Unfortunately, the Commission's NPRM went about it the wrong way.

We should not modify the UHF discount without simultaneously reviewing the national audience cap, which currently stands at 39 percent. The NPRM recognized the interdependent relationship between the national audience cap and the UHF discount, acknowledging that "elimination of the UHF discount would impact the calculation of nationwide audience reach for broadcast station groups with UHF stations." Or, to put the matter succinctly, eliminating the UHF discount would substantially tighten the national ownership limit. For example, one company that is now more than 19 percentage points under the cap would be only 3 points below the cap if the UHF discount were eliminated.

I was therefore disappointed that we proposed to end the UHF discount without asking whether it is time to raise the 39 percent cap. Indeed, this step is long overdue, notwithstanding *any* change to the UHF discount. The Commission has not formally addressed the appropriate level of the national audience cap since its 2002 Biennial Review Order, and it has been about a decade since the 39 percent cap was established. The media landscape is dramatically different today than it was then, and I wish that the NPRM had addressed the national television rule in a comprehensive manner.

AM Radio.—This past October, the Commission launched an AM Radio Revitalization Initiative, something I had championed for more than a year. It's been over two decades since we last comprehensively reviewed our AM radio rules. Over that time, the AM band has struggled. Interference problems, declining listenership, fi-

nancial challenges for minority-owned broadcasters, and other factors have brought the band low. But millions of Americans—myself included—still rely on and believe in AM radio. So this initiative is close to my heart.

The Commission's NPRM embraced a sensible two-stage strategy for improving AM radio service. *First,* we proposed several ways to give AM broadcasters relief in the short term. For instance, we suggested a number of changes to our technical regulations, such as eliminating the "ratchet rule," which effectively prevents AM broadcasters from improving their facilities. And perhaps most importantly, we sought public input on letting AM stations apply for new FM translators so that it is easier for them to reach listeners with a quality signal. I'm the first to acknowledge that these and other proposals will not be an immediate panacea for the difficulties confronting the AM band. But based on the conversations I have had with AM broadcasters across the country during the past year, I am convinced that they can make a substantial, positive difference to numerous AM stations.

Second, we also invited the American public and stakeholders to share their proposals for the long-term future of the AM band. What steps can the Commission take so that there will be a vibrant AM radio service 10 or 15 years from now?

The comment cycle closed last week, and we received many insightful and creative submissions from broadcasters, engineers, and others with an interest in AM radio. While we continue to review those comments, I am optimistic that the Commission will act quickly to implement an initial set of reforms to help the AM band. Indeed, my office's quick review of the comments that were filed suggests overwhelming support for many of the Commission's proposals.

Connecting Americans to 911.—Federal law designates 911 as "the universal emergency telephone number within the United States for reporting an emergency to appropriate authorities and requesting assistance." So when Americans dial 911, they expect and deserve to reach emergency personnel who can assist them in their time of need. Unfortunately, a recent tragedy shows that this is not always the case.

On December 1, Kari Rene Hunt Dunn met her estranged husband in a Marshall, Texas hotel room so that he could visit their three children, ages 9, 4, and 3. During that encounter, Kari's husband forced her into the bathroom and began stabbing her. Kari's 9-year-old daughter did exactly what every child is taught to do during an emergency. She picked up the phone and dialed 911. The call didn't go through, so she tried again. And again. And again. All in all, she dialed 911 four times—but she never reached emergency personnel. Why? Because the hotel's phone system required her to dial 9 to get an outside line. Tragically, Kari died as a result of this vicious attack. Kari's daughter behaved heroically under horrific circumstances. But the hotel's phone system failed her, her mother, and her entire family.

At first, I was shocked to hear that such a situation could exist. But when you think about it, it's probably the case in many places—hotels, office buildings, college campuses, and schools—that use "multiline telephone systems" or MLTS. But the truth of the matter is that we don't know the extent of the problem. That's why I launched an inquiry in January to gather the facts. As a first step, I sent a letter to the chief executive officers (CEOs) of the 10 largest hotel chains in America. As we continue to examine the information provided by those companies, I am encouraged by their willingness to respond and work with us to ensure everyone can reach a 911 operator when they need to. I am also encouraged that the American Hotel and Lodging Association, which represents 9 of the top 10 chains and many, many more hotels and motels, has convened an internal task force to address the issue.

So what is the issue, precisely? In the case of Kari Hunt Dunn, it was what we call the "Direct Dial" issue—whether somebody picks up on the other end if you dial 911. But there are a couple of accompanying issues that come along with it. First is the question of who should pick up the other end of the line. Should it always be someone at the Public Safety Answering Point (PSAP)? Or in some buildings, should it be an on-site security office or front-desk clerk? And if the call does to go the PSAP, how does someone in the building find out that a call has been placed so that he or she can provide more immediate assistance or guide first responders to the correct room?

The second question is *location.* Do the first responders know where the call is coming from? In large office buildings or complexes, on college campuses, and in hotels, it's not enough for first responders to show up at the front door, if one even exists. Conveying accurate location information to these emergency personnel is critical. If someone calls 911 in this building, for instance, think about how long it could take emergency medical technicians (EMTs) to find a person in distress if they don't know exactly where to go.

We can't erase the tragedy that occurred in a Marshall, Texas hotel room last December. But we can work to prevent such tragedies from happening again, and that's what I am determined to do. I am confident that everyone here shares my

belief that when an emergency strikes, people, whether in a hotel or office building, should be able to reach someone who can help.

Process Reform.—Before concluding, I would like to touch on a subject that affects all areas of the Commission's work: process reform. The U.S. House of Representatives recently passed the Federal Communications Commission Process Reform Act of 2013, H.R. 3675. I hope that this commonsense bill, as well as the Federal Communications Commission Consolidated Reporting Act of 2013, H.R. 2844, which the House of Representatives passed 415 to 0 back in September, will soon be enacted into law. Together, these bills squarely address the need to modernize the FCC to reflect our dynamic, converged communications marketplace. And they would eliminate outdated mandates on the agency, streamline its operations, and make it more accountable to the public. These are two pieces of straightforward, good-government legislation, and I hope that the President will soon have the opportunity to sign them.

The FCC, however, should not and need not sit still waiting for Congress to act. We should do what we can on our own to improve our internal processes. Our goal should be clear: The FCC should be as nimble as the industry that we oversee. All too often, proceedings at the Commission needlessly drag on for many years. I am encouraged that Chairman Wheeler has said that process reform is a priority, and many of the reforms proposed in last month's staff process reform report are a good starting point.

Indeed, a variety of reforms would improve the Commission's performance. We should streamline our internal processes where possible. For example, let's adopt a procedure akin to the U.S. Supreme Court's *certiorari* process for handling applications for review—but one that maintains accountability by giving each of the five Commissioners the opportunity to bring a Bureau-level decision up for a Commission vote. Let's speed up our processing of smaller transactions. Let's establish more deadlines, such as a 9-month deadline for ruling on applications for review and petitions for reconsideration along with a 6-month deadline for handling waiver requests—and let's ensure our internal calendar sets a schedule for getting those items prepared and circulated in time so that we can meet those deadlines. When we adopt industry-wide rules, let's more frequently use sunset clauses that require us to eventually revisit the wisdom of (and, if necessary, revise or repeal) those rules.

We should also become more transparent to the public and to Congress about how long it takes the Commission to do its work. One way to do this would be by creating an FCC Dashboard on our Web site that collects in one place key performance metrics. Let's keep track of how many petitions for reconsideration, applications for review, waiver requests, license renewal applications, and consumer complaints are pending at the Commission at any given time. And let's compare the current statistics in all these categories against those from a year ago, from 5 years ago, so everyone can see if we are headed in the right direction. If we make it easier for others to hold us accountable for our performance, I'm confident that we would act with more dispatch.

My emphasis on acting promptly is not just about good government. It is also about the impact that the FCC's decisions (or lack thereof) have on our economy. As the pace of technological change accelerates, so too must the pace at the Commission. We can't let regulatory inertia frustrate technological progress or deter innovation.

Finally, I should note that while all Commissioners are asked to vote on a budget proposed by the Chairman that is delivered to the Office of Management and Budget, I have never been asked to participate in the development of the agency's budget request. With that context in mind, I will do my best to respond to any questions you may have.

APPENDIX—A STUDENT-CENTERED E-RATE PROGRAM

A student-centered E-Rate program focuses on five key goals:

(1) Simplify the Program
- —Schools need to fill out *only two forms*: an initial application and a report back on how the money was spent
- —Initial application can be *no more than one page*
- —Universal Service Fund (USF) administrator does all the calculations, reducing the burden on schools
- —*Less red tape* means fewer delays, more predictability, and no need to hire consultants

(2) Fairer Distribution of Funding

—Allocates E-Rate budget across *every school in America*; every school board and parent knows how much funding is available on day one
—Schools receive money on a per-student basis; *funds follow students* when they change schools
—*Additional funds* allocated for schools in *rural and/or low-income areas as well as small schools* to account for higher costs and different needs

(3) Focus on Next-Generation Technologies for Kids
—Eliminates disincentive to spend money on *connecting classrooms*
—No more funding for stand-alone telephone service
—*Students come first*; funding directed only to instructional facilities, rather than non-educational buildings like bus garages
—Equal funding for all eligible services; *local schools (not Washington) set priorities*

(4) More Transparency and Accountability
—*Creates Web site* where anyone can find out exactly how any school is spending E-Rate funds; *enables parents, schools boards, press, and public to conduct effective oversight*
—School district superintendent or school principal must *certify* that E-Rate funds were *used to help students*

(5) Fiscal Responsibility
—*Ends the "more you spend, more you get" phenomenon*: Schools given fixed amount of money and must contribute at least one dollar for every three E-Rate dollars they receive
—*Better incentives, reduced waste, and less red tape* allows program to *accomplish a lot more* with the same amount of money; over $1 billion more in first year provided for next-generation technology
—*Caps overall USF budget* before any increase in E-Rate budget; any expansion in E-Rate must be accompanied by *corresponding cuts* elsewhere in USF

	Legacy E-Rate Program	Student-Centered E-Rate Program
Spending Priorities	—Prioritizes voice telephone service, long-distance calling, cell phone service, and paging ahead of connecting classrooms with broadband Internet access —Funding available for non-instructional facilities such as bus garages and sports stadiums	—Focuses on next-generation services; no funding for stand-alone telephony service —All eligible services treated equally (including connecting classrooms); local schools, not Washington, should set priorities —Students come first; funding directed only to instructional facilities
Process	—Complicated —Schools face up to 6 separate forms plus outside review by an approved planner —Schools must spend money on consultants to navigate web of rules such as the 28-day rule, the 2-in-5 rule, and discount calculations —Backlog of appeals stretches back a full decade	—Simple —Only 2 forms required; initial application is only one page —Streamlined rules eliminate need for consultants —USF Administrator does all the calculations
Funding Allocation	—Funding tied to discounts; higher-discount schools get more funding overall and funding for more services —Complex rules encourage arbitrage and gaming —Differences in spending among States and within States are largely arbitrary —More than $400 million lost each year due to red tape	—Funding follows the student —Funding allocated to all schools based on student population, adjusted for challenges that schools in rural and low-income areas face —Additional allocation for very small schools and schools in remote areas like Alaska —Much less money lost as a result of red tape means more money for students
Financial Planning	—Funding available to a school may change dramatically from 1 year to the next —Funding tied to decisions of every other school in the country —Schools must bid out services before they know if funding is available —Funding not secured until months or even years after funding year starts	—Funding available immediately to all schools, independent of decisions made by other schools —Minimal fluctuations from 1 year to the next allow for long-term financial planning

	Legacy E-Rate Program	Student-Centered E-Rate Program
Fiscal Responsibility	—The more you spend, the more you get —Some schools have little skin in the game by receiving up to a 90 percent discount —Priority and group-discount rules discourage long-term, efficient-scale purchasing —Cap on E-Rate but not overall Universal Service Fund	—Fixed pot of money for each school and matching requirement of one dollar for every three from E-Rate promotes prudent spending —Reducing wasteful spending allows the program to accomplish a lot more with the same amount of money; over $1 billion more provided in first year for next-generation technology —Cap overall Universal Service Fund before any increase in E-Rate budget
Transparency and Accountability.	—Funding available to schools not disclosed until after the fact —Parents can't go online to see precisely how a school's E-Rate funds are being spent; online catalog just shows funding for each recipient divided into four broad categories —Relies on complicated rules and Federal audits and investigations for accountability	—Funding available to schools publicly disclosed immediately to enable parents, school boards, press, and public to conduct local oversight —Schools to report online exactly what they're getting for E-Rate dollars; school administrators must certify it's spent on students —Transparency and local control are key; Federal oversight a backstop
Relation to Libraries	—Libraries receive about 10 percent of E-Rate funding	—Libraries receive about 10 percent of E-Rate funding

Senator UDALL. Thank you very much, Commissioner Pai. Thank you both for your testimony.

We are going to proceed with 7-minute rounds for each member, and then we will go through multiple rounds if the members desire, however long.

Chairman Wheeler, I wanted to focus—you have mentioned this, both of us have mentioned the $36 million increase, which is a 10 percent increase, and you have discussed a little of that. I am wondering if you can talk a little bit—with these additional funds, will they improve the FCC's ability to carry out its mission? And what would be the impact if you didn't have those funds?

I am trying to look at the other side of it. You put, I think, very solidly forward the positive side. What would be the impact of not doing that?

FCC FUNDING

Mr. WHEELER. Thank you, Mr. Chairman.

You know, I am 5 months on the job now. And having come from the private sector, I am still learning the realities of Government. But one of the things that we have been trying to focus on is a basic concept of efficiency and how do you make things work and work well?

As I indicated previously, the IT situation at the FCC is intolerable. It is a situation that no American business would allow to exist. We have begun to put in place solutions. We have brought in a crackerjack chief information officer (CIO) who understands what needs to be done. Absent the resources to do it, however, we are going to sit there with incompatible devices, with the inability to have common databases.

We have—just to give you an example—98,000 different data points inside our agency that make it totally impossible to build the database, to relate back and forth. We have got to consolidate

all of those. So, clearly, one thing is how do we become more efficient?

And one of the frightening things, when you look at it from a budgeting point of view, we are asking for $13 million to fix IT. It is going to cost us more than that the next 2 years for baling wire and glue if we don't. So, clearly, there is cause and effect here, and there are results that come from it.

Like Commissioner Pai, I strongly support what you have proposed insofar as an online consumer database. We just couldn't do it—we didn't have the tools to do it. Yes, it ought to be online. Yes, it ought to systematized. It is ridiculous.

And as Commissioner Pai indicated, we are looking at other process reform kinds of activities. If we don't deal with the challenges presented by an $8.4 billion program that is being overhauled in all of its components and enforce our rules and our expectations, as is our fiduciary responsibility, then we won't be carrying out our fiduciary responsibility.

Twenty-five people enforcing an $8.4 billion program doesn't make sense. So what I have tried to do, sir, is to—is to bring to the job a businessman's approach and say, okay, what are the challenges? How do we fix them? And then let us demand the results on that.

RURAL BROADBAND

Senator UDALL. Thank you very much for that.

In my second question, I wanted to focus on rural broadband. And as you are well aware, this is a really, really critical challenge.

And I am wondering, how will you continue to advance universal service reform to ensure that unserved areas are targeted for broadband support? How will you balance the need to connect areas with no broadband service while upgrading areas with slow service? And how will the additional staff requested in the budget help achieve these goals?

Mr. WHEELER. So you said the key word, "balance." And one of the joys that I have learned and that you all experience daily is making choices and how do you balance between various things.

Yes, we have to get service into unserved areas. Yes, we have to make sure that in areas where there is service, that that service is expanding in its quality and speed. Yet we have a finite pot. And so, that balance is crucial.

My concern and why we have asked for additional FTEs for the Wireline Competition Bureau is that these are huge issues to have these balancing of interests and to have fairness across an incredibly diverse country.

And what we have—we are constrained in the Wireline Bureau because of all of the issues that we are dealing with. And when we pull people away to do enforcement, we are pulling them off of things like this. And we need to make sure that we have the right kind of enforcement activities so that we are then are not robbing Peter to pay Paul in the rural broadband kinds of decisions that have to be made.

Senator UDALL. The thing that is striking to me from your 2012 Broadband Progress Report is 19 million Americans lack access to broadband. That is 6 percent of the population. Rural Americans

are 13 times more likely to lack access to broadband than Americans in urban areas.

My State of New Mexico ranks 44th among 50 States when it comes to broadband access, and over 14 percent of New Mexicans do not have access to broadband. So we appreciate your initiatives, and we appreciate you working to really push us forward in that area.

And with that, Senator Johanns, I call on you for your first round of questions.

FTE DEPLOYMENT

Senator JOHANNS. Thank you, Mr. Chairman.

Chairman Wheeler, as you have pointed out, one of the most significant increases in your budget is the 45 FTEs anticipated in the Universal Service Fund program, if you will. You have also acknowledged that the FCC budget request essentially parks most of the new USF hires in the Wireline Competition Bureau, but I think you are anticipating that they could be spread elsewhere.

For example, I could see they could go to the Wireline Bureau, the Enforcement Bureau, the Office of Inspector General, the Office of Managing Director. The difficulty that creates for us who are supposed to be providing some oversight here is how are these people going to be deployed? So I have a couple of questions for you.

Can you give me—give the subcommittee here more specificity as to where you think you are heading here maybe today, but also as this rolls out?

And then the second thing I want to ask because your testimony prompts this question, with the sorry state of your IT as you have described it, does it make sense to try to get that up to speed and allocate resources there more aggressively and think about FTEs in a future budget request? So those are my questions.

Mr. WHEELER. Thank you.

Senator JOHANNS. And Commissioner, I will ask you to offer some thoughts on that, too.

Mr. WHEELER. Thank you, Senator.

Let me be specific on where the people go. Fifteen people into the Enforcement Bureau, which is almost doubling the number of enforcement people for universal service. Ten people into the Office of Managing Director.

And the reason that is important is that the Universal Service Administrative Corporation, which is the structure, the quasi-independent structure that disburses the funds, reports in through the Office of the Managing Director, and that is where you need to have auditing capability and oversight capability there. So there are 10 people for that.

Six people for the Office of Inspector General, and as you know, they run their own shop.

Senator JOHANNS. Right.

Mr. WHEELER. We don't dictate how they do that.

And then the remaining 14 are for the Wireline Competition Bureau, which is for multiple reasons. One, what happens in enforcement is you get a series of appeals and things like this, and that gets handled by the Wireline Bureau. And also, as I was saying to

Senator Udall, we have been robbing Peter to pay Paul to do enforcement. So that is the specific breakout of it.

Now insofar as your question about IT versus enforcement, I wish that I could make that decision, sir. But I don't see how—I mean, I think that we have got two fiduciary responsibilities here.

One is to make sure that $8.4 billion is appropriately spent. And with all respect, I think that we have some catching up to do on our oversight and enforcement of those programs. And we are in the process of modernizing.

And second, as you suggested, the IT system, I mean, we just simply cannot go on this way. Here is a little interesting fact. As a result of my being here today and being in the news, we will see a precipitous increase in the amount of attacks on the FCC Web site, just because people say, "Oh, FCC, let's go." We cannot tolerate that.

If we have responsibility for the economic engine of the 21st century, we can't be sitting here, one, without capabilities and, two, exposed as we are. So the choosing between these is incredibly difficult.

Senator JOHANNS. You know, Mr. Chairman, your observation is correct. You know, back in my U.S. Department of Agriculture days, one of the most surprising things I learned in the first days of being there is how aggressively the system was attacked. Every minute, every day, it was just constantly being pinged by somebody who was trying to find a weak point.

So that is what prompted my question. If you had to make tough choices, and I know you would like to do it all, where would you go? Would it be IT, or would you go to employees, the new ones that you have requested?

Mr. WHEELER. And I appreciate what you are saying. I think we have a fiduciary responsibility on both counts. I can't sit here and say to you, sir, and members of the committee, that we can allow enforcement to continue as it has on the Universal Service Fund and all its components.

I have stood up a special strike force to be able to deal with waste, fraud, and abuse. There are two things. Both of these issues undermine the basic foundation of both activities. If you don't have a good IT system, it undermines your ability to get things done at the agency. And if you don't have a good enforcement system, it undermines the credibility of the program itself. I wish I could cut the baby in half, sir.

Senator JOHANNS. Commissioner Pai, do you have any thoughts?

USF FUNDING

Mr. PAI. Senator, just briefly, I think the exchange you have just heard is reflective of the difficult balance that has to be struck. On one hand, the FCC has to vindicate the public interest. On the other hand, the American people deserve and expect a measure of fiscal responsibility, and that is a difficult balance to strike in any situation.

I think it also comes in the context of the overall cap in domestic discretionary spending, which is slated to increase, as you know, only by 0.1 percent. And so, I think it is incumbent on us, both to

justify the proposed increase and to devote those resources that are approved to worthy causes.

With respect to USF enforcement, I, of course, support robust enforcement of the agency's rules and the law. I, myself, have not been presented with a very specific plan about how those resources would be deployed in terms of the particular tasks the particular employees would be devoted to. Would it be time limited or permanent, et cetera? But I certainly look forward to working with the Chairman and this committee on that regard.

With respect to IT spending, I do agree that we need to devote more attention to our IT systems. For example, our internal tracking system, among other things, is rather slow, shall we say. A charitable way of putting it. And so, I think it would help us operate more efficiently, deliver better results for the American public if that were speedier.

On the other hand, I also think it is important for us to use the IT spending resources we get more effectively. And so, for example, we spent a great deal of money on the FCC Web site. It is a Web site that many people find incredibly difficult to use. More often than not, people actually click through to the old Web site, which looks like it was, you know, cutting edge back in 1998. I myself do that.

And so, I think it is important for us to focus on the IT priorities that really matter and to make sure that that balance between the public interest and fiscal responsibility always is maintained.

Senator JOHANNS. Mr. Chairman, I have some more questions, but I will wait until the next round.

Senator UDALL. Senator Moran.

Senator MORAN. Mr. Chairman, thank you very much.

Mr. Chairman and Commissioner, thank you very much for being here.

Senator Udall, thank you for having this hearing.

We had a hearing on the FCC in which we had the Chairman and a number of the commissioners here 2 years ago before you were the chairman and when I sat in the chair of Senator Johanns. That was the first hearing this subcommittee had had in 9 years on the FCC.

And I think this is—your agency is one of the most important. You happen to have three Senators here who represent pretty rural States, and I appreciate the focus that we can bring to this attention. And I thank you for your leadership.

On IT acquisition, Senator Udall and I are interested in trying to determine how to have a system of IT acquisition that is well founded across the Federal Government. And I am going to submit for the record a number of questions in writing about IT acquisition at the FCC.

In response to certainly Senator Johanns' question, what I see, Mr. Chairman, is that you have found two areas in which you think there is a need for additional funding, two that are priorities. Hard to differentiate which one has the highest priority.

In your short time that you have been Chair of the FCC, have you found places that the FCC is spending money that it should not or does not need to or is a low priority?

Mr. WHEELER. Yes. I think the issue that we have is, again, when I came on, what I discovered was about 70 percent of the budget is people, without much flexibility in the people other than moving desks around from one assignment to the other. And so, as our priorities change, what we end up doing is reassigning people rather than seeking new budgets or things like this.

So, yes, we have had some dramatic changes from—in the Wireline Bureau, from narrowband activities being repurposed into broadband activities, being repurposed into rural broadband activities in particular.

In the Wireline Bureau things are being repurposed into the new Internet protocol transition that is taking place in networks. I mean, something as current as this morning, sir.

The matter of what are the rights of traditional telephone companies operating on twisted copper pairs to end their service and say we are going to go over to an IP service that can affect the ability to power the phone in the middle of a tornado in Kansas, can affect the ability of a burglar alarm to communicate and other kinds of things. We are having to switch resources.

So what I am trying to say, in an answer to your question, is we are constantly reprioritizing. It doesn't show up like a business account normally does in a line-by-line kind of operation because what we are doing is moving existing bodies back and forth among tasks.

RURAL BROADBAND

Senator MORAN. When you and I first met, Mr. Chairman, the initial conversation, you were going through the nomination process.

Mr. WHEELER. Yes, sir.

Senator MORAN. The first conversation, we had several topics, but rural broadband is often front and center with me. You indicated in a House hearing—and I appreciate that conversation. You said things that I like to hear, and you followed through with changes in the order of 2011.

You indicated in a House hearing that the QRA would be altered. And my question is, can you give us an update on your plans? What will replace the QRA? How long of a term strategy—what is the long-term strategy in regard to Universal Service Fund?

Mr. WHEELER. The long-term strategy for the Universal Service Fund, we could be here past lunch. But first of all, I thank you for the kind words and the credit for the change decision on the QRA and particularly, as you pointed out, that it was a unanimous decision out of the Commission.

But I know you raised this, and believe me, you weren't the only member of this body or the other body that raised it with me. So I had to dive in and learn about it. And you know, the QRA was a really well-intentioned, well-meaning pursuit of perfection. And like everything else in life, you know, the perfect is the enemy of the good. And the complexities just went out of control. And so, my comment was, "Timeout, let us stop this."

Now the question is, what are we going to replace it with? There are multiple proposals that have been submitted by rate-of-return

carriers and their various representatives. We are trying to sort through those right now.

I can't tell you what the answer to that is going to be right now. We have just reverted to the previous process before the QRA and continue working on the old allocation methodologies.

But we will—I believe the record is just in the process of closing, if it hasn't just closed. And we will take all of those and try and piece them together.

The interesting thing to me, though, is that there are different approaches being proposed by the same kinds of carriers, which again puts us back in this position of, okay, how do you make decisions or how do you say, okay, here is another alternative that we ought to be looking at?

Senator MORAN. Timeframe?

Mr. WHEELER. I hope that we get done with that in the next 6 months.

Senator MORAN. Mr. Chairman, I used most of my time complimenting you, but I assume that the time still has expired. I am glad we are having another round.

Thank you.

TRIBAL ISSUES

Senator UDALL. Okay. We will go for another round here.

You mentioned QRA, and I also, I think, communicated with you that we welcomed your plan to scrap that. In the case of New Mexico, I think that hurt many small rural telephone cooperatives, and so we appreciate that effort there.

Wanted to talk a little bit about tribal broadband and the FCC Office of Native Affairs and Policy, Chairman Wheeler. I want to express my appreciation to the Commission's efforts to address the digital divide facing Native American communities. Telephone access on tribal lands still lags far behind the rest of the country.

By the FCC's own report, the number of people without broadband access on rural tribal lands is eight times worse than the national average. This digital divide creates real hardships for people. We know that. We see it on a firsthand basis in visits out in New Mexico in these rural areas. And it is also a barrier to economic development, which is obviously crucial.

So I support the recent positive developments, such as the work of the FCC's Office of Native Affairs and Policy. I am concerned, however, that the FCC's budget request does not include specific funding to support this office's critical mission for Indian Country, which encompasses, as you know, 565 federally recognized tribes, approximately 231 federally recognized Native Alaskan entities, and about 38,000 beneficiaries of Hawaiian homelands.

Can you explain to me how the FCC budget request will address the telecommunication challenges facing Native American communities and how high a priority are tribal issues to you?

Mr. WHEELER. Yes, sir. Thank you.

The only reason it isn't spelled out in the budget is that you don't spell out offices. But I can assure you that the $300,000 that this subcommittee has in the past suggested and that was affected by sequestration is definitely in there and will be appropriately spent.

Insofar as our policy with regard to tribal lands, I met probably 3 weeks ago with leaders of the Native American community, and I told them several things. First of all, I learned something. I learned about the concept of trusteeship and how I am a trustee and I didn't know I was. And I learned about how the concept of consultation is not the concept—is not the use of the word that I have always grown up using. There are specific responsibilities associated with that.

And I committed to these leaders and I committed in front of their large meeting several things. One, that we would improve the consultations. Two, that I took the trusteeship seriously. And three, that I wanted their help on three specific goals. One is improving broadband in Indian country. Two is dealing with the question of access to the spectrum that passes over Indian country. And three is assuring the diversity of voices, which is the question of priority licensing for radio stations that operate in Indian country.

I also told them that we would refresh and strengthen the Native Nations Broadband Task Force and that I would physically be in Indian country addressing these issues with the people.

I also noted to them in passing that because of my son, I am probably the only FCC Chairman that has ever attended powwows on Indian reservations from the Dakotas down to Arizona. Unfortunately, never in West Virginia—never in New Mexico, Senator.

Senator UDALL. Thank you.

And I think, I know my two Senators who are up here on the dais with me understand a lot of these tribal and Native American issues. But you are absolutely right. The trust responsibility is one that is there, Federal Government with the tribal communities, and needs to be one that is respected and worked with and understood.

And also consultation. I mean, it is a different kind of consultation, and that is why the office we have is so important. Because the folks in there know and understand that. They reach out in a very significant way and involve all of these many communities across the United States to participate and be a part of the dialogue, among many other things. So thank you very much for that.

I am going to try to get one more question in here on E-Rate, and I mentioned the importance of E-Rate in my opening remarks, and I am excited about the potential innovations to help improve student achievement. Could you expand on your testimony about how E-Rate could be modernized to better meet the needs of schools in the current broadband era?

Mr. WHEELER. Yes, sir.

We need to focus on a 21st century goal, which is high-speed broadband to schools. When the E-Rate was put in place in 1996, the world was a little different. We were talking about dial-up modems then. And the idea of connecting schools was quite different.

We are in a situation today where we are spending $2.4 billion on the E-Rate, and over half of that is not going to high-speed broadband. Now over the years, paying for pagers, paying for dial-up voice service, paying for cell phone service, things like this were logical. But the world has changed, and I am again back to—we have got to make decisions on how we spend a finite pot of money.

So we are in a process right now of developing a new rulemaking, which we will bring to the Commission this summer, that modernizes the E-Rate program to focus on the delivery of broadband as a priority. To make sure that rural America doesn't end up dealing with the leftovers as it often has in the P2, the Part 2 of the program—making sure that it is less burdensome on the schools.

I mean, it is—first of all, back to the IT issue, it is done on paper. It is really ridiculous in the way it is done. And it is done annually. Continuing on, we need to make sure that there is efficiency in the way in which the program is both administered at our level and at the local level. And that the buying is done right, that we emphasize buying consortia who can get better prices and that we create a structure that does that. And that is what we are doing in this new modernization order.

Senator UDALL. Thank you very much.

Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman. Just a couple more questions.

Let me, if I might, Chairman Wheeler, shift gears a little bit here to positive train control.

Mr. WHEELER. Yes, sir.

Senator JOHANNS. My understanding is that the FCC has put together a proposal known as program comment that is intended to function as an amendment to the FCC's 2004 programmatic agreement. I understand that FCC's licensing authority over spectrum necessary for positive train control triggers an FCC role in the infrastructure.

Why would the FCC not be able to recommend to the Advisory Council on Historic Preservation (ACHP) that the utility poles that are necessary here in the railroad rights-of-way be excluded from the historic preservation review? Wouldn't the ACHP exempt activity where the potential effects on historic properties are foreseeable and likely to be, de minimis, minimal and not adverse? And could you—do you feel you could make that recommendation to them?

And I guess what I am looking for here, we know we have got a big problem out here. You must carry this around in the back of your mind as the must-do checklist for the next few months. Isn't there a way to put some streamline behind this, and because at the end of the day, it needs to get done, right? We all face that.

Mr. WHEELER. Yes, sir, Senator.

And it is not in the back of my mind. Yes.

Senator JOHANNS. Front and center, yes.

Mr. WHEELER. The points you make are all spot-on. There are two roles the Commission has in positive train control (PTC). One is spectrum, and the other is antenna siting. I think on the spectrum side, we get pretty good marks because we facilitated the transfer of spectrum. We facilitated the sharing of spectrum. That is working.

As you point out, the National Environmental Protection Act and the National Historic Preservation Act have specific provisions that say that there needs to be tribal sign-off on any antennas.

Now I came out of the wireless business. When you are going one-off, that can be done. When you come in with tens of thousands

like we have to do here, it chokes the system. So there are two options that I faced.

Option one is, yes, we could do what you suggested, and we could go amend the whole process. The joy of that is that the processes you have to go through to get there—and then the court review, and then everything that comes with it—probably puts us on the other side of the deadline date here.

So my decision was how do you make things move faster? Because the reality is the railroads have a date, a deadline that you established. The tribes had no deadline. So we started back to the consultation concept.

We brought together a couple of meetings and have developed a process for batch processing, if you will, to handle these in groups rather than one-off that we hope is going to break through the logjam. I must say that the issue has been exacerbated by the fact that there were many, as in thousands, of antennas put in place by railroads before any recognition of this. And the need to go back and catch up on those while moving forward on the others is a nontrivial undertaking.

But again, I think that we have developed a process that speeds it up by doing batch. But I can assure you, sir, that we are keenly aware of what you are talking about. And this is a statutory responsibility, two statutory responsibilities, and our job is to facilitate and obey both.

Senator JOHANNS. Yes, and here is what I would offer, Mr. Chairman and Commissioner Pai. This is the kind of issue where us getting in the middle of it and doing this, that, or the next thing may only interfere with the process. On the other hand, I think both the chairman, myself as ranking member, Senator Moran, others who work with the tribes every day, every week in our office would be more than willing to be as helpful as we can because this deadline is real. And unless we change the deadline, we have all got a big problem on our hands. So I just put that out there.

ISSUE DIALOGUE

The last thing I wanted to say—and I will have some questions that I will just submit to the record. But this is more of an offer, Mr. Chairman, than a question. I think, in your job, if you could satisfy two issues, they would be naming the building after you.

Spectrum and net neutrality. And you know, you have this huge history. You have kind of worked with everybody here. I find these issues enormously interesting and engaging. I have got no ax to grind. I am not running for reelection. I am going to move on in life.

Here is an offer that I would make. I would love to start a dialogue with you in just a general way about these issues. I would welcome it. Obviously, at the end of the day, it might be more dialogue than anything, but I think these are—I love to tell the story about my first car phone where my wife took my car for a day, got this huge surprise for me. Got a phone installed. You know, one of these big clunky things on a cord.

I loved this thing. I used it every day for that first month. I got the first bill, darn near had to mortgage the house to pay the first bill.

Look at the difference that has occurred in a rather brief period of time. The key to the way forward, though, and the impact on our economic growth in this country really deals with many issues, but these two issues are so at the core of it. And I would love to pick your brain about it.

Mr. WHEELER. This afternoon, our offices will be in contact, and I would look forward to that a lot.

Senator JOHANNS. Thank you. I welcome that dialogue, and let us hope it continues. So thank you.

Mr. WHEELER. Thank you, sir.

Senator UDALL. Thank you both.

Senator Moran.

RURAL RATES

Senator MORAN. Chairman, thank you again.

Commissioner Pai indicated in his opening statement about the impact of the announced rate floor increase. I wanted to highlight for you, Mr. Chairman, in Kansas our companies currently charge rural customers anywhere from $11.77 to $18.25 per month for phone service. By State law, they are prohibited from increasing that rate more than $1.50 in any 1 month for a 12-month period.

So by State law, it just seems to me there is no capability of complying with this decision. The new rate of $20.46, they just can't meet that July 14 deadline. And so, I am interested in what the FCC's response is into that particular problem.

But further, many rural customers in Kansas receive both phone service and broadband service from the same company. And therefore, when the phone service costs are increased, I think a natural reaction, and it is particularly true in today's world, is to eliminate the land line. And the costs then fall for broadband even more directly. I mean, my guess is that broadband services become even more expensive as a result of the increasing phone rate.

I wondered if you had—if you have any thought that that is a rational occurrence, if I am making something up or that is the propensity to do that exists? Have you given any thought to what the consequence is to broadband customers because of the increasing cost of phone service? And then are you willing to address this issues?

Mr. WHEELER. Well, that is—on the second point, I would like to get some research on that and not just shoot from the hip. But I mean that is a legitimate issue.

On the first point, again, this is the joy of this job. I, Senator Johanns, thank you for your thought that they might name the building after me. This is not a goal, okay?

But if there is anything that I hope that folks will say at the end of my term is that at least we made decisions. Because the thing that American business can't afford and American consumers can't afford is limbo.

Senator MORAN. Certainly.

Mr. WHEELER. So as Commissioner Pai said in his statement, and he and I are in agreement on this, it was a unanimous decision out of the FCC before we arrived to set up the structure that led to exactly what you talk about. So I inherit the results of the algorithm that everybody agreed to that produces this result.

We have two responsibilities—to adhere to the statute and not to be stupid. And it seems to me that if we create a situation where we run headlong into the kind of Public Utility Commission (PUC) problems you were talking about, where we create a situation where suddenly there is a 46 percent rate hike that gets slapped on everybody in July, that is tending towards the other thing that we don't want to have.

So what I am going to be proposing is that, one, we delay the implementation beyond July because you have got to provide the window for the PUCs to be able to deal with—the companies to be able to deal with the PUCs to be able to deal with things. And secondly, that we develop a phase-in so that this isn't hitting everybody's bills bang on, but comes in over time.

Because there still is a statutory responsibility that the rates be reasonably comparable. And it is not just urban subscribers who are doing some of this subsidization of rates. It is other rural subscribers who are doing this subsidization of rates as well.

So it is not a question of whether. It is a question of how, and how do you do it reasonably.

INTERNAL REVENUE SERVICE USF POLICIES

Senator MORAN. Thank you.

I don't want Commissioner Pai to have been here and not had an opportunity. But before I turn to him and before my time expires, let me raise another topic and then hear from either or both you.

I have never thought of this before. This question was brought to my attention, that the Internal Revenue Service (IRS) treats all universal service high-cost funding, including the Connect America Fund Phase 1 dollars, as general revenue instead of a contribution to capital. You are smiling. So you know this topic.

The general revenue has tax liability consequences that will diminish the effectiveness of the fund. And I am curious as to whether or not the FCC has had ongoing conversations with the IRS. I am told that there is a comparable analogous situation that occurred previously, and I am curious as to whether you are addressing this issue between the FCC and the IRS.

Mr. WHEELER. So I am smiling because I recently became aware of this as well. There was literally a company, in seeing this yesterday, that said that they had just been told by the IRS to follow the same rules as had been used in the Broadband Technology Opportunities Program (BTOP) that you are referencing.

And so, what I am doing is asking our general counsel to get into this and to find out what is going on. I was smiling when you mentioned the IRS because it is that time of year.

Senator MORAN. I don't know that the IRS brings many smiles.

Here or at home. Commissioner Pai, either one of those topics?

RATE FLOOR

Mr. PAI. Sure. To start, Senator, you should know that the Chairman is already making his mark. The very first floor at the FCC is labeled "TW," and I think it is a sign of things to come. Even in 5 months, he is getting the floors renamed for him.

But more seriously——

Mr. WHEELER. It stands for "12th Street."

Mr. PAI. Well, so they say. I am not buying it yet.

But to the first topic, with respect to the rate floor, the FCC has twin responsibilities here under the law. We have to make sure that the rates are reasonably comparable. We have to make sure that communication services are affordable.

The way I think about it is from the perspective of a consumer in Washington, DC, versus my hometown of Parsons, Kansas. The rates are different. I mean, in DC, it is $20.46. In Parsons, it is $14. But if you look at the median income, the median income in Washington, DC, is $64,000. The median income in Parsons is $38,000.

So if you try to pair those statutory responsibilities, it seems to me that reasonably comparable doesn't just mean that the exact rate has to be equal. It has to mean that these services are affordable for people, regardless of where they live, taking into account all of the circumstances.

Second, in terms of State law, I think it is critical for us from an institutional perspective to have a good relationship with our State and local colleagues who, to the extent that the rate floor would end up overriding State law or putting these carriers in a catch 22—either they comply with State law or Federal law—I think that is something to be avoided.

The second thing, though, that you mentioned is something that is really close to my heart, and I think the chairman captured it exactly right in his opening statement. We live in an Internet age. And so, it follows from that that the consequence of not having broadband Internet access or access to other advanced communication services is that almost quite literally you live in another era. And that is becoming all too real for people in rural America.

And the reason that I say that in answer to your question is that line loss in rural America is real. I have heard it from carriers in Kansas, Nebraska, New Mexico, States across this country. And so, as a result, if they lose universal service support because people just feel compelled to drop that land line, either the carrier has to try to make a go of it on broadband alone, for which there is no support, or they simply go out of business. And I think that is an untenable state of affairs.

And so, stepping back from the trees of the QRA and the rate floor, et cetera, and looking at the forest of universal service, my own vision is that we would move to a Connect America Fund for rate-of-return carriers. We would move to a system that would allow standalone support for broadband facilities, recognizing that, for an increasing number of Americans today, voice isn't a distinct service as it used to be for the last 100 years. It is simply another application riding over the Internet.

And if we embrace that kind of a vision depending, of course, on what the particulars of the record show, I think we are going to be in a situation where rural Americans and urban Americans will have a more level playing field in terms of, you know, the Internet access and other communications opportunities that truly do fall at the heart of the Communications Act.

So that is something to flag for the future. And I think, Senator Johanns, you would be perfectly positioned to take a role on this

issue going forward. That is the real level playing field, I think, for our people going forward.

Senator MORAN. Commissioner, thank you.

If the voting schedule allows, I will be in your hometown of Parsons tomorrow, visiting the community college and the community hospital.

Mr. PAI. I hope you say "hi" to my parents.

Senator MORAN. I hope to see them. Thank you.

Mr. WHEELER. Are they going to name those after you?

Mr. PAI. I am by far not the most august person from Parsons. Even now there is a quarterback in the NFL who deserves that title.

Senator UDALL. Thank you for those comments.

Chairman Wheeler and Commissioner Pai, I just want to add to the earlier comments about the impact on small rural telephone cooperatives of a potential new increase in terms of the local service rate floor.

New Mexico telephone providers in rural areas of Chaves and Lincoln Counties, for example, are very worried that this will cause a spike in their customers' phone bills. So I do appreciate your willingness to look carefully at the concerns that are raised here and thank you for doing that.

RURAL TRANSLATORS

I just have one additional question here. And to both of you, this is about TV translators. Nearly 54 million Americans, including most—almost 600,000 New Mexicans rely exclusively on over-the-air TV. In New Mexico, many of those TV viewers rely on more than 200 translators located throughout the State to receive broadcast television. This is especially the case in rural areas and on tribal lands. As the Commission proceeds with the incentive auction rulemaking, will you consider the importance of protecting TV viewers in rural areas who are served by TV translators?

Mr. WHEELER. I have been hogging. Do you want to go first?

Mr. PAI. Sure. So, Senator, I take that concern very seriously. I have heard from folks across the country, but especially in the Mountain West and Midwest that this is an area of concern for a lot of people.

And that is specifically why I mentioned when the FCC adopted the Notice of Proposed Rulemaking on September 28, 2012, that the FCC should flag this issue and make sure that we do whatever we can, within the constraints of the law, to make sure that the people who rely on these translator services don't suddenly find that they are left in the dark, so to speak.

Mr. WHEELER. Ajit just put it right. Do everything we can within the constraints of the law. I mean, the difficulty in the law is that it specifically excluded translators and low-power TV stations in the repacking kinds of activities.

I believe that there are—I believe that there are solutions to this that range from, one, fortunately these are in rural areas, and the spectrum crunch does not exist in rural areas. So the betting odds that a translator gets caught up in this are slim. There may be some. But in those instances where there are, I think that there are other alternatives, and what we are going to be doing is trying

to work through developing those other pathways so that we can maintain exactly what Ajit said, which was how do you maintain, keep the service from going black, at the same point in time adhering to the law? And again, that is what you pay us for.

Senator UDALL. Right. Thank you very much for that.

I know that I may have additional comments for the record. I know my distinguished ranking member may also.

I think Senator Moran has one final question, he tells me.

INCENTIVE AUCTIONS PROCESS

Senator MORAN. Thank you, Mr. Chairman and Ranking Member, for your indulgence.

I want to talk about license—about spectrum auction, excuse me. There is a lot of focus on the nature of the auction, how that is—how it is going to occur.

What I think may be missing is whether there is going to be any spectrum to auction. And I think broadcasters are looking for, you talked earlier about certainty, the business community needs some certainty. When can a broadcaster begin to understand what their company spectrum may be worth?

They have got to enter into contracts for towers and employees. You have got to plan your business, and I don't know that any broadcaster knows what return, what they may receive if they put their spectrum up for auction. Is there—I think you are going to be in front of the broadcasters here in Las Vegas before very long. I assume this would be a question. Any thoughts?

Mr. WHEELER. Yes, sir.

There is a timeline that basically works this way. Starting next week, we start working inside the Commission with commissioners, such as Commissioner Pai, and working through the options that we see that are on the table and narrowing it down. Same point in time, working with you all up here to share with you what our thoughts are in terms of how to structure the auction.

As you mentioned, then I go out to talk to the National Association of Broadcasters (NAB). I am not going to give a speech that says here are all the answers. But what will follow from that is a series of meetings with broadcasters that roll out here are the various concepts.

But I think that it is beyond that. That I spent the last almost decade investing in companies and selling companies. I am used to seeing a book, that the investment banker comes forward and says, okay, here are all the numbers you need to know. Here are the assumptions. Here are the spreadsheets. Plug in whatever assumptions you want and kick out conclusions at the end.

I think it is incumbent upon us to meet with broadcasters and say here is a book. Here is what it means in your particular circumstance. You make the decision. This is a voluntary auction. You've got to decide whether you want to come, then you decide whether you want to stay in it.

But we are going to approach this in a business-like manner that provides to the broadcasters the information they need to make an informed decision. And you can't do it on a blanket kind of a basis. You have got to sit down and say, okay, now in this community, with these kinds of realities, these are the expectation.

Senator MORAN. I hope you are successful in accomplishing that. Mr. Chairman, thank you.

Senator UDALL. Thank you, and thank you both, Senator Johanns and Senator Moran, for participating today. Really appreciate that.

I want to thank everybody who participated in the hearing. And especially our staff members, who I think worked very closely with your staff to make this a successful hearing. And appreciate hearing from the top officials of the FCC about the resource needs and the opportunity to explore a number of important and timely issues.

Today's discussion has provided helpful insights, I think, into the FCC's operations and, really, the challenges that you all face. This information will be instructive as Congress moves forward with our work on the fiscal year 2015 funding.

ADDITIONAL COMMITTEE QUESTIONS

And with that, I believe our hearing is concluded. And well, let me also say the hearing record will remain open until next Thursday, April 3 at 12 noon for subcommittee members to submit statements and/or questions to be submitted to witnesses for the record.

[The following questions were not asked at the hearing, but were submitted to the Commission for response subsequent to the hearing.]

QUESTIONS SUBMITTED TO HON. TOM WHEELER

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

CONSUMER COMPLAINTS DATABASE

Question. Chairman Wheeler, thank you for your comments about the importance of improving how the Federal Communications Commission (FCC) handles consumer complaints. As you know, Senator Nelson and I wrote to you before the hearing to ask that the Commission implement an online consumer complaints database.

What steps can the Commission take now to begin to implement a consumer complaints database?

More generally, how should the Commission use new technologies to help guide its enforcement and policymaking activities?

Answer. Despite limited funds for mission-critical information technology (IT) projects, the Commission is making significant progress toward modernizing the FCC's consumer complaints process and supporting IT. To speed this process, we are exploring the use of cloud-based, commercially available, "off-the-shelf" technology to address consumer needs. With careful use of fiscal year 2014 funds and the infusion of fiscal year 2015 funds, we hope to meet our goal of having a new consumer complaint system in place by the end of the calendar year. In the interim, the Commission will make modifications to existing systems that support progress toward a new system, and engage in related outreach efforts.

As part of our modernization process, the Commission will solicit input from stakeholders, including both service providers and consumer groups. These comments will assist the Commission in developing design features for the new consumer complaint Web site that support core mission objectives—accessibility, transparency and functionality. The planned system will be designed to accommodate a more user-friendly complaint portal for consumers and allow consumers to check their complaint status online. This redesign also will make available summarized data about the volume and type of complaints to provide more information to the public and our partners as part of a "dashboard."

A streamlined consumer complaints process and the implementation of modern technologies will provide essential support to Commission staff as they review consumer complaints and initiate enforcement activities. In addition, the Enforcement Bureau is reviewing new methods for streaming information from agents in the field. These combined system improvements and modernization will enable better

tracking of complaints, cases, and related information. Overall, the ability to review complaints in a more efficient fashion will provide a foundation for policy decisions that rely upon statistical data analysis while supporting less workforce-intensive information gathering efforts.

DATA CAPS

Question. Mr. Wheeler, I previously authored legislation to help wireless consumers avoid "bill shock" after inadvertently exceeding monthly usage limits. Today, most consumers are accustomed to online access at home with a broadband subscription that allows unlimited access to data from the Internet. Yet many wireline and wireless Internet service providers are now experimenting with or implementing usage-based pricing and "data caps." My understanding is that consumer groups have asked the Commission to collect information on how companies implement and administer such data caps.

What steps has the Commission taken to do so?

Will you commit to studying the impacts of data caps for consumers and publicly reporting the Commission's findings?

Answer. In August 2013, the Commission's Open Internet Advisory Committee investigated the use of data caps for wireline broadband services and identified policy issues that data caps raise. That report can be found at http://transition.fcc.gov/cgb/oiac/Economic-Impacts.pdf.

Building on the report and consumer concerns, the May 15, 2014 Open Internet Notice of Proposed Rulemaking asked a number of questions about data caps, including whether the Commission should require both wireline and wireless providers to disclose network practices that relate to data caps. We also have asked whether the Commission should require disclosures enabling end users to identify application-specific usage, to distinguish which user or device contributes to total data usage, to identify traffic potentially exempt from caps, and to identify current consumption levels. We will fully examine the record garnered by the Notice of Proposed Rulemaking (NPRM) and from other sources on data caps, and address consumer concerns in any future order.

DIGITAL TELEVISION CHANNEL 6 RADIO INTERFERENCE PROTECTIONS

Question. Public radio stations operating at FM frequencies near the digital television (DTV) channel 6 petitioned the FCC in 2009 to updates its interference rules. In general, such rules are important to preventing harmful interference between various broadcasters. Yet my understanding is that the Commission's current rules for DTV channel 6 interference are based on analogue TV technology.

Given the DTV transition, will the FCC consider reviewing proposals to update its DTV channel 6 interference rules?

Answer. National Public Radio filed a Petition for Rulemaking in October 2009 seeking the elimination of the current rule that protects TV Channel 6 from noncommercial FM station interference. At the end of 2009, the Commission placed the Petition out for public comment. While I recognize that the Petition was filed several years ago, Commission action remains pending given our work to implement the Incentive Auction provisions contained in the Middle Class Tax Relief and Job Creation Act of 2012 (Spectrum Act). One of the options for TV broadcasters under the Spectrum Act is to volunteer to move from a UHF channel to a VHF channel (which includes Channel 6 allotments). It may well be prudent to wait to see what the final channel plan will look like before modifying any interference rules between the different services.

EMERGENCY 9–1–1 CALL CENTERS "DO-NOT-CALL" REGISTRY

Question. The Middle Class Tax Relief and Job Creation Act of 2012 requires the Commission to create a "Do-Not-Call" Registry for telephone numbers used by emergency 911 call centers, or Public Safety Answering Points (PSAPs), and to prohibit the use of automatic dialing "robocall" equipment to contact those numbers. Your budget request includes a resubmitted fiscal year 2014 base item increase of $500,000 to implement PSAPs' Do-Not-Call Registry.

Could you explain in more detail how this funding will be used to improve emergency 9–1–1 operations?

Answer. The Commission's budget request supports the October 17, 2012 FCC Order establishing the Do-Not-Call Registry for telephone numbers used by Public Safety Answering Points (PSAPs). This registry is essential to protecting the integrity of PSAP communications. Under the Middle Class Job Relief Act of 2012 and the 2012 FCC Order, verified PSAP administrators or managers must be able to place into the registry telephone numbers that are used for the provision of emer-

gency services or for communications between public safety agencies. The current Federal Trade Commission (FTC) Do-Not-Call List does not support these numbers and creates a gap where robocallers can interfere with essential first responder actions and communications. The Commission currently is exploring the least expensive alternatives for implementing this list, including potentially utilizing the sofiware and contractors involved in the development of the FTC's Do-Not-Call List.

FCC REGULATORY FEES

Question. Last year, the Commission adopted an order to update its regulatory fee structure. This followed a Government Accountability Office (GAO) report that found the Commission's regulatory fee structure is out of date given changes in the telecommunications market, in regulation, and in the Commission's work over the last decade. The FCC order describes the changes as initial steps to more comprehensively revising the Commission's regulatory fee program. The order also notes that the Commission will issue "shortly" a Second Further Notice of Proposed Rulemaking once more public input is considered.

When does the Commission plan to take the next steps to modernizing its regulatory fee structure?

Answer. The Commission is currently involved in a multi-year effort designed to ensure fairness and transparency within the section 9 regulatory fee structure. Congress annually requires the Commission to collect regulatory fees "to recover the costs of . . . enforcement activities, policy and rulemaking activities, user information services, and international activities." To calculate regulatory fees, the Commission allocates the total amount to be collected among the various regulatory fee categories. This allocation is based on the number of full time employees (FTEs) assigned to work in each regulatory fee category. Below is a summary of the Commission's rulemaking efforts:

Reform Effort Summary

2008 Further Notice of Proposed Rulemaking.—FCC sought comment on revising its regulatory fee schedule to address significant changes in the communications industry and the Commission since FTEs were allocated to regulatory fee categories in 1998.

2012 NPRM.—FCC inquired into updating the FTE allocations for the first time since 1998.

2012 GAO Report.—General Accountability Office (GAO) recommended fundamental reevaluation of how to align regulatory fees more closely with regulatory costs.

2013 NPRM; 2013 Report and Order.—FCC applied current FTE data to determine the number of FTEs working on regulation and oversight of Interstate Telecommunications Service Providers and other fee categories and revised the calculation of FTEs in the International Bureau to categorize most of those FTEs as indirect.

FCC also adopted permitted amendments (reclassification of services in the regulatory fee schedule as defined in section 9(b)(3) of the Communications Act of 1934, as amended (the act)) which requires notification to Congress prior to implementation. Notifications are planned to be provided for fiscal year 2014 regulatory fees.

—Consolidation of UHF and VHF television stations into one regulatory fee category.

—Assessment of regulatory fees on Internet Protocol TV (IPTV) licensees by including them in the cable television category.

The Commission also committed to a further notice to consider additional regulatory fee reform and conclusively readjust regulatory fees within 3 years.

2014 Ex Partes.—FCC staff engaged a wide and numerous array of Commission regulatees to obtain further input concerning regulatory fee reform.

2014 Draft Second Further Notice of Proposed Rulemaking.—FCC staff have drafted and circulated a Further Notice seeking comment on additional reform measures to improve the regulatory fee process, including the adoption of methodologies tailored to ensure more equitable distribution of the regulatory fee burden among categories of Commission licensees under the statutory framework in section 9 of the act. Some of the issues for which the draft Further Notice seeks comment were raised by commenters in fiscal year 2013 (or earlier), along with subsequent *ex parte* meetings, and the Further Notice now tailors its inquiry, in response to the more developed record, to further examine these proposals.

FCC RESOURCES FOR MERGER REVIEWS

Question. Chairman Wheeler, given recent announcements of telecommunications mergers, does the Commission's budget proposal include sufficient funding to support the timely review of major telecommunications transactions? What impact does the review of large transactions have on the Commission's resources?

Answer. The Commission maintains a special Transaction Team within the Office of General Counsel (OGC), which confers with other bureaus and uses administrative efficiencies to ensure transparent and timely review of large-scale mergers. The volume of these transactions varies year-to-year, but we have found that the creative use of intra-agency teams of this nature provides the required level of support for our mission-critical activities.

The Commission overall has the lowest level of FTEs in 30 years as well as half as many contractors as 4 years ago. This situation, coupled with unwieldy, relic IT systems, hobbles our efforts in all agency operations. If this Committee supports our overall budget request, the Commission should have sufficient resources to handle transactions as well as other OGC projects.

LIFELINE

Question. Chairman Wheeler, your testimony highlights plans to increase universal service oversight. I am pleased that the FCC has already increased oversight of the Lifeline program, which helps low income persons get telephone service. As you know, Lifeline dates to the Reagan administration and was expanded to include wireless phone service during the presidency of George W. Bush. This initiative can be a "Lifeline" for low income persons in a time of emergency, or when applying for a job. That is why the Commission must continue reforms to guard against waste, fraud, and abuse. One of those reforms is a new National Lifeline Accountability Database. This will help weed out "double dipping" if there are duplicate participants receiving Lifeline assistance.

How soon will this database be implemented?

Answer. Last month, the National Lifeline Accountability Database (NLAD) became fully operational in all States and has had a significant impact in reducing waste, fraud, and abuse. Thus far, NLAD already has identified $169 million in annual savings by flagging existing duplicates for elimination while preventing enrollment.

NET NEUTRALITY

Question. Chairman Wheeler, as you know, I am a supporter of a free and open Internet. The principle of such "network neutrality" is that Internet users should be able to access lawful online content and applications regardless of the source, without blocking or interference from their Internet service provider. This helps innovators and startups compete on a level playing field with established companies. Following the *Verizon* v. *FCC* decision by the U.S. Court of Appeals for the District of Columbia Circuit, you stated that you intend to propose new open Internet rules. You further noted the Commission's responsibility to preserve the Internet "as an open platform for innovation and expression while providing certainty and predictability in the marketplace."

Do you believe that the authority granted under section 706 of the Communications Act gives the Commission adequate authority to ensure a free and open Internet?

Under what circumstances would the Commission use its authority under title II of the Communications Act to ensure a free and open Internet?

Answer. For over a decade, the Commission has struggled with the idea of net neutrality. There has been a bipartisan consensus, starting under the Bush administration with Chairman Powell, on the importance of an open Internet to economic growth, investment, and innovation.

In January of this year, the U.S. Court of Appeals for the D.C. Circuit agreed that the Commission has the legal authority under section 706 of the Telecommunications Act of 1996 to craft enforceable rules to preserve a free and open Internet, even while it found that two of the rules we adopted in the 2010 Open Internet Order went beyond the FCC's authority.

On May 15, 2014, the Commission adopted a *Notice of Proposed Rulemaking* initiating the process of crafting rules to protect and promote the open Internet. The proposals we put forward and the questions we ask in this Notice focus on maintaining an open, fast, and robust Internet that continues to serve as a platform for economic growth, investment, innovation, free expression, and competition.

I believe that the section 706 framework set forth by the Court of Appeals in *Verizon* is sufficient to give us the authority to adopt and implement robust rules that will accomplish this goal. At the same time, the Notice asks whether the best path forward may be under title II. The entire purpose of an NPRM is to give Americans the ability to express themselves and provide analysis and guidance. I look forward to a broad and thoughtful debate on the record.

We have specifically created a means by which Americans who may not otherwise participate in an FCC proceeding can make their voice heard through our new Open Internet e-mail address: openinternet@fcc.gov. And to ensure sufficient opportunity for broad public comment, we have provided for a comment and reply period that will give everyone an opportunity to participate.

NUMBER PORTABILITY

Question. Under the Commission's local number portability (LNP) rules, consumers can generally keep their existing phone number when switching to a new telephone service provider. Today, this is something many consumers take for granted. A private, third-party entity administers the number portability system on behalf of the Commission. My understanding is that the Commission is in the process of considering proposals for administering this system.

Without commenting on any specific proposal before the Commission, will you assure me that the Commission will preserve consumer protections such as number portability in the transition to Internet protocol- or IP-based telephone networks?

Answer. The Commission will work to preserve consumer protections such as number portability in the transition to Internet Protocol- or IP-based telephone networks.

POSITIVE TRAIN CONTROL

Question. After the crash between a commuter train and a freight train in 2008, Congress moved quickly to require the installation of a safety system, known as "positive train control." It was not clear at that time how many antennas and stations would be required along the tracks. We now know that over 20,000 antennas need to be installed and approved by the FCC. In some areas, the approval process includes consultation with tribal governrnents.

How will the FCC balance the need to move expeditiously to permit this new safety system while ensuring that the proper environmental and historical reviews are taking place?

Does the budget request include enough resources to complete this task in time to meet, the statutory deadline for installing the positive train control system?

How is the FCC coordinating with other Federal, State, local and tribal officials on this issue? Have you encountered any problems in those collaborations?

Answer. On May 16, 2014, the Advisory Council on Historic Preservation (ACHP) voted to approve a Program Comment that modifies the FCC's usual procedures for historic preservation review. The process outlined in the Program Comment is tailored to the unique circumstances surrounding the deployment of Positive Train Control (PTC) facilities, and provides a mechanism for timely review by all parties. PTC is a transformative technology that has the power to save lives, prevent injuries, and avoid extensive property damage. It is a top priority of the Commission to facilitate an efficient and timely review process that complies with the National Environmental Protection Act (NEPA) and the National Historic Preservation Act (NHPA) while expediting this important safety measure. I believe the timelines set forth in the Program Comment will help the Commission reach this balance.

Additionally, I am pleased that we have reached an agreement with the freight rail industry that will resolve the siting issues for one-third of the PTC poles while providing substantial resources to tribal nations and States to support and advance historic preservation. As a result of this agreement, the freight railroads are immediately able to start using nearly 11,000 previously constructed poles for important testing and other preparatory activities and for the ultimate provision of PTC.

As part of the agreement, the seven class I freight railroads have agreed to create a Cultural Resource Fund totaling $10,000,000 to provide funding directly to tribal nations and State Historic Preservation Offices to support cultural and historic preservation projects. A neutral third-party administrator will administer the fund. Each freight railroad has also committed to training its employees on environmental and historic preservation compliance and to building working relationships with tribal nations.

The Memoranda of Understanding between the freight railroads and the FCC is available on the FCC Web site at http://www.fcc.gov/encyclopedia/positive-train-control-ptc.

The Program Comment Public Notice is also available on the FCC Web site at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-14-680A1.pdf.

The FCC moved resources from other projects to the PTC project over a year ago and continues to dedicate additional personnel and resources to resolving this issue. The pending budget request for fiscal year 2015 does not contain a specific request for PTC funding but the Commission has been able to fully fund the necessary resources for this project from its internal S&E account, utilizing FTEs and resources within the Wireless Telecommunications Bureau and the Consumer and Governmental Affairs Bureau.

During this time we have worked closely with tribal nations, State Historic Preservation Officers, the Advisory Council for Historic Preservation, the Federal Railway Administration, the National Transportation Safety Board, and land-holding Federal agencies. We have a constructive working relationship with all of these parties which led to the adoption of the procedures in the Program Comment and the landmark agreement with the freight rail industry.

TELEHEALTH

Question. Telehealth tecimologies can greatly enhance rural medical services. New Mexico is a large State with many residents living far from urban areas. Telehealth sometimes offers the best avenue to help meet healthcare needs. That is why I am working in a bipartisan manner with Senator Thune and others to help reduce some of the barriers to telemedicine. In December 2012, the Commission updated its existing rural healthcare universal service mechanism, making $400 million available to rural healthcare providers for broadband services through the "Healthcare Connect Fund."

What other actions can the FCC take to encourage greater use of telehealth technologies?

Answer. We must leverage all available technologies to ensure that advanced healthcare solutions are readily accessible to all Americans, from rural and remote areas to underserved inner cities. By identifying regulatory barriers and incentives and building stronger partnerships with stakeholders in the areas of telehealth, mobile applications, and tele-medicine, we can expedite this vital shift.

That's why I recently announced the formation of a new Commission Task Force—CONNECT2HEALTHFCC—that will bring together the expertise of the FCC on the critical intersection of broadband, advanced technology, and health. I appointed a senior, experienced staffer—Michele Ellison as Chair of the Task Force and Deputy General Counsel.

Specifically, the CONNECT2HEALTHFCC Task Force will consider ways to accelerate the adoption of healthcare technologies by leveraging broadband and other next-gen communications services. To advance this broad initiative, our Task Force will work hand in hand with the leadership of the Commission, in particular with the FCC's Director of Health Care Initiatives and the Chiefs of the Wireline and Wireless Bureaus and Office of Engineering and Technology. The Task Force will also collaborate with public and private stakeholders in the healthcare and technology space.

TRIBAL MOBILITY FUND ELIGIBILITY

Question. The Eastern Navajo Agency in New Mexico, along with the Ramah Navajo and Zuni Pueblo, are some of the most underserved areas in the continental United States. It is my understanding that first phase of the Tribal Mobility Fund auction treated the vast majority of the Eastern Navajo Agency as having 3G service. This meant that those areas were not eligible for funding. Yet my understanding is that mobile broadband service is not actually available throughout this area.

Will the Commission take steps to confirm the level of service available in these areas before excluding them from consideration in future Tribal Mobility Fund auctions?

Answer. I recognize the importance of finding solutions and ensuring robust service on tribal lands and I will continue to take actions that support this goal.

TV BLACKOUTS DURING RETRANSMISSION DISPUTES

Question. Last year during a dispute over retransmission fees, nearly three million Time Warner Cable customers lost access to CBS programming. In response, then Acting Chairwoman Clyburn stated that media companies should "accept shared responsibility" for putting consumers' interests above other interests during such disputes.

Given the Commission's authority under section 325 of the Communications Act, what more can the Commission do to better protect consumers during such retransmission disputes?

Answer. There is no question that the video marketplace has changed since Congress established the retransmission consent regime in 1992. Additionally, retransmission agreements have become more complicated with the advent of digital distribution options. The Commission's rules require parties to negotiate in good faith for retransmission consent. Although not directly related to blackouts, we recently modified our rules to prohibit joint retransmission consent negotiations between two non-commonly owned, top-four ranked TV stations in the same market in order to help level the playing field and get negotiations back to a one-on-one discussion, as Congress intended. With respect to blackouts, the Commission continues to monitor situations when disputes occur, and we will continue to help facilitate fair and effective completion of negotiations for the benefit of consumers.

TELECOMMUNICATIONS RELAY SERVICES

Question. The Americans with Disabilities Act (ADA) recognizes the importance of telecommunications for persons with disabilities, including those who have difficulty hearing or speaking on the telephone. With Video Relay Service (VRS), individuals using sign language can make relay calls through communications assistants. These assistants then voice what is signed to the called party. For Americans who communicate best with sign language, VRS provides an important service.

Will you give your assurance that the Commission will fully meet its obligations under the Americans with Disabilities Act with respect to telecommunications relay services?

Answer. I agree that the Commission must fully meet its obligations under the Americans with Disabilities Act with respect to telecommunication relay services and I will continue to take all actions necessary to facilitate this program.

21ST CENTURY COMMUNICATIONS AND VIDEO ACCESSIBILITY ACT

Question. Passed by Congress in 2010, the Twenty-First Century Communications and Video Accessibility Act contains protections that enable people with disabilities to access broadband, digital and mobile innovations. According to a 2009 FCC study, persons with disabilities are less likely to use Internet-based communications technologies. For examples, 65 percent of Americans have broadband at home, yet only 42 percent of Americans with disabilities have these services. This gap is due in part to physical barriers that people with disabilities confront in using the Internet.

What is the level of compliance with the communications provisions of the Twenty-First Century Communications and Video Accessibility Act?

What other actions can the FCC to ensure that Americans with disabilities have access to new broadband technologies?

Answer. The Commission has completed all rulemakings associated with statutory deadlines established by the provisions of the Twenty-First Century Communications and Video Accessibility Act (CVAA). You will find below a list of implementation deadlines requiring compliance with the Act's provisions. Generally, the Commission has been very pleased with the efforts of covered entities to meet these deadlines in a timely fashion.

The Commission's Disability Rights Office (DRO), housed in the Consumer and Govenmiental Affairs Bureau, is active on various proceedings designed to ensure access to new broadband technologies. These include proceedings requiring access to Internet-based telecommunications relay services, updating the hearing aid compatibility requirements, and ensuring disability access to wireline communications as we make the transition from the public switched telephone network to IP-based forms of communication. In addition, through its complaint process, DRO keeps abreast of and addresses accessibility barriers as these arise. Finally, DRO maintains an email list, AccessInfo, of over 2000 individuals through which DRO regularly informs consumers, state and local governments, and industry stakeholders nationally and internationally of Commission rulemakings, events, and other actions pertaining to expansion of the rights of people with disabilities.

SUMMARY OF COMPLIANCE WITH THE ACT

IMPLEMENTATION OF THE TWENTY-FIRST CENTURY COMMUNICATIONS AND VIDEO ACCESSIBILITY ACT OF 2010 (CVAA)

Section 102. Hearing Aid Compatibility

Extends hearing aid compatibility requirements to handsets used for advanced communications services.

No implementation deadlines.

Section 103. Relay Services

Revises the definition of telecommunications relay services (TRS).

No implementation deadlines.

Requires VoIP service providers to contribute to the TRS Fund by October 8, 2011.

On October 7, 2011, the FCC adopted rules requiring covered entities to register with FCC by December 31, 2011; report revenues for fourth quarter 2011 by April 1, 2012, to determine contributions for the 2012–2013 TRS Fund year; and to report revenues and contribute to the TRS Fund annually thereafter.

Section 104. Access to Advanced Communications Services and Equipment

Adds sections 716 (accessibility requirements for advanced communications services and equipment), 717 (recordkeeping and enforcement provisions), and 718 (accessibility requirements for Internet browsers built into mobile phones) to the Communications Act.

1. Requires implementing rules for Sections 716 and 717 by October 8, 2011.

   On October 7, 2011, the FCC released a report and order adopting rules. Covered entities must comply with accessibility requirements by October 8, 2013. FCC established new request for dispute assistance and informal complaint procedures, effective October 8, 2013, for alleged violations of Sections 255, 716, and 718 of the Communications Act.

2. Requires recordkeeping obligations to commence 1 year after rules become effective.

   Rules became effective January 30, 2012; recordkeeping obligations began January 30, 2013. FCC established Web-based system for submission of recordkeeping compliance certifications and contact information (RCCCI Registry) by April 1, 2013, and annually thereafter.

3. Requires Section 718 to be effective October 8, 2013.

   On April 26, 2013, the FCC adopted rules to implement Section 718. Covered entities must comply with the accessibility requirements by October 8, 2013.

4. Requires the FCC to establish an accessibility clearinghouse by October 8, 2011.

   The FCC launched its Accessibility Clearinghouse in October 2011.

5. Requires FCC biennial reports to Congress; first report by October 8, 2012.

   The FCC submitted its first biennial report to Congress on October 5, 2012; next report due October 2014.

6. Requires the Comptroller General to conduct a study and report to Congress by October 8, 2015.

Section 105. National Deaf-Blind Equipment Distribution Program (NDBEDP)

Adds Section 719 to the Communications Act, which authorizes up to $10 million from the TRS Fund annually to support programs that distribute accessible telecommunications, advanced communications, and Internet services equipment to low-income individuals who are deaf-blind. Requires implementing rules by April 8, 2011.

On April 4, 2011, the FCC adopted rules to establish the NDBEDP as a pilot program. The FCC certified state-based entities and launched the pilot program on July 1, 2012. The FCC will adopt rules for a permanent NDBEDP by June 2015.

Section 106. Emergency Access Advisory Committee (EAAC)

1. Requires the FCC to establish the EAAC within 60 days after October 8, 2010.

   On December 7, 2010, the FCC announced the appointment of EAAC members.

2. Requires the EAAC, within 1 year after member appointment [or by December 7, 2011], to conduct a national survey and submit a report with recommendations to the FCC.

   The EAAC conducted a national survey and submitted a report and recommendations to the FCC on December 6, 2011.

3. Authorizes the FCC to promulgate regulations.

No implementation deadlines. On May 8, 2013, the FCC adopted rules to require bounce-back messages by September 30, 2013, when text-to-911 messages are not supported. Major carriers volunteered to support text-to-911 by May 15, 2014.

Section 201. Video Programming Accessibility Advisory Committee (VPAAC)

1. Requires the FCC to establish the VPAAC within 60 days after October 8, 2010.

On December 7, 2010, the FCC announced the appointment of VPAAC members.

2. Requires the VPAAC to submit, within 6 months after the VPAAC's first meeting on January 13, 2011 [or by July 13, 2011], a report with recommendations about closed captioning of IP-delivered video programming ("first report").

The VPAAC submitted its first report to the FCC on closed captioning on July 13, 2011.

3. Requires the VPAAC to submit, within 18 months after October 8, 2010 [or by April 9, 2012], a report with recommendations about video description, emergency information, user interfaces, program guides, and menus ("second report").

The VPAAC submitted its second report to the FCC on April 9, 2012.

Section 202. Video Description, Emergency Information, and Closed Captioning

Amends Section 713 of the Communications Act with respect to the provision of video description, accessible emergency information, closed captioning on video programming delivered using Internet protocol, and petitions for exemption from the closed captioning requirements.

Video Description

1. Requires, 1 year after the enactment of the CVAA, or by October 8, 2011, the reinstatement of FCC regulations that mandated the provision of video description on video programming, with certain modifications.

On August 25, 2011, the FCC released a report and order reinstating the video description rules, effective October 8, 2011, and requiring compliance by July 1, 2012.

2. Requires, not later than 1 year after the completion of the phase-in of the reinstated regulations, or by July 1, 2013, the FCC to initiate an inquiry on video description and report to Congress 1 year after initiating that inquiry, *i.e.,* by July 1, 2014.

The FCC initiated an inquiry on video description on June 25, 2013.

3. After filing its report to Congress by July 1, 2014, but no later than October 8, 2016, 6 years after the enactment date of the CVAA, the FCC must extend the video description requirements to broadcast stations in the top 60 television markets.

The FCC's video description rules extend requirements to broadcast stations in the top 60 television markets beginning on July 1, 2015.

4. Not before July 1, 2016, 2 years after completing its report to Congress, the FCC may increase the video description requirement by up to 75 percent (from 50 to 87.5 hours per quarter) for televised video programming.

5. Nine years after the date of enactment of the CVAA, or by October 8, 2019, the FCC must submit to Congress a report assessing the provision of video description, particularly with respect to television markets outside the top 60.

6. Ten years after the date of enactment of the CVAA, or on October 8, 2020, the FCC is authorized to phase in the video description regulations for up to 10 additional television market areas each year.

Emergency Information

Requires the FCC to adopt rules, not later than 1 year after the second VPAAC report, or by April 9, 2013, that require video programming owners, providers, and distributors to convey emergency information in a manner that is accessible to individuals who are blind or visually impaired.

The FCC adopted rules on April 8, 2013, to require, by May 26, 2015, the use of a secondary audio stream to convey televised emergency information aurally, when such information is conveyed visually during programming other than newscasts, for example, in an on-screen crawl.

Closed Captioning on Video Programming Delivered Using Internet Protocol (IP)

Requires the FCC to adopt rules, not later than 6 months after the first VPAAC report, or by January 13, 2012, to require closed captioning on IP-delivered video programming that was published or exhibited on television with captions after the effective date of such regulations.

On January 12, 2012, the FCC adopted rules governing the closed captioning requirements for IP-delivered video programming. Implementation was phased in for two different types of IP-delivered programming: (1) programming newly added to an IP distributor's inventory; and (2) programming already in an IP distributor's inventory.

Programming that is newly added to an IP distributor's inventory must be captioned if the program was shown on television with captions on or after the following dates:

—September 30, 2012—for pre-recorded video programming that is not substantially edited for the Internet.

—March 30, 2013—for live and near-live video programming.

—September 30, 2013—for pre-recorded video programming that is substantially edited for the Internet.

Programming already in an IP distributor's inventory must be captioned according to the following implementation schedule:

—Within 45 days after the program is shown on television with captions on or after March 30, 2014 and before March 30, 2015;

—Within 30 days after the program is shown on television with captions on or after March 30, 2015 and before March 30, 2016; and

—Within 15 days after the program is shown on television with captions on or after March 30, 2016.

Exemptions Based on Economic Burden

Replaces the term "undue burden" with the term "economically burdensome" as the standard by which the FCC is to assess requests for exemptions from the closed captioning requirements.

No implementation deadlines. On July 19, 2012, the FCC amended its rules to replace the term "undue burden" with "economically burdensome" and determined that the four factors in Section 7 13(e) of the Communications Act will be used to evaluate requests for exemption.

Section 203. Closed Captioning, Emergency Information, and Video Description Capability

Amends Section 303(u) and adds Section 303(z) to the Communications Act to update requirements for apparatus that receive, play back, or record video programming to be compatible with closed captioning, video description, and accessible emergency information so that these features and services reach viewers.

Apparatus Closed Captioning Capability

Requires the FCC to adopt rules to update apparatus closed captioning capability requirements within 6 months after the first VPAAC report, or by January 13, 2012.

On January 12, 2012, the FCC adopted rules that require apparatus manufactured on or after January 1, 2014 to comply with the updated closed captioning capability requirements.

Apparatus Video Description and Emergency Information Capability

Requires the FCC to adopt rules for apparatus video description and emergency information capability within 18 months after the second VPAAC report, or by October 9, 2013.

The FCC adopted rules on April 8, 2013, to require apparatus manufactured on or after May 26, 2015, to provide a secondary audio stream to convey required video description and televised emergency information aurally, when such information is conveyed visually during programming other than newscasts, for example, in an on-screen crawl.

Section 204. User Interfaces on Digital Apparatus

Adds Section 303 (aa) to the Communications Act. Requires user interfaces on apparatus designed to receive or play back video programming, including IP-delivered video programming, to be accessible to and usable by individuals who are blind or visually impaired, and mandates a mechanism that is reasonably comparable to a button, key, or icon for activating closed captioning and video description features. Requires the FCC to adopt rules for these provisions within 18 months after the second VPAAC report, or by October 9, 2013.

On October 29, 2013, following the shutdown of the Federal govermnent due to a lapse in appropriations, the FCC adopted rules requiring video programming apparatus user interfaces to be accessible to and usable by individuals who are blind or visually impaired, and a mechanism for activating closed captioning and video description by December 20, 2016.

Section 205. Access to Video Programming Guides And Menus Provided on Navigation Devices

Adds Section 303(bb) to the Communications Act. Requires on-screen text menus and guides provided by navigation devices (set-top boxes) to be audibly accessible in real-time upon request by individuals who are blind or visually impaired, and mandates access to any built-in closed captioning capability through the use of a mechanism that is reasonably comparable to a button, key, or icon designated for activating the closed captioning or accessibility features. Requires the FCC to adopt rules for these provisions within 18 months afier the second VPAAC report, or by October 9, 2013.

On October 29, 2013, following the shutdown of the Federal government due to a lapse in appropriations, the FCC adopted rules requiring on-screen text menus and guides provided by navigation devices to be accessible to individuals who are blind or visually impaired, and a mechanism for activating closed captioning by December 20, 2016. Small multichannel video programming distributors (MVPDs) must comply by December 20, 2018.

UNLICENSED SPECTRUM

Question. Spectrum is a scarce and valuable resource. This is the case for both licensed and unlicensed spectrum. Unlicensed spectrum fuels innovation and, according to one recent study, helped generate over $220 billion in value to the US economy last year. Given the growth of WiFi and the explosion of connected devices sometimes referred to as the "Internet of things," the value of unlicensed spectrum will likely continue to grow.

As the Commission proceeds with upcoming spectrum auctions, will you work to preserve adequate access to unlicensed spectrum?

Answer. As contemplated by the Middle Class Tax Relief and Job Creation Act, the May 15th Incentive Auction Report and Order adopted rules to permit unlicensed use of technically reasonable guard bands required to protect licensed services in the new 600 MHz band, in addition to Channel 37 and remaining TV White Spaces. This action will make available a significant amount of low-band spectrum for unlicensed use, much of it on a consistent, nationwide basis.

We also are actively participating in ongoing efforts with the Department of Transportation and industry to resolve technical issues in a portion of the 5 GHz ITS band currently used for vehicle-to-vehicle communications and with the Defense Department to resolve issues in a portion of the 5 GHz band used for military radar. Resolving these issues could make an additional 195 MHz of spectrum available for wireless broadband. We hope and expect parties to engage productively, and we will be watching closely.

BUDGET REQUEST FOR UNIVERSAL SERVICE FUND (USF) REFORM

Question. The fiscal year 2015 President's budget requests an additional 45 FTE for Universal Service Reform. Please provide a table that lists each new FTE by office and bureau, with a description of the proposed responsibilities for each new FTE.

Answer. The FCC's $10,877,000 request would provide 45 additional FTEs for enforcement-based oversight and supplement the 25 FCC employees tasked with oversight of the $8.4 billion USF programs. Specifically, the requested funds will provide for a Joint USF Anti-Fraud Task Force to combine resources agency-wide and develop a strategic, targeted approach to identifying, preventing, eliminating and prosecuting activities that undermine the integrity of the USF program. The 45 FTEs will be spread throughout the agency as follows:

—6 FTES for Office of Inspector General (investigations and enforcement)
—20 FTEs for Enforcement Bureau (increasing EB 's capacity to handle complex cases)
—10 FTEs for Office of Managing Director (financial systems and operational oversight)
—9 FTEs for Wireline Competition Bureau (oversight and compliance activities such as identifying potential rule violations, reviewing data and reports from beneficiaries)

Below are detailed descriptions of the bureau activities and the bulk of these employees, but note that there may be adjustments based on budgetary constraints and a final programmatic review:

FCC USF Anti-Fraud Joint Task Force Plan: Wireline Competition Bureau

—The Wireline Competition Bureau (WCB) oversees the Federal Universal Service Fund. WCB manages the four USF programs—Lifeline, E-Rate, Connect

America Fund and Rural Health Care—as well as contributions. Because WCB manages the Fund in close coordination with USAC, WCB often becomes aware of potential abuse of the Fund, mainly through USAC audits, appeals, annual filings, press reports and! or through discussions with stakeholders.

—WCB's role will fall into three main categories: initial inquiry into potential rule violations; internal support and consultation; and coordination and outreach.

—*Initial Inquiry into Potential Rule Violations.*—WCB is well-positioned to serve as the eyes and ears of the agency to identify potential rule violations. WCB meets with funding recipients and others involved with USF on a daily basis and in the course of those meetings frequently identifies situations that deserve further scrutiny. WCB also coordinates with USAC on a daily basis and often becomes aware through that process of potential violations.

WCB staff will enhance and augment these existing functions by dedicating expert staff to these tasks as well as to analyzing data (e.g., National Lifeline Accountability Database data, FCC Forms and Annual Reports), to identify potential targets for investigation, conduct initial assessments, and make prompt referrals to the EB Strike Force.

—*Internal Support and Consultation.*—WCB will serve as a resource on factual (including historical) and legal issues regarding waste, fraud and abuse in each of the USF programs. The team will identify patterns of fraud/fraud risk in and among the USF programs. Based on lessons learned in this process, the team will advise policymakers on how to mitigate the risk of waste, fraud and abuse going forward. The team would also provide USAC with guidance and training on fraud related issues and will have a role in the development and review of compliance plans. Finally, the team will recommend areas for intensive review or auditing to USAC, the EB Strike Force, and the OIG.

—*Coordination and Outreach.*—WCB will work with other representatives of the USF Anti-Fraud Task Force to coordinate efforts with OGC and OIG on fraud issues and will work with OMR on crisis communications.

Role	Description	# FTEs
WCB Anti-Fraud Director	Direct overall Anti-Fraud activities for WCB; report to Chief of TAPD	1
Anti-Fraud Dedicated Staff Experts	For each program, at least one legal expert and at least one finance/auditing expert initially allocated as follows with but with flexibility to shift experts among programs as needed: —2 E-Rate legal experts (also support Rural Health Care) —2 E-Rate compliance/auditing experts (also support Rural Health Care) —1 Lifeline legal expert —1 Lifeline compliance/auditing expert —1 Connect America Fund legal expert —1 Connect America Fund compliance/auditing expert	8

Enforcement Bureau USF Strike Force

—The EB USF Strike Force will target fraud, waste, and abuse in all four components of the USF: Lifeline, E-Rate, High Cost programlConnect America Fund, and Rural Health Care.

—Strike Force—working in teams composed of attorneys, investigators, and forensic analysts—will pursue violations of the Communications Act, the Commission's rules, the False Claims Act, the Debt Collection Improvement Act, and other laws bearing on USF programs.

—The Strike Force will investigate allegations of wrongdoing by specific targets, analyze data (e.g., NLAD data, USAC E-Rate funding request data, etc.) to identify patterns of misconduct, conduct undercover work, and target recidivists who resurface under different corporate guises.

—The Strike Force will coordinate internally with other components of the Joint USF Anti-Fraud Task Force (e.g., on investigations where appropriate, on rulemakings, on policy issues) and externally with DOJ and State authorities (e.g., Public Utilities Commissions (PUCs), State attorney generals (AGs) and other law enforcement) to investigate and pursue wrongdoers.

POSITIONS

Role	Description	# FTEs
Strike Force Director	Direct overall activities of Strike Force; report to EB Bureau Chief	1
Deputy Directors	Three deputies with responsibilities divided as follows: —1. E-Rate —2. Lifeline, Contributions —3. High Cost, Rural Health	3
Strike Force Teams	Three 4-person teams responsible for specific cases. Teams consist of: —1 attorney (team leader) —1–2 investigator (interviews, undercover, doc production, etc.) —2–3 forensic examiners (document and financial analysis)	14
Policy Counsel	One attorney tasked with working collaboratively with other FCC stakeholders on policy matters, rulemakings, etc.	1
DOJ Trial Attorney Detailee	Funding for a DOJ criminal trial attorney detailee dedicated to handling USF fraud, waste, and abuse cases	1

Office of the Managing Director: FTEs to Eliminate Improper Payments; and Improve Operational and Financial Oversight

The Office of the Managing Director (OMD) manages and oversees the functions of the Universal Service Administrative Company related to auditing, improper payments assessments and reporting, finance, accounting, procurement, information technology, administration, and personnel issues.

Identifying, Recovering and Reducing Improper Payments

—As required by the Improper Payments Elimination and Recovery Improvement Act of 2012, OMD has worked to develop assessments for each of the universal service programs that disburse funding: Lifeline, E-Rate, High Cost programlConnect America Fund, and Rural Health Care. Improper payments are any payments that were not made or any payments that should have been made. The law requires the Commission to have an error rate of lower than 1.5 percent of total disbursements for each program.

—For the High Cost/CAF, E-Rate and Lifeline programs, the Commission must analyze and constantly review and improve procedures to accurately capture improper payments based on OMB guidance. Specifically, additional OMD staff will focus on working with other Commission offices and USAC to bolster the assessments for those programs so we can demonstrate that we are testing all of the key components of those programs. In addition, as the programs are reformed, assessments procedures must be updated and revised accordingly.

—Based on the findings in the completed assessments—as well as findings from other audits and investigations—the Commission must develop corrective action plans to reduce improper payments under the statute. OMD staff will work other Commission offices and with USAC to address areas of concern, including by proposing rule changes, referring actions to the Enforcement Bureau, performing further targeted audits, conducting additional outreach, improving predisbursements reviews, and taking other actions as necessary to remediate the issues identified.

—OMD staff will work to increase recovery of funds from payment recapture audits (USF Beneficiary and Contributor Audits, or BCAP). Nearly $300 million in potential recoveries is outstanding based on audit findings. Staff will determine whether audit findings were correct and if funding can be collected before recovery can proceed. Staff will review outstanding issues and provide guidance to USAC and stakeholders.

Operational and Financial Oversight

—*Financial.*—OMD staff will analyze USF program cash management practices to determine whether to revise the current commitment and disbursement policies and procedures. Work with agency's CFO to ensure compliance with Federal financial requirements. Oversee USAC efforts to reduce outstanding commitments and disbursements.

—*Information Technology.*—OMD staff will work with USAC and coordinate with other offices to modernize and improve USF financial and programmatic systems. Improvements in the financial systems will (1) ensure the proper funding is being disbursed for each program; (2) provide stakeholders with updated and user-friendly access to Commission and USAC systems, information and data; and (3) improve data collection and analysis to support policymaking and to de-

termine whether the Commission's programmatic and administrative goals are being met for each program.

—*Risk Assessments.*—To comply with GAO recommendations, OMD staff will manage and oversee program risk assessments for E-Rate and Lifeline. OMD staff will also analyze, review and implement recommendations that result from the risk assessments.

POSITIONS

Role	Description	# FTEs
Director of USF Oversight	Direct, plan and coordinate overall activities administrative oversight team; report to Managing Director	1
Improper Payments Reduction and Reporting Team.	As described above	3
Information Technology Modernization Team	As described above	2
Financial Management Team	As described above	2
Risk Assessment Team	As described above	2

QUESTIONS SUBMITTED BY SENATOR MIKE JOHANNS

Question. In our hearing, you indicated that a change to the regulation governing the FCC's implementation of their responsibilities would take too long and therefore be of little value in helping the rail industry meet the deadlines specified in the Positive Train Control statute.

If the FCC is able to utilize the Program Comment and any modified procedures in the 2004 Programmatic Agreement specified by the Program Comment, what do you expect the pace of Positive Train Control (PTC) pole approval to be, assuming the parties subject to compliance obligations submit timely and complete data packages to the FCC?

Answer. On May 16, 2014, the Advisory Council on Historic Preservation (ACHP) voted to approve a Program Comment that modifies the FCC's usual procedures for historic preservation review. The Program Comment permits several changes to our existing procedures that should significantly reduce the time required for necessary review. First, the Program Comment contains new, significant provisions that, subject to certain exceptions, exclude from review deployments of PTC poles installed in railroad rights of way within 500 feet of existing equipment that is at least 25 feet tall, including signaling equipment that includes a vertical post, catenary bridges or masts, or above ground utility transmission or distribution lines and associated structures.

For those poles not excluded from review, the Program Comment provides for streamlined processing times. Once a railroad submits a deployment notification, State and Tribal Historic Preservation Officers have 30 days to express their interests or concerns. If there is no response within 30 days, the railroad can refer the matter to the FCC, which in turn has 10 business days to decide whether a Tribe or SHPO can participate in the review. In addition, the Commission must resolve disputes between the railroads and Tribes and SHPOs within 10 days. These are meaningful improvements to current processing times.

Question. The FCC's budget proposes to retain $106 million collected from auction revenues to develop, implement and maintain its auction program. This is $7.5 million above the fiscal year 2014 level. In fiscal year 2013 the FCC sought a $13.7 million dollar anomaly, increasing the cap from $85 million to $98.7 million, specifically for costs associated with the first-ever incentive auction. The auction cap was again set at the higher level in fiscal year 2014 at $98.7 million, citing the need for additional resources for the incentive auction. The fiscal year 2015 FCC budget again seeks an increase, now to $106 million, for essentially the same purpose.

Given concerns about transparency, the fiscal year 2014 Omnibus adopted House report language which required the FCC to submit to the Committees a report with specific detail on the Commission's fiscal year 2015 projected auction expenditures.

The Committee just received the first required Auction Expenditure report and it is difficult to understand what costs are attributable to various auctions and what progress is being made towards the rollout of the incentive auction with the use of these funds.

Would you please provide the Committee with more specific detail on how those funds will be spent and any update you have on the progress of the incentive auction process?

Answer. The Commission must maintain its systems and staff to carry out traditional auctions while creating and maintaining new systems and structures to handle the Incentive Auction process. Prior to 2013, the Commission maintained its systems for a 10-year period at $85 million without any inflationary adjustments. During that period, the Commission administered its spectrum auction program, raising billions of dollars for the Treasury and providing tens of thousands of licenses. The Commission recently completed the $1.65B H Block auction, while the AWS–3 auction is scheduled for the current year. Accordingly, the next fiscal year will place additional strain on the traditional auction process.

The increases during the past two fiscal years are specifically geared toward the incentive auctions process. The first increase funded start-up and initiation costs of a complex, unique system, and the next fiscal year will see an intensification of the auctions activities process. Below is a description of the work and continuing activities generating the added costs for the auctions program.

Public Releases

—The Incentive Auction rulemaking process continues, with the adoption of the *Incentive Auction Report and Order, Wireless Microphones Report and Order,* and *Mobile Spectrum Holdings Report and Order* on May 15, 2014.

—To assist the Commission in making policy decisions, and to support auction research conducted by our outside auction design experts, the staff runs studies daily, using complex software developed to support these tasks. Preliminary results from these studies have been released to the public in the *Repacking Data Public Notice,*[1] and the accompanying workshop/webinar discussing these results,[2] and in the *Aggregate Interference Public Notice,*[3] which is scheduled to be released concurrent with the *Incentive Auction Report and Order.*

Software Development

—*IT Upgrades.*—Conducting the first-ever Incentive Auction is complicated, and requires advanced computer system development and upgrades to the Commission's current auction system to support integrating the reverse and forward auctions with the "repacking" of television stations in the UHF band.

—*Feasibility Checking.*—The voluntary reverse auction, where descending prices are offered to broadcast television licensees in return for relinquishing usage rights, can continue only insofar as the Commission is able to guarantee that any bidder that exits the auction can receive a channel in its "home" (UHF, upper VHF, or lower VHF) band. To determine how prices decrease and how winners are selected, our outside auction system designers have developed software called a "feasibility checker" to perform thousands of these checks in real-time.

—*Optimization.*—To determine an initial spectrum clearing target, as well as a final channel assignment, the Commission will need to run integer optimization software. In conjunction with our outside auction designers, we are also continuing to explore the use of integer optimization solvers at other points of the reverse and forward auctions, or in the repacking process. The staff has been working to develop elaborate optimization models to achieve a balance between cost and computational time.

—*Auction Bidding Systems.*—The Commission has an online auction system ("ISAS") that has served well since the debut of spectrum auctions. However, the system as it is currently built cannot support the unique nature of the Incentive Auction, and staff has been working with our outside auction service provider to design a replacement bidding system engine that will support our current and future needs. The three components of the Incentive Auction are all integrally connected, and major features, including to the user-experience, require a redesign to allow for a successful bidding process.

—*Systems Integration.*—Similarly, if any one component of the Incentive Auction system fails, it could cause the entire auction system to fail. Recognizing that systems integration is a crucial component to achieving the goals of the Spectrum Act, the staff has focused much attention on ensuring that connected

[1] *Incentive Auction Task Force Releases Information Related to Repacking; Announces Workshop/Webinar to Provide Additional Detail,* GN Docket No. 12–268, ET Docket No. 13–26, Public Notice, 29 FCC Rcd 47 (2014).

[2] LEARN Workshop on Feasibility Checking During Repacking Process, FCC (Feb. 21, 2014), available at http://www.fcc.gov/events/learn-workshop-feasibility-checking-during-repacking-process.

[3] *Incentive Auction Task Force Releases Updated Constraint File Data Using Actual Channels and Staff Analysis Regarding Pairwise Approach to Preserving Population Served,* GN Docket No. 12–268, ET Docket No. 13–26, Public Notice, DA 14–677 (2014).

pieces communicate successfully (from the clearing target optimizer to the reverse auction bidding engine and feasibility checker, for example). We have also begun the process of hiring a team to help with systems user acceptance testing, and an independent verification and validation team.

Studies

—As in the previously mentioned public releases, the Incentive Auction team runs studies and study scenarios to inform staff and Commission decisions regarding policy decisions, and the cost-benefit analysis of certain design considerations. The staff works closely with our outside contractors to develop and refine study software to test auction designs.

—The auction studies feed into cross-bureau and office teams, and have been integral in negotiations with Mexico and Canada on the possibility of performing a joint repacking of the UHF band.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

Question. Thank you for your assurance at the hearing that the FCC has a timeline and process to provide broadcast TV stations a "book" of financial data to help stations understand the kind of prices they can expect to earn if they choose to participate in the upcoming incentive auction. Strong participation by broadcasters will be critical to the success of the auction. Could you please provide the Committee with the timeline of the FCC process you referenced in your testimony, including an approximate estimation about when TV stations can expect to receive the financial information they need to determine whether or not to participate in the auction?

Answer. I agree that strong participation by broadcasters will be critical to the success of the Incentive Auction, and I am committed to providing information to facilitate broadcasters' ability to make informed, fact-based decisions about whether and how to participate. On May 15, 2014, the Commission adopted its rules for the Incentive Auction. We will be providing additional data and information to broadcasters in the coming weeks and months, including a timeline for our future actions, and a "book" of financial data to provide broadcasters with an estimate of potential prices in the reverse auction.

Question. As was noted in Commissioner Pai's testimony, the FCC has traditionally generated large revenue for the Treasury from its spectrum auction program, but between fiscal year 2009 and fiscal year 2013, Congress appropriated to the FCC $452 million for auction-related expenses and the Commission only generated $73.25 million in auction revenue. The FCC budget proposal asks for $106 million for costs associated with auctions, which is just shy of a 25 percent increase from the $85 million Congress allocated for most of the last decade. As you know, the administration has suggested that they do not envision clearing additional spectrum for auction after next year's auctions and they will instead focus on spectrum sharing. If spectrum sharing becomes the preferred strategy, should we expect the Commission's auctions-related costs and corresponding personnel levels to drop in fiscal year 2016 and beyond since there are no additional major spectrum auctions planned?

Answer. Certainly spectrum sharing is a goal of the Commission, and spectrum clearing is also possible in other instances. In some instances, shared spectrum may be auctioned, as will be the case with our AWS–3 auction scheduled for this Fall. We have spectrum auctions authority during the next decade, and sometimes those auctions will be small but with significant economic impact. For instance, during the period where you noted that the Commission only generated $73.25 million in revenue, we auctioned more than 16,000 licenses, resulting in important growth benefits for numerous businesses nationwide. Also, it is essential to recognize the overall numbers—that auctions spending has cost less than 2 percent of the revenue received from the program, which is a terrific record for any government or private program.

Question. The 's Wireline Competition Bureau recently announced a rate floor increase, which will have a major impact on Kansas telephone customers across the country. Rural Kansas telephone companies currently charge rural customers anywhere from $11.77 to $18.25 per month for phone service, and under Kansas law, they are only allowed to increase rates by $1.50 per month in any 12-month period. The new rate of $20.46 will be impossible for companies in my state to comply with by the July 1, 2014 deadline. Are you willing to commit to delaying the rate floor increase, and will you work with companies to address their challenges so they can comply with the law?

Furthermore, if a carrier increases its rates to match the rate floor, I understand that it does not lose any universal service support. This appears to counter the argument that the rate floor reduces "excessive" universal service subsidies, yet increases rates despite the statute's requirement that telephone rates be "affordable." What purpose does the rate floor serve other than making rural rates less affordable?

Answer. For 2014, the Commission has delayed any further reductions in universal service support until we have more information on the number of lines affected. The Commission adopted an Order on April 23, 2014, that maintains the requirement that carriers file with the Universal Service Administrative Company the number of lines with rates below the rate floor, but delays any potential universal service support reductions until January 2015. In addition, the universal service support reductions that go into effect in January will only be for those lines with rates below $16, with no further increases until July 2016. The Order also excludes Lifeline recipients in order to ensure that people with the least means are not affected. Future reductions will be limited to an increase of no more than $2 per year.

Although I understand the concern regarding increased landline rates because of the increased rate floor, what we have seen since the Commission implemented this rule in 2012 is a minimal impact. The rate floor increased from $10 in 2012 to $14 in 2013, a 40 percent increase. Our rules do not require carriers to raise their rates. The fact that many carriers continue to report some lines with rates well below the $14 rate floor suggests that they may have made a business decision to grandfather the lower rates for those customers and accept the associated support reductions. In 2013, carriers in 34 study areas in 16 states were still reporting a number of lines with residential local service charges of $5 or less, further reinforcing that individual carriers may choose not to raise rates in response to the current rate floor.

Question. On March 31, the FCC approved a plan to restrict television broadcasters' use of joint sales agreements (JSAs). What data and facts were considered by the FCC to make a determination that the use of JSAs was inconsistent with the spirit of media ownership rules? Does the FCC currently collect information on JSA usage among television broadcasters? If so, how many are there in the United States? How many television stations owned by women and minorities participate in JSAs? How many JSAs were approved by the FCC since 2002?

Answer. The Commission's attribution rules "seek to identify those interests in licensees that confer on their holders a degree of 'influence or control that the holders have a realistic potential to affect the programming decisions of licensees or other core operating functions.'" The attribution rules are taken into account when calculating ownership interests under the local TV and local radio ownership rules. The Commission first proposed to attribute JSAs that involve the sale of 15 percent or more of the weekly advertising time between same market television stations in 2004, and sought additional comment in 2010.

Based on the records developed, and our ongoing review of TV JSAs as part of license transfer applications, there was growing concern that the increasing prevalence of such agreements warranted attribution similar to the radio attribution rules adopted in 2003, because they "provide incentives for joint operation that are similar to those created by common ownership."

It is important to note that the Commission does not review or approve JSAs, but does take such agreements into consideration when reviewing applications to transfer licenses between entities. With the adoption of the new rules, TV stations will now be required to file any attributable JSA with the Commission, and will have 2 years to unwind any attributable JSAs where the local TV ownership rule would not allow joint ownership. Additionally, under existing rules, all radio and TV stations are required to place a copy of JSAs in their public files. Based on these self-reporting requirements, approximately 130 stations currently report being involved in a JSA. Within the Order, the Commission recognized that there could be some exceptions to the new rule, where a JSA could be found to be in the public interest, and provided an expedited waiver process to address those instances.

Question. Almost all small and medium-sized cable operators license most of their programming through a single buying group, the National Cable Television Cooperative (NCTC). In October 2012, the FCC issued an FNPRM that tentatively concluding its definition of a "buying group" needs to be modernized and sought comment on this and other related matters to ensure that buying groups utilized by smaller cable operators can avail themselves of certain program access rules as Congress intended. What is the status of this proceeding?

Answer. The Media Bureau is currently evaluating the record in this proceeding, which raises complex legal and policy issues impacting not just small cable operators but also programmers. The Bureau is analyzing the costs and benefits of such a rule change as well as the effect of this proposed rule change on the video market-

place generally. While I understand the concerns raised by the NCTC, nothing is prohibiting the NCTC from qualifying as a buying group under the existing rules, as they previously have done.

QUESTIONS RELATED TO INFORMATION TECHNOLOGY STRATEGY AND INVESTMENTS

Question. Describe the role of your agency's Chief Information Officer in the oversight of IT purchases. How is this person involved in the decision to make an IT purchase, determine its scope, oversee its contract, and oversee the product's continued operation and maintenance?

Answer. The Commission's Chief Information Officer ("CIO") or a member of the CIO's team is involved in every major IT acquisition by the FCC. The FCC IT Team has recently launched an updated enterprise planning approach that will improve transparency, accountability, and responsibility throughout the entirety of the IT investment lifecycle. The IT team is involved from the submission of an investment request to seeing the projects to completion as well as simultaneously tracking the on-going benefits of the investment made as a result of the project.

Question. Describe the existing authorities, organizational structure, and reporting relationship of your agency Chief Information Officer. Note and explain any variance from that prescribed in the Information Technology Management Reform Act of 1996 (aka, The Clinger-Cohen Act) for the above.

Answer. The FCC's CIO is located within the Office of the Managing Director ("OMD"). The Managing Director directs operations in OMD and reports directly to the Chairman. The CIO in turn reports to the Managing Director on the FCC's organizational chart and for practical purposes coordinates with the Managing Director on the day-today activities of the IT team at the FCC. For longer tenn, high priority, and high visibility IT projects, the CIO along with the Managing Director brief the Chairman on a regular basis.

The Clinger-Cohen Act specifically designated the CIO as reporting to the agency head for certain matters related to strategic planning in larger agencies listed in 31 USC § 901(b) that are considered Chief Financial Officer Act ("CFO Act") agencies.[4] While the FCC is a smaller agency and is not a CFO Act agency; the CIO does regularly advise the Chairman on IT issues as mentioned above.

Question. What formal or informal mechanisms exist in your agency to ensure coordination and alignment within the CXO community (i.e., the Chief Information Officer, the Chief Acquisition Officer, the Chief Finance Officer, the Chief Human Capital Officer, and so on)? How does that alignment flow down to agency subcomponents?

Answer. The FCC's smaller size and management structure lends itself to a high level of coordination among the FCC's CXOs. The CIO, CFO, CHCO, and CAO are all a part of OMD. The team meets at least weekly as a group to discuss ongoing issues and to coordinate on agency-wide matters.

Question. How much of the agency's budget goes to demonstration, modernization, and enhancement of IT systems as opposed to supporting existing and ongoing programs and infrastructure? How has this changed in the last 5 years?

Answer. The FCC has spent the vast majority of its fiscal year 2014 IT budget, as it has in previous years, towards ongoing Operations and Maintenance (O&M) of existing systems versus delivering new functionality to the bureaus and offices it supports. To date, the FCC has only spent 23 percent of its budget outlay on development, modernization, and enhancement efforts. The remaining 77 percent has been spent on O&M, mainly directed towards systems far beyond the normal upgrade cycles. These numbers will change as a new system is built out to accommodate the incentive auction scheduled for 2015.

Question. Where and how are you taking advantage of this Administration's "shared services" initiative? How do you identify and utilize existing capabilities elsewhere in government or industry as opposed to recreating them internally?

Answer. Since the arrival of our new CIO, Dr. David Bray, the FCC has conducted a number of information gathering sessions with industry and with agencies and departments in government to ascertain the best practices and best solutions available for various IT functions. The FCC is pursuing avenues to have infrastructure services channeled through larger, and better resourced, agencies in order to minimize its exposure, both physical and monetary, to risks associated with the use of the Internet.

The FCC recognizes that it cannot maintain a security posture nearly as well as larger and better equipped agencies in government. As an example, the FCC has been pursuing a course of action with Defense Information Systems Agency (DISA)

[4] See 40 USC § 11315(c).

as a provider. Unfortunately, DISA is looking for at least 50,000 users in an organization when it provides these services. The FCC's size at less than 1,800 employees does not readily lend itself to the DISA solution without additional incentives for them to take on the work.

On the application side, the FCC has been working at outsourcing its Office of Inspector General (OIG) system to an agency with mature and well-funded solutions, such as NASA. In this case, both government agencies that do provide the service for other agencies are out of capacity. The CIO is continuing to reach out to other agencies as well as to industry providers to move capacity to a more flexible and modern environment in a modular fashion. The above examples demonstrate some of the FCC's ongoing efforts to find shared solutions. Since 40 percent of the systems at the FCC are 10 years old, or more, the need for a change is absolute, but re-creating the same applications on a new platform inside the FCC' s four walls is not the preferred approach.

Question. Provide short, two-page, summaries of three recent IT program successes, projects that were delivered on time, within budget, and delivered the promised functionality and benefits to the end user. How does your agency define "success" in IT program management?

Answer. Please find three summaries of recent FCC IT program successes below. The FCC can provide additional details as necessary.

—*ELS Enhancement.*—The Experimental Licensing System (ELS) Web portal was upgraded to allow for the licensing of four new types of devices, medical in nature. This upgrade accelerates the delivery of these medical devices for use in the population.

—*OGC Tracking System.*—The Office of General Counsel expanded its capabilities for the tracking of court cases. This was an internal upgrade to help OGC's specific business needs. This upgrade deferred the need to build a new system and was accommodated within the existing infrastructure by building upon a system that already existed at the FCC.

—*EAS Redesign.*—An agile development exercise with nine sprints (discrete roll outs of functionality) which addressed some security issues and developed the first phase of a new login system. The new login system improves the ability of users from outside the agency to login without having to go through a separate unrelated system at the FCC to receive a separate numeric login. This improvement assists users and saves time.

Question. What "best practices" have emerged and been adopted from these recent IT program successes? What have proven to be the most significant barriers encountered to more common or frequent IT program successes?

Answer. The introduction and infusion of agile development and behaviors throughout the organization has resulted in more timely and better suited outcomes from development and projects in general. The organization conducted numerous Agile training sessions ensuring that all of the staff is aware of the methodology and practice of Agile.

The process of collecting and communicating requirements has long been a sore point in the development and deployment of successful systems. The FCC, through Agile development and better performance tracking, has been able to overcome the initial challenges of producing requirements that actually meet business goals. Through proper discipline, and breaking down and measuring work in digestible slices, the FCC can better understand and control the deliverables.

The FCC IT department has also adopted a strategy which includes using "intrapreneurs" as the vehicle for strengthening partnerships with the 18 bureaus and offices of the FCC. Using this system, each bureau and office has a liaison working closely with them in defining requirements and establishing a business case which is then fed through a capital planning and investment control (CPIC) process for evaluation. This approach promotes budget transparency and provides the opportunity to drive data driven dashboards across all of the projects in IT.

Question. Describe the progress being made in your agency on the transition to new, cutting-edge technologies and applications such as cloud, mobility, social networking, and so on. What progress has been made in the CloudFirst and ShareFirst initiatives?

Answer. FCC IT has also instituted a layered approach driven by modular development which allows for agility, and cost-savings, through re-use of code, templates, and business functions. Resiliency in FCC operations is also a major driver in the modernization of the FCC. Protecting data, systems, and privacy by design through the use of multiple tools and approaches has delivered a more secure environment for FCC employees and clients. Examples of FCC commitment to modernization and security can be evidenced in the roll-out of Virtual Desktop Infrastructure (VDI) and delivering secure connections to mobile devices, whether FCC or personally owned.

In committing to finding CloudFirst and ShareFirst approaches, the FCC is modernizing in a modular fashion which will allow for faster deployment to new environments as they become available. In moving data to the cloud environment and creating a datamart, the FCC is attempting to consolidate its sources of information to eliminate redundancies in processes and data gathering.

The deployment of VDI, allowing for the use of devices anywhere at any time in a secure fashion, has gone a long way towards making FCC staff more mobile. The FCC has also facilitated the use of staffs personally owned devices by deploying secure technologies allowing for mobile device use in a secure fashion.

Furthermore, the FCC is moving to a new and more interactive platform on its Web site which will allow for more timely and interactive exchanges with the public as well as its employees.

To facilitate these many ongoing efforts and bring strategic vision to the future of IT at the FCC, the CIO's team has identified the 7 tracks below as the primary paths forward for the IT organization's support of the mission of the FCC:

—Improving Security to enhance telework and mobility.
—Securing internal and external collaborations.
—Strengthening FCC's IT security posture.
—Transforming access to FCC enterprise data.
—Modernizing legacy systems and tracking.
—Improving FCC.gov and complaint reform.
—Increasing transparency and system usability.

Question. How does your agency implement acquisition strategies that involve each of the following: early collaboration with industry; RFP's with performance measures that tie to strategic performance objectives; and risk mitigation throughout the life of the contract?

Answer. The newly installed CIO of the FCC has instituted a process by which providers who offer distinct solutions in areas where the FCC is interested have an opportunity to present to relevant staff in our Technology Center. This process is ongoing and allows the staff to understand what is possible rather than focusing on the status quo. Through this process, the FCC has chosen some technology paths which allow for participation with technology providers who can solve present problems with modernization and technology dependent solutions.

There are numerous examples of where the FCC has experienced success in using performance measures for major IT investments. One clear example was the replacement of its Core Financial System. As part of the procurement process, the FCC asked bidders to prepare a quality assurance surveillance plan (QASP) founded on an initial set of performance metrics established by the FCC. The QASPs submitted by the bidders were evaluated as part of the procurement process, and the FCC has used the QASP throughout the lifecycle of the contract to evaluate the quality, accuracy, and timeliness of products and services provided by the vendor that was selected. Using the QASP process, a monetary incentive or disincentive is assigned at regular intervals throughout the lifecycle of the contract. The incentives correspond to the project's performance standards.

Furthermore, the FCC has risk management processes built into its major IT services contracts that were established as part of the acquisition process. Through these processes, the FCC's vendors seek first to plan appropriately to avoid risk. If risks do arise, the vendors track the risks, seek to mitigate them, and generate regular risk management reports by which IT staff can monitor the contracts throughout their lifecycles.

Question. According to the Office of Personnel Management, 46 percent of the more than 80,000 Federal IT workers are 50 years of age or older, and more than 10 percent are 60 or older. Just 4 percent of the Federal IT workforce is under 30 years of age. Does your agency have such demographic imbalances? How is it addressing them? Does this create specific challenges for attracting and maintaining a workforce with skills in cutting edge technologies? What initiatives are underway to build your technology workforce's capabilities?

Answer. The FCC does not base hiring decisions on age or consider age as a factor in determining workforce composition. Being mindful of increasing levels of the staff becoming eligible for retirement, however, the FCC has sought to use a combination of new hires and detailed employees from other agencies to fortify its information technology group.

By building a workforce based on skilled veteran employees as well as new hires and detailed employees from other agencies, the FCC would be able to increase its knowledge base. Outside expertise will help inform the current staff about solutions used in other organizations and agencies.

Question. What information does your agency collect on its IT and program management workforce? Please include, for example, details about current staffing

versus future needs, development of the talent pipeline, special hiring authorities, and known knowledge gaps.

Answer. Having recently brought in a new CIO to the FCC, the CIO's transition team is evaluating the current workforce to identify knowledge gaps and the agency's long-term staffing needs for the IT workforce. Through this process, the CIO has identified staffing needs that it is filling through both outside hires and detailed employees from within the agency. Also, as mentioned above, the CIO is using detailed employees from other agencies to provide a bridge across knowledge gaps while the team seeks to fill open positions.

QUESTIONS SUBMITTED TO HON. AJIT PAI

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

EMERGENCY 9–1–1 IN HOTEL ROOMS

Question. Commissioner Pai, I understand from your testimony that you are examining how to improve emergency 9–1–1 service in hotel rooms. Could you explain briefly what the challenges are?

Answer. Yes. As you know from my written testimony, the problem is that some of the "multiline telephone systems" (or MLTS) that are in use in hotels, office buildings, college campuses, schools, and other large facilities require users to dial an access code (like "9") to complete a 911 call. In the case of Kari Rene Hunt Dunn, which is discussed in my testimony, this meant that her daughter was required to dial "9–911" to complete a call to 911. In emergencies, consumers will not necessarily know that they are dialing from a phone that requires an access code or what that access code might be.

So far, my inquiry has revealed that the challenges are not technical, at least not for modern MLTS systems. Both the MLTS vendors and the hotels I have heard from say that their MLTS systems can be programmed or reprogrammed to allow consumers to reach emergency personnel when they dial "911."

The problem is that a substantial number of these devices just aren't set up that way, and many hotels do not realize that this is an issue. When facilities that use MLTS are made aware of this issue, I have found that they are willing and able to take steps to fix it. Take La Quinta, for example. After surveying its franchisees earlier this year, the company discovered that in about 60 percent of its franchised hotels a guest would not reach emergency services by dialing "911" alone. La Quinta understood that this situation was unacceptable and instructed its franchisees to solve the problem. It stated that, by April 1, 2014, it expected that *all* La Quinta-branded hotels would have systems in place that would connect guests with emergency personnel when they dial "911." This means that one company showed that it was possible to fix this problem in hundreds of hotels in just 2½ months. Similarly, the InterContinental Hotel Group informed me that the telephone provider for two of their hotel brands has already agreed to push out a no-cost software update to allow for direct 911 dialing.

Based on these responses, I am not aware of any challenges that would prevent hotels that use modern MLTS devices from ensuring that their guests can reach emergency personnel when they dial 911. However, from talking with various industry representatives about this issue, I have heard that some older MLTS devices might not be capable of being reprogrammed to allow direct access to 911. I have not heard a definitive age or date range that would define that category of devices (though some have suggested anecdotally that it might be in the 10–15 plus year range); nor do I have data about the percentage of any such devices that may still be in the marketplace. I am going to continue to explore this issue.

Question. How can the Federal Communications Commission (FCC) help address these challenges?

Answer. One of the most important ways the FCC can help address this issue is to bring public awareness and attention to the problem. As suggested above, hotels in my experience are willing and able to fix the problem when they are made aware of it.

I am committed to continuing to work on this issue and raise awareness. As my testimony indicated, I launched an inquiry earlier this year and started out by sending letters to the chief executive officers of the 10 largest hotel chains in the United States. I have also been working with the American Hotel and Lodging Association (AH&LA) to find solutions to this problem. I expanded my inquiry at the end of March by sending letters to some of the leading vendors of MLTS devices and services, because this issue may occur not just in hotels but also in the office buildings

where Americans work and in the schools where our children learn, among other places. In order to address the problem on this broader scale, the entire MLTS vendor community must be involved. I am looking forward to reviewing their responses to my inquiry.

SUBCOMMITTEE RECESS

Senator UDALL. And with the subcommittee being concluded, the subcommittee is hereby recessed.

Thank you.

[Whereupon, at 11:18 a.m., Thursday, March 27, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2015

WEDNESDAY, APRIL 2, 2014

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Tom Udall (chairman) presiding.

Present: Senators Udall, Coons, Johanns, Moran, Mikulski, Johnson, Graham, Kirk, and Coats.

DEPARTMENT OF THE TREASURY

OFFICE OF TERRORISM AND FINANCIAL INTELLIGENCE

STATEMENT OF HON. DAVID S. COHEN, UNDER SECRETARY

OPENING STATEMENT OF SENATOR TOM UDALL

Senator UDALL. Good afternoon. The subcommittee will come to order.

I'm pleased to convene this hearing of the Financial Services and General Government Subcommittee to consider the fiscal year 2015 funding needs of Treasury's Office of Terrorism and Financial Intelligence and its enforcement of sanctions.

I welcome my distinguished ranking member, Senator Mike Johanns. I believe our Chairwoman, Barbara Mikulski, will be here at some point, and other colleagues, I think, will also join me on the dais today, and they may arrive through the course of this proceeding.

This hearing will be unclassified, but if any Senator has a question that requires a classified response, we will reconvene in a secure setting, when schedules permit.

So, with that, I'm going to start with my opening statement, and then I'll turn to Senator Johanns to jump in, and then we'll go to our honorable witness, here, David Cohen.

Good afternoon. I'm pleased to convene this hearing of the Appropriations Subcommittee on Financial Services and General Government. I would very much like to welcome—well, I was welcoming Chairwoman Mikulski, but she's not here yet, so I'll welcome her when she gets here—and certainly welcome Senator Johanns, and we'll have other folks here today.

I also want to welcome our witness, Under Secretary of Terrorism and Financial Intelligence, Mr. David Cohen. Thank you for your service, and I really look forward to your testimony today.

The Office of Terrorism and Financial Intelligence—what some call, I think, TFI—is a small, specialized unit of the Treasury Department, but it is a critical component of our foreign policy. TFI safeguards our financial system and implements sanctions against rogue nations, drugpins, terrorists, and proliferators of weapons of mass destruction.

The employment and use of sanctions has changed greatly. In 2008, the U.S. sanctions against Iran were largely ineffective because of Iran's ongoing oil exports and trade with other nations. Since 2008, it's a different story. Congress has passed new sanctions against Iran. The administration has led an international effort to leverage those sanctions. The Iranian economy is crumbling, and this—look at what these sanctions have done—the Iranian economy is crumbling, inflation is rampant, oil exports have been slashed, and the currency is in freefall. These sanctions brought Iran to the table. Not only are the United States and Iran talking, but with four other permanent members of the U.N. Security Council and Germany, which, as we all know, is known as the P5 + 1, we have—that group, working together, has negotiated a Joint Plan of Action and are working to negotiate a final agreement to prevent Iran from acquiring a nuclear weapon.

This is an important example. Sanctions can help achieve foreign policy goals, but they are a means to an end, not an end in itself. The progress in Iran is also a reminder, sanctions can be implemented in many different ways. It makes a large difference in the outcome, depending on how we use this powerful tool.

A great deal depends on who is pursuing the sanctions. Analysis shows that sanctions are the most effective when more nations are enforcing them. Unilateral sanctions are less likely to be effective. And also, effectiveness depends on when we use them. If sanctions are applied at the wrong time, such as while our negotiators are working to iron out a deal, the administration has strongly urged Congress to hold off further sanctions on Iran at this sensitive time, because it could derail negotiations and limit our options.

During this time, most sanctions are in full effect on Iran, and there are concerns that some companies are taking things a bit too far. So, I am interested to hear commitments that the sanctions regime is still strong. Properly applied, sanctions can work. We have seen this in Iran, and we have seen a renewed interest in sanctions as a foreign policy tool. For example, last week, in response to Russia's annexation of Crimea and continued defiance of the international community, the United States Senate gave the President new tools to punish the Russian Government for destabilizing Ukraine and seizing Crimea. I hope to hear more about these new sanctions, how they will be implemented by the Treasury Department to carry out our foreign policy goals with regard to Russia, and also how existing sanctions have worked with the Iranian Government, using the right leverage at the right time.

Elsewhere, there have been failures, such as the sanctions against Saddam Hussein's Iraq and the ongoing failure of Cuban isolation that has continued for more than 50 years. They are a re-

minder, too. Sanctions should be used in concert with diplomacy and other efforts. This committee has an important oversight responsibility ensuring that Federal funds are spent wisely for the American people.

We have two basic questions: What are the funding requirements of TFI to fulfill its critical mission? And what is the consequence of a shortfall?

I have the honor of chairing this subcommittee and serving with Senator Johanns, and I really look forward to working with him on this topic. And I now turn to our ranking member, Senator Johanns, for any remarks he would like to make.

And I also welcome our two colleagues here, Senator Coons and Senator Johnson, who have joined us.

Thank you.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Mr. Chairman, thank you so much for calling the hearing today. We're going to discuss a very important topic. We're going to talk about sanctions, their enforcement, their administration.

TFI plays an important national security role. Its components and bureaus work together to safeguard our country's financial system and to combat terrorism, proliferation of weapons of mass destruction, money laundering, drug trafficking, and a whole host of national security interests. I think we all agree that sanctions can be a powerful tool and a useful tool in carrying out U.S. foreign policy and national security goals.

An important example is in our dealings with Iran. Iran is a destabilizing force in the Middle East that continues to support terrorism and threatens our allies, such as Israel. For decades, Iran has provided funding, weapons, training, and sanctuary to numerous terrorist groups. I believe the only acceptable solution for a nation with this kind of track record is the full abandonment of its nuclear program.

I think we all agree that the implementation of sanctions on Iran is what helped bring them to the negotiating table. However, I continue to have concerns about the effects of easing sanctions as the administration has done under the Joint Plan of Action. I also have concerns about how the administration is prepared to respond if a final agreement with Iran is not reached and negotiations collapse.

I've joined a number of my colleagues in supporting a very bipartisan effort to impose stricter sanctions on Iran if ongoing negotiations between Iran and other nations fail to produce results. This bipartisan sanctions legislation, brokered by Senator Menendez and Senator Kirk, would simply keep the pressure on the Iranian regime while talks continue. If the negotiations do not reach the goal of a nuclear-free Iran, the sanctions in this bill are necessary. It also gives the administration continued flexibility in up to a year to reach a final agreement, provided Iran meets its obligations.

I also believe this sanctions legislation should not be prevented from coming to a vote on the Senate floor. Remarkably, this legislation has 58 cosponsors, but, unfortunately, the Senate Majority Leader has blocked attempts to vote on this legislation because of objections from the administration.

We must continue to send a firm message to Iran that its nuclear program must end. Recent actions by Russia also highlight the need for a robust and effective program for the administration and enforcement of sanctions.

I think it's important for the United States and our European allies to impose economic sanctions in response to what Russia has done in the Ukraine. A strong response holding Russia accountable now might help deter it from similar pursuits in the future. I don't think President Putin cares one whit about what we say about him, but he'll be watching, very carefully, the actions we take. Strong sanctions could have an economic impact that would create problems for him with his citizens. I welcome the President's efforts to impose targeted sanctions against Russia.

PREPARED STATEMENT

I think there are real opportunities for the President to step forward and unite European countries to push back using economic force. The Russian incursion into the Crimean region of Ukraine requires an unequivocal response that sends a clear message that Russia cannot interfere with the sovereignty of other countries.

Mr. Chairman, I know that Iran and Russia are just a few of the countries for whom TFI administers and enforces sanctions. So, as we review the Treasury Department's budget request for fiscal 2015, I look forward to working with you, as we have always done in the past, to ensure that TFI has the resources necessary to carry out its critical mission.

Thank you, Mr. Chairman.

[The statement follows:]

PREPARED STATEMENT OF SENATOR MIKE JOHANNS

Mr. Chairman, thank you for calling this hearing today to discuss the Department of the Treasury's Office of Terrorism and Financial Intelligence (TFI) and its administration and enforcement of sanctions.

TFI plays an important national security role. Its components and bureaus work together to safeguard our country's financial system and to combat terrorism, proliferation of weapons of mass destruction, money laundering, drug trafficking and other national security threats.

The emphasis of today's hearing is on sanctions. The Office of Foreign Assets Control (OFAC) is responsible for administering and enforcing economic and trade sanctions against targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction.

Sanctions can be a powerful and useful tool in carrying out U.S. foreign policy and national security goals.

An important example is in our dealings with Iran. Iran is a destabilizing force in the Middle East that continues to support terrorism and threaten our allies, such as Israel.

For decades, Iran has provided funding, weapons, training and sanctuary to numerous terrorist groups.

I believe the only acceptable solution for a nation with Iran's track-record is the full abandonment of their nuclear program.

I think we all agree that the implementation of sanctions on Iran is what helped bring them to the negotiating table.

However, I continue to have concerns about the effects of easing sanctions, as the administration has under the Joint Plan of Action.

I also have concerns about how the administration is prepared to respond if a final agreement with Iran is not reached.

I have joined a number of my colleagues in supporting a bipartisan effort to impose stricter sanctions on Iran if ongoing negotiations between Iran and other nations fail to produce results.

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This legislation has 58 cosponsors, but unfortunately, the Senate Majority Leader has blocked attempts to vote on any Iran sanctions package because of objections from the Obama administration.

We must continue to send a firm message to Iran that its nuclear program must end.

Recent actions by Russia also highlight the need for a robust and effective program for the administration and enforcement of sanctions.

I think it is important for the United States and its European allies to impose economic sanctions in response to Russia's armed incursion into Ukraine.

A strong response holding Russia accountable now might help deter it from similar pursuits in the future.

I don't think President Putin cares one whit about what we say about him but he will be watching carefully to see what actions we take.

Strong sanctions could have an economic impact that would create problems for him.

I welcome the President's efforts to impose targeted sanctions against Russia.

I think there are real opportunities for the President to step forward and unite European countries to push back using economic force.

The Russian incursion into the Crimean region of Ukraine requires an unequivocal response that sends a clear message that Russia cannot interfere in the sovereignty of other countries.

Mr. Chairman, I know that Iran and Russia are just a few of the countries for whom TFI administers and enforces sanctions.

As we review the Treasury Department's budget request for fiscal year 2015, I look forward to working with you to ensure that TFI has the resources necessary to carry out its important mission.

Senator UDALL. Thank you very much, Senator Johanns.

And I would now recognize Chairwoman Mikulski for her opening remarks.

STATEMENT OF CHAIRWOMAN BARBARA A. MIKULSKI

Chairwoman MIKULSKI. First of all, Mr. Chairman, I want to thank you and Senator Johanns for holding this hearing. It is the first hearing ever in the Financial Services Subcommittee on the—on making sure that we have adequate resources to implement sanctions. And I think that this really shows the vitality and vibrancy. And I'm glad it's going to be a bipartisan one, because, when it comes to national security, that's where it should be.

So—we have a lot of Maryland constituents today—so, we thank you for this first-ever hearing.

Mr. Cohen, I'm really proud of you, and I'm really proud of the 413 people—only 413 people—who work for the Department of Treasury implementing this, because, when we look at sanctions, it is the most important tool of diplomacy that we have to bring people to the table to begin serious negotiations or to comply with the negotiations agreed to. So, we look forward to hearing your testimony. I want you to be able to speak and us to get into very meaty, robust questions, but I will hope that we can focus on, What is it that we need to make sure you're provided with so that you can do the job the Commander in Chief and the Congress, through its authorizing legislation, ask you to do in these really hot spots

around the world, particularly Iran, North Korea, Syria, and now with the new challenges of sanctions with Ukraine?

So, thank you very much for your service, to all 413 people, and we look forward to your testimony and working with you in this very important foreign policy area.

Senator UDALL. Thank you, Chairwoman Mikulski.

And now I would invite Under Secretary Cohen to present your remarks.

SUMMARY STATEMENT OF HON. DAVID S. COHEN

Mr. COHEN. Thank you, Chairman Udall, Ranking Member Johanns, Chairwoman Mikulski, distinguished members of the Committee on Appropriations. And thank you for the opportunity to appear before you today to discuss the Department of Treasury's Office of Terrorism and Financial Intelligence.

I'm especially proud to be here to discuss the work of TFI. For just over 3 years now, I have had the privilege of serving as the Under Secretary for Terrorism and Financial Intelligence. The women and men of TFI are an outstanding group—skilled, creative, patriotic, and enormously dedicated to their increasingly demanding jobs. I am impressed, every day, by the truly remarkable work of my colleagues. And, in the course of this hearing, I hope to convey to this subcommittee how much we all benefit from their magnificent work.

TFI will soon celebrate its 10-year anniversary. And over this past decade, TFI's financial measures have become an increasingly crucial tool for protecting and advancing our core national security and foreign policy interests.

The reason behind TFI's broadening mandate is simple. Nearly every national security threat has an important financial component. Effectively mitigating these threats requires creative thinking about how to leverage, pressure, and often exploit our adversaries' financial vulnerabilities. As a result, TFI has been increasingly called upon to deploy our tools to address national security threats in nearly every corner of the globe. The variety of the threats we face means that TFI's output must be the sum of TFI's many parts, from marshaling financial intelligence and analytical capabilities, to engaging businesses and governments around the world, to deploying regulatory actions and sanctions authorities, to enforcement actions.

We are able to do this because of the unique structure of TFI and because of the support that we have received from this committee and from the Congress over the years.

Treasury is the only finance ministry in the world with its own in-house intelligence unit. TFI's Office of Intelligence and Analysis, OIA, is comprised of subject-matter and trade-craft experts who provide all source intelligence analysis used by Treasury officials and other intelligence customers throughout the U.S. Government, including the President. These analysts, who rely on financial intelligence as well as other sources, follow the money to help map the networks of our adversaries. Harnessing OIA's intelligence capabilities is crucial to the mission of other TFI components, including the Office of Foreign Assets Control (OFAC), our sanctions implementation arm.

As you all know, OFAC's workload has grown dramatically since the creation of TFI, from managing 17 sanctions programs in 2004 to 37 today, addressing issues ranging from Iran to North Korea to Syria to, most recently, Ukraine, while still also pursuing our counterterrorist financing and narcotics trafficking programs, as well as others.

Our sanctions programs are most effective when they stand on a foundation of strong systemic safeguards and financial transparency. To promote financial transparency, TFI's Office of Terrorist Financing and Financial Crimes, TFFC, develops policies and implements strategies to strengthen the integrity of the financial system and safeguard it from terrorist financing, money laundering, drug trafficking, organized crime, and proliferation finance.

Meanwhile, the Financial Crimes Enforcement Network, FinCEN, implements the Bank Secrecy Act by designing and enforcing a regulatory framework to defend the U.S. financial system from money laundering and other serious financial crime.

And finally, Treasury's Executive Office of Asset Forfeiture guides the strategic use of forfeited assets across the U.S. Government to disrupt and dismantle criminal enterprises.

In sum, over the past decade, TFI has become a central part of the national security community, advancing important national security and foreign policy interests of the United States. And, as our country continues to turn to financial measures to address our thorniest foreign policy challenges, TFI will continue to craft these tools, implement them, and vigorously enforce them.

PREPARED STATEMENT

Before I conclude, let me say a word about our resource levels. Notwithstanding the recent growth in our workload, the $102 million provided in the fiscal year 2014 Departmental Offices appropriation is sufficient to allow us to accomplish our mission, as is the President's budget request for fiscal year 2015. We have been able to increase our sanctions programs and other output by generating program efficiencies through effective management and by transferring funds, when needed, among organizations and programs within TFI.

Thank you, and I look forward to addressing your questions.

[The statement follows:]

PREPARED STATEMENT OF HON. DAVID S. COHEN

Chairman Udall, Ranking Member Johanns, and distinguished members of the Subcommittee on Financial Services and General Government: Thank you for the opportunity to appear before you today to discuss the Department of the Treasury's Office of Terrorism and Financial Intelligence (TFI). My remarks will focus on the history of TFI, TFI's components, TFI's role in implementing sanctions programs, and the President's fiscal year 2015 funding request for TFI.

I am especially proud to be appearing before this subcommittee to discuss the work of TFI. The women and men of TFI are an outstanding group—skilled, creative, patriotic, and enormously dedicated to their increasingly demanding jobs. For just over 3 years now, I have had the privilege of serving as the Under Secretary of TFI, and I am impressed every day by the truly remarkable work of my TFI colleagues. In the course of this hearing, I hope to convey to this subcommittee how much we all benefit from their magnificent work.

TFI BACKGROUND AND HISTORY

September 11, 2001, served as the catalyst for an important shift in the U.S. Government's approach to national security. Following that fateful day, there was a newfound recognition across the Government that disrupting the financial infrastructure of terrorist groups needed to be a part of our counterterrorism strategy.

And in the 12 years since those tragic attacks, we have made great strides in developing a comprehensive, whole-of-government approach to combating terrorist financing. By all accounts, the United States has been at the forefront of this effort globally. The Treasury Department—and our powerful financial toolkit—have been key to this effort.

And as the national security landscape has evolved over the past decades, so have Treasury's efforts. Far from just being focused on issues related to terrorist financing, Treasury's use of financial measures has become a crucial tool for protecting and advancing a much broader range of national security and foreign policy interests of the United States.

The reason behind TFI's broadening mandate is simple: Nearly every national security threat has an important financial component. Effectively mitigating these threats requires creative thinking about how to leverage, pressure, and often exploit our adversaries' financial vulnerabilities.

That is where TFI comes in. TFI has been recognized as a leader within the Government for its intelligence, enforcement, diplomatic, and regulatory capabilities. We have also been recognized for our substantive expertise on topics as varied as virtual currency, transnational organized crime, counterterrorism, and nuclear nonproliferation.

As a result, we have been increasingly called upon to deploy our various tools to address national security threats in nearly every corner of the globe. These tools include financial and economic sanctions, regulatory actions including section 311 of the USA PATRIOT Act, civil enforcement actions, advisories to the private sector, and conversations to alert foreign government officials as well as the private sector to particular threats.

TFI COMPONENTS

The diversity of the threats that we face and the tools that we have to mitigate those threats means that TFI's output must be the sum of many crucial parts. Each of these parts meaningfully contributes to TFI's mission, from marshaling financial intelligence and analytical capabilities to engaging businesses and governments around the world to deploying regulatory tools and sanctions authorities.

To better understand how all of these parts come together under the TFI umbrella, let me provide some detail on the structure of our office.

TFI is comprised of five components: the Office of Intelligence and Analysis (OIA), the Office of Foreign Assets Control (OFAC), the Office of Terrorist Financing and Financial Crimes (TFFC), the Financial Crimes Enforcement Network (FinCEN), and the Treasury Executive Office of Asset Forfeiture (TEOAF).

Treasury is the only finance ministry in the world with its own in-house intelligence unit. OIA subject-matter and tradecraft experts contribute to every aspect of the intelligence cycle, providing all-source intelligence analysis to Treasury officials and other intelligence customers throughout the U.S. Government, including the President.

Harnessing OIA's intelligence capabilities is crucial to the mission of other TFI components, including OFAC. OFAC designs, implements, and enforces sanctions programs to disrupt and dismantle the support networks of terrorist groups, weapons of mass destruction (WMD) proliferators, drug traffickers, and organized criminal groups. OFAC's workload has grown tremendously since the creation of TFI. When TFI was formed in 2004, OFAC managed 17 sanctions programs. Today, it manages 37.

Sanctions programs are most effective when they stand on a foundation of strong systemic safeguards in the financial sector. Indeed, one of the TFI's core missions is to ensure that these safeguards are part of our own domestic financial system and to encourage the adoption of similar safeguards around the world.

The aim of these safeguards can be captured in one word: transparency.

Transparency is critical to enabling financial institutions and law enforcement, regulatory, and other authorities to "follow the money"—that is, to identify traces of illicit finance so that they can protect the integrity of the international financial system. Their efforts, in turn, deny terrorists, proliferators, and other criminals access to the financial system, forcing them to turn to costlier and riskier alternative ways of moving money.

To promote international financial transparency, TFFC develops policies and implements strategies to strengthen the integrity of the financial system and safeguard it from terrorist financing, money laundering, drug trafficking, organized crime, and proliferation finance. TFFC also establishes strategic relationships across the globe to foster adoption of best practices while identifying priority threats to, and vulnerabilities in, the U.S. and international financial systems.

Domestically, FinCEN implements the Bank Secrecy Act, designing and enforcing a regulatory framework to defend the U.S. financial system from money laundering and other serious financial crimes. To do so, FinCEN requires financial institutions to create and maintain records that are highly useful to law enforcement and collects, analyzes, and disseminates financial intelligence. FinCEN also works with counterpart financial intelligence units around the world to share information in an effort to prevent criminals from exploiting international borders to hide from justice.

Meanwhile, TEOAF guides the strategic use of forfeited assets by Treasury, the Department of Justice, U.S. Immigration and Customs Enforcement, U.S. Customs and Border Protection, U.S. Secret Service, and other law enforcement agencies to disrupt and dismantle criminal enterprises.

I will turn now to TFI's role in designing and implementing some of our sanctions programs. While these sanctions efforts vary in size and scope, all have achieved meaningful results in furthering important national security goals.

UKRAINE-RELATED SANCTIONS ACTIONS

The Treasury Department has played a major role in the U.S. and international community's response to Russia's recent actions in Ukraine, including its support for an illegal referendum in Crimea, the purported annexation of Crimea, the dangerous risk of escalation caused by Russian troops in Crimea, and the potential for violence related to the buildup of Russian forces on Ukraine's eastern border.

In response to Russian aggression, President Obama has issued three Executive orders (E.O.), which together provide the Secretary of the Treasury, in consultation with the Secretary of State, the authority to impose broad sanctions on Russia and others individuals and entities responsible for the situation in Ukraine.

Armed with these new authorities, we have followed through on President Obama's warning that there will be real costs for Russia's incursion into Ukraine and its violation of Ukrainian sovereignty. So far, we have designated 31 individuals—including Crimean separatist leaders, Russian Government officials, and members of the inner circle of the Russian leadership—as well as Bank Rossiya, a mid-sized Russian bank.

Those designated have had their assets in the U.S. frozen and are barred entirely from conducting business with, in, or through the United States. I suspect that they will also find it very difficult to conduct business outside the U.S., because our experience with other sanctions programs has demonstrated that major financial centers around the world often adhere to U.S. guidelines when it comes to the implementation of sanctions. In short, these individuals will find their ability to transact in the world economy severely constrained.

Of particular note, the President has given the Secretary of the Treasury the authority to target Russian Government officials as well as those who materially support or act on behalf of senior Russian officials. Using this authority we designated individuals such as Gennady Timchenko, whose activities in the energy sector have been directly linked to President Putin, and Yuri Kovalchuk, the largest shareholder of Bank Rossiya and personal banker for senior officials of the Russian Federation.

As I noted, we have also designated Bank Rossiya, which has served as the bank for President Putin and other senior Russian Government officials. Prior to its designation, Bank Rossiya was the 17th largest bank in Russia, with about $10 billion in assets and numerous U.S. dollar-denominated correspondent accounts here in the U.S., as well as correspondent accounts in Europe and elsewhere denominated in other currencies.

Following our action last week, the bank's assets under U.S. jurisdiction are blocked, it has been frozen out of using the dollar, and it no longer has access to its correspondent accounts within U.S. financial institutions. And we are working with our partners in foreign governments and in the international private sector to further isolate the bank and stymie its operations.

On March 20, the President signed the latest E.O., which authorizes the Secretary of the Treasury, in consultation with the Secretary of State, to sanction any individual or entity determined to operate in sectors of the Russian economy specified in the future by the Secretary of the Treasury, including the energy, metals, and mining sectors. This authority is a very powerful yet flexible tool that will allow us to respond quickly and meaningfully as events develop in Ukraine.

We recognize that these measures will have the greatest impact when harmonized with the actions of our international partners, in particular in Europe and Asia, because of their extensive economic ties to Russia. We are in daily communication with our counterparts in the G–7, the European Union (EU), and other countries with significant financial and economic links to Russia to discuss how we can best adopt collective measures.

These are serious measures with implications across the global economy. But while a diplomatic resolution remains the preferred outcome to the situation involving Ukraine, Russia must know that any escalation will only isolate it further from the international community and the international economy.

Beyond our sanctions effort, Treasury has also used our tools to halt the misappropriation of assets from Ukraine. FinCEN has issued two advisories to U.S. financial institutions related to the unrest in country. These advisories remind institutions of their obligation to apply enhanced scrutiny to accounts and transactions conducted on or behalf of senior Ukrainian political officials, including those of the former Yanukovych administration, and to report any suspicious financial transactions.

IRAN SANCTIONS PROGRAM

Our unprecedented sanctions on Iran have led the way in demonstrating the power and efficacy of our financial measures.

From the outset of the Obama administration, we have pursued a dual-track strategy that paired an offer to Iran to rejoin the community of nations if it addresses the international community's concerns over its nuclear program with increasingly powerful and sophisticated sanctions if it continued to ignore those concerns.

When Iran initially chose another path, we responded by crafting and implementing the most comprehensive, powerful, and effective set of sanctions in history.

Today, Iran stands isolated from the global financial system with slashed oil revenues, an eroded currency, and a severely weakened economy.

Our oil, financial, and trade-based sanctions helped drive Iran into deep recession. Since 2011, oil sanctions imposed by the EU and the U.S. have cost Iran over $100 billion in lost sales. Last year, Iran's economy contracted by 6 percent and is expected to perform badly this year as well. Its currency, the rial, has lost about 60 percent of its value against the dollar since 2011. And its inflation rate is about 30 percent, one of the highest in the world.

This enormous pressure on the Iranian economy did not come about overnight. We have worked side-by-side with Congress to craft sanctions that target Iran's key sources of economic strength. We maximized the impact of these sanctions through TFFC's robust and persistent engagement with foreign governments and the private sector. Working alongside our interagency partners, we leveraged our in-house intelligence component, OIA, to identify Iranian pressure points. And then OFAC took action against illicit actors and their financial networks by targeting them with powerful sanctions.

This has not been a simple task. In all, TFI enforces a sophisticated and complex regime of sanctions on Iran that encompasses 10 statutes, 26 E.O.s, and 4 United Nations Security Council Resolutions. We supplement these tools by issuing public guidance, licenses that advance U.S. objectives, and advisories warning of concerning trends and practices.

Although our sanctions have proved to be incredibly potent, we have not imposed sanctions for sanctions' sake. All along, the goal of our sanctions has been to induce a shift in the decisionmaking calculus of the Iranian Government and to build the necessary leverage for serious negotiations about its nuclear program.

We are now in the midst of those negotiations. In the Joint Plan of Action (JPOA) that went into effect in late January, Iran agreed to take important steps to halt the advance of its nuclear program in exchange for limited, targeted, and temporary relief for 6 months. And as Iran has implemented its commitments to date, we have worked to fulfill our own.

Even as we now seek to negotiate a comprehensive solution over Iran's nuclear program, the core architecture of U.S. sanctions—especially our potent oil, financial and banking sanctions—remains firmly in place. And over the remaining 4 months of the JPOA period, we will continue to vigorously enforce these sanctions as well as the broad array of sanctions targeting Iran's human rights abuses and its support for terrorism.

SYRIA SANCTIONS PROGRAM

In Syria, the U.S. Government's policy is to isolate and degrade violent extremist networks and facilitate an orderly end to the conflict, with a clear transition to a

new competent and representative authority. U.S. and international sanctions are a key component of this effort, and are designed to deprive the Assad regime of the financial means needed to support its relentless campaign of violence against the Syrian people.

In the absence of UN sanctions regime, the United States has worked with the EU, the Arab League, and a host of other countries to build a robust international sanctions regime designed to pressure the Syrian Government and bring about an end to the conflict. In close coordination with our colleagues at the State Department, Treasury has played a key role in international engagement on Syria through the Friends of the Syrian People International Working Group on Sanctions, contributing to the U.S. Government's effort to coordinate broader and more effective sanctions implementation among like-minded countries.

Since the Syrian uprising began in March 2011, President Obama has issued five E.O.s, each delegating authority to the Treasury Department to impose sanctions in response to the violence in Syria. These E.O.s significantly expanded the tools available to the U.S. Government to respond to the crisis in Syria, namely by isolating the Assad regime and key regime supporters and denying it the resources needed to fund its continued repression of the Syrian people.

From the start of the uprising to date, Treasury has designated more than 200 Syrian individuals and entities pursuant to all of its relevant authorities. We have also used our authorities to expose the involvement of foreign actors in Syria. Treasury designations have drawn attention to Iranian support for the Syrian regime, whether directly or through its proxy, the Lebanese terrorist group Hizballah. Since the uprising began, we have designated the Islamic Revolutionary Guard Corps-Qods Force, Iran's Law Enforcement Forces, Hizballah, and Hizballah's Secretary General Hassan Nasrallah for providing material support to the Syrian regime's violent response to peaceful protests.

Apart from sanctions against the Assad regime and its supporters, Treasury has also used its global terrorism authorities to target the activities of extremists groups operating in Syria such as al-Nusrah Front and the Islamic State of Iraq and the Levant (ISIL), the group formerly known as al-Qa'ida in Iraq (AQI). We have also been closely tracking the funding streams of these groups and have sanctioned numerous terrorist financiers sending funds to extremists in Syria.

NORTH KOREA SANCTIONS PROGRAM

Following the DPRK's April 2012 Taepo Dong-2 launch, the December 2012 Taepo Dong-2 launch, and the February 2013 nuclear test, Treasury measures—including designations targeting the DPRK's nuclear, ballistic missile, and proliferation activities as well as the regime's access to luxury goods, and the financial networks that support its illicit activities—have impeded the development and slowed the pace of the DPRK's illicit programs.

Over the past year, Treasury has designated two key North Korean banks: Foreign Trade Bank and Daedong Credit Bank, both of which provided crucial financial support to other U.S. and UN-designated DPRK entities, including North Korea's premier arms dealer. Since August 2010, there have been seven Treasury designations under E.O. 13551, which targets individuals and entities facilitating North Korean arms sales, the procurement of luxury goods, and illicit economic activities; and 31 designations under E.O. 13382, which targets individuals and entities engaged in WMD proliferation-related activities.

The DPRK's recent missile launches using ballistic missile technology on February 27, March 3, and March 26, 2014 are a clear indication that the DPRK is committed to aggressively pursuing its ballistic missile and nuclear programs, which have been prohibited by multiple UN Security Council (UNSC) resolutions. The United States will continue to fully implement both UNSC and U.S. sanctions authorities until it is clear to the DPRK that denuclearization is the only path forward and Pyongyang undertakes complete, verifiable, and irreversible denuclearization.

NARCOTICS SANCTIONS PROGRAM

Treasury has made significant progress in our efforts to target drug lords worldwide through authorities granted to us in the Foreign Narcotics Kingpin Designation Act ("Kingpin Act"). The Kingpin Act aims to hit drug traffickers in their wallets, depriving them and their key lieutenants and money launderers of access to the U.S. financial system. Since the law was passed, more than 1,400 individuals and entities have had their access to the U.S. financial system cut off.

In 2013, Treasury designated 83 individuals and 67 entities pursuant to the Kingpin Act, and the President identified six significant international narcotics traffickers. Treasury focused on cartels operating out of Mexico and Central America

by repeatedly targeting the family members and close associates of the Sinaloa Cartel, the associates and businesses of Los Zetas, and an ever-expanding network of narcotics trafficking organizations in Central America. Treasury also continued to track the activities of major narcotics trafficking organizations in Colombia, which have ties to these Mexican and Central American organizations.

One of the most influential designations last year was the September action targeting the Los Cachiros, a Honduran drug trafficking organization which plays a critical role in the transportation of narcotics from Colombia to Mexico. On the same day that Treasury designated this organization, the Government of Honduras embarked on a week-long seizure action against Los Cachiros' financial and commercial assets, including those businesses designated by OFAC, pursuant to the Honduran Asset Forfeiture Law. This success is similar to other forfeiture actions that have followed OFAC designations in Colombia and elsewhere.

GLOBAL COUNTER-TERRORISM PROGRAM

Over the past 12 years, OFAC has designated more than 800 individuals and entities under our counterterrorism sanctions program. In 2013, we designated 87 individuals and entities with the aim of disrupting and degrading some of the most dangerous terrorist threats to our country, including al-Qa'ida in the Arabian Peninsula (AQAP), Lashkar-e Tayyiba, the Haqqani Network, and the Iranian Revolutionary Guards Corps Qods Force.

Beyond the blocking of assets, a Treasury designation exposes terrorists' activities publicly, drawing them out of the shadows and alerting financial institutions and foreign governments to their nefarious activity. It also encourages corresponding actions from counterterrorism partners and the United Nations. But most importantly, the designations disrupt and degrade the finances of terrorist groups as those designated will never again be able to openly access the international financial system.

TFI RESOURCE LEVELS

Now that I have outlined some of our sanctions programs, I will discuss TFI's resource levels. Despite the recent growth in our sanctions programs, the $102 million provided in the fiscal year 2014 Departmental Offices appropriation is sufficient to allow us to accomplish our mission. We have been able to increase our sanctions programs and other output by generating program efficiencies, effective management, and transferring funds when needed among organizations and programs within TFI.

In short, Treasury's Departmental Offices appropriations in years past have been sufficient to support our operations and I believe that the fiscal year 2015 budget request is no different.

CONCLUSION

Over the past decade, TFI has become a central part of the national security community. Comprised of an extraordinarily talented and skilled group of intelligence analysts, policy advisors, sanctions investigators, and regulators, TFI, working with our interagency partners, has been crucial to our Government's efforts to disrupt illicit networks, protect the integrity of the U.S. and international financial systems, and, in doing so, advance the core national security and foreign policy interests of the United States.

And as our country continues to turn to financial instruments to resolve our thorniest foreign policy challenges, TFI will continue to craft these tools, implement them, and vigorously enforce them.

Thank you.

Senator UDALL. Thank you very much. And thank you for staying on time, there.

I'm going to recognize each Senator for 7 minutes in each round and in the order of arrival here. And I'm going to start.

IMPACT OF SEQUESTRATION

Under Secretary Cohen, you mentioned in your testimony that fiscal year—the fiscal year 2014 level of $102 million for TFI is sufficient to accomplish the mission of the office. However, in 2013, funding for TFI was $96 million, significantly less than both the current level and the fiscal year 2015 request of $106 million, be-

cause of sequestration. Can you explain how decreased funding affected TFI's ability to administer and implement sanctions, what activities were stopped or delayed, or what is the consequence of those reductions on our foreign policy goals? And how would fiscal year—the fiscal year 2015 request level allow Treasury to implement a more robust sanctions program?

Mr. COHEN. Thank you, Mr. Chairman.

There's no question that the sequestration in fiscal year 2013 had an impact on our ability to pursue our mission and to function at the highest level of effectiveness.

Our budget is largely comprised of two components: salary and travel expenses. There are obviously some other aspects to it, but those are the two principal components, which, I think, reflects what we do. We have people who work on our sanctions programs, who are intelligence analysts, who are sanctions investigators, who put together the packages, who enforce our sanctions; and I have people who travel the world, meeting with foreign governments, meeting with the private sector around the world to talk about what we're doing, to seek support, to explain our sanctions programs, and to elicit as much complementary action from others as possible.

I think you made the point, Mr. Chairman, that our sanctions programs are more effective when they are multilateral. There's no question that that's true. And one of the very important things that we do, beyond imposing sanctions, is travel the world to try and, as I said, elicit support from others to pursue the same objectives that we're pursuing.

So, the sequestration cuts that were mandated impaired both our ability to fill jobs that became vacant through normal attrition. One way we addressed the cuts was by delaying hiring; as people would leave, we wouldn't fill those jobs as quickly as we would have liked. And we cut back on our travel. And so, our ability to meet with foreign counterparts to pursue our mission through those sorts of engagements was impaired.

There's, you know, some long-lasting impact, particularly from the inability to hire as quickly as we would have liked to have hired. Happily, the sequestration has ended, and I think that the budget that we have for this year, and the budget request for next year, should allow us to pursue our mission completely.

Senator UDALL. Thank you very much.

BUDGET FLEXIBILITY

You know, the President's budget for fiscal year 2015 was submitted to Congress on March 4 of this year. Since then, the Russian military marched into Crimea; last weekend, North Korea exchanged fire with South Korea; global events continue to unfold. Does this budget request include flexibility to respond to emerging global events? And how would you adjust resources if new global events occurred that were not anticipated?

Mr. COHEN. Mr. Chairman, it does allow us to react to events as they unfold. To some extent—you mentioned the North Koreans; we obviously already have sanctions programs in place. I have people in my office who are dedicated to the—North Korea's sanctions effort and to all of the associated work involving North Korea. The

situation with Russia and Ukraine is new. I did not have a cadre of people, certainly not on the order that I have working today, focused on those issues, you know, 6 months ago.

That being said, the people who work for me in TFI are enormously skilled and capable of working on more than one program at a time and shifting their focus from one set of issues to another. And what we have done is drawn people and surged so that we are in a position to fulfill the demands coming from the President and across the administration, to ensure that we have very strong sanctions in place that are being implemented, and that we are prepared as the situation continues to unfold involving Russia and Ukraine.

Senator UDALL. Great. Thank you for both of those.

I'm going to end a little early, because we have so much participation here, and try to set an example, in terms of time. We're going to try to stick to the 7 minutes so we can get everybody in.

So, Senator Johanns, I'm going to turn to you for your questioning, and then to Senator Mikulski.

Senator JOHANNS. Thank you, Mr. Chairman.

And, Secretary Cohen, it's good to have you here today. We appreciate it immensely.

IRAN SANCTIONS

The administration, as we have worked with them on sanctions relative to Iran, has remained firm in their position that additional sanctions would be difficult, or even harmful, to the current negotiations. Despite the fact that I—as I pointed out in my opening statement, I think that's the reason why we got Iran to the table, if you will.

So, what I would like to ask you initially here is, What would the plan be to ensure that, in the event that there isn't a final agreement—let's say discussions collapse—what is the United States prepared to do, and what are you prepared to administer, in terms of a swift, firm response to those circumstances?

Mr. COHEN. Well, Senator, I'd quite agree that it has been the sanctions, and the pressure that has been brought to bear through the sanctions programs that we've developed, and we've developed along with the Congress, that was a hugely significant factor in bringing Iran to the table in a much different fashion than we had seen over the preceding years. They came to the table last fall with a recognition that they needed sanctions relief to try to repair their economy, and that the only way that President Rouhani would be able to fulfill the pledge that he made to the Iranian people during the elections, of bringing the economy back from the dire situation that it was in, was through sanctions relief. And they understood that the only way that they could get that sanctions relief was through addressing the concerns—the very serious concerns with their nuclear program.

We are continuing to implement the vast majority of the sanctions architecture that brought Iran to the table in the first place. There have been some that have been suspended, but the really powerful sanctions—the oil sanctions, the banking sanctions, the financial sanctions—those all remain in place even as we are ful-

filling our commitments under the Joint Plan of Action to provide the limited, targeted relief that we've agreed to.

In terms of what we would be prepared to do if a comprehensive solution is not achieved through these negotiations, I don't want to speculate on particularly what form or fashion those sanctions might take. I think we have said, from the President on down, that if the Iranians are not prepared to reach a comprehensive solution here, a negotiated solution, that we will not only ensure that the sanctions that have been suspended will come back into force, but that we will work with Congress to put in place more stringent sanctions, going forward.

I think it's best to leave to another day exactly what that would look like, but I think there's no question that we recognize that—if we are unable to reach a comprehensive solution here, that we will be working with Congress on enhanced sanctions.

Senator JOHANNS. One of the things I worried about—and I'm guessing it was a concern of yours—that some relief is given through the Joint Plan of Action—and I think that's been estimated to be about $7 billion——

Mr. COHEN. Right.

Senator JOHANNS [continuing]. Some argue it's actually more than that, some experts out there have written about that—one of my concerns is that, once the door opens, the temptation for other countries, other parts of the world, to squeeze that door further open and further open is just too great to pass up. Have you seen any evidence, at this point, relative to Iran, that that, in fact, is happening, that there's leakage occurring, that companies or countries are taking advantage of this Joint Plan of Action?

Mr. COHEN. Sir, that is something that we have, as you might imagine, been watching very carefully, and have been taking very aggressive steps to try to forestall. And I can say, with some confidence, that we have not seen companies anywhere—Europe, the Gulf, Asia—trying to take advantage of this—as you described, the narrow opening, the—really the quite limited suspensions of the sanctions, to sort of get into the Iranian market, enter into business deals that would otherwise be sanctionable. We have not seen it. The estimate that we came up with at the time the Joint Plan of Action was agreed to, as you noted, was that it would be worth approximately a maximum value of about $6 to $7 billion.

Senator JOHANNS. Right. Right.

Mr. COHEN. The Joint Plan of Action has now been in effect for a little over 2 months. Nothing that we have seen leads us to question that estimate. If anything, that estimate is probably on the high side. We are not seeing companies trying to go into the Iranian market, strike deals that would be sanctionable, or frankly even, to any great extent, taking advantage of the narrow suspended sanctions that are permissible under the Joint Plan of Action.

One of the reasons, I think, that that is the case is that we, in early February, announced a whole set of sanctions against people and entities, really, across the world. There was a financial institution in Germany that we applied sanctions to. There were three individuals in Georgia who were part of a sanctions evasion network that we applied sanctions to. There was an individual and his com-

pany in Spain, an individual and his company in Turkey. They were all subject to sanctions—we put sanctions on them in early February—which really, I think, gave a concrete example to what I've been saying, what Secretary Lew has been saying, what Secretary Kerry's been saying, and what the President said, which is that if anybody tries to violate the sanctions during this period of the Joint Plan of Actions we'll come down on them, as the President said, like a ton of bricks. We did that, and I think that sent a very strong message.

Senator JOHANNS. Thank you, Mr. Chairman.

Senator UDALL. Thank you, Senator Johanns.

Senator Mikulski.

Chairwoman MIKULSKI. Thank you, Mr. Chairman.

STAFFING

So, Mr. Cohen, according to the President's budget, you would get $4 million more this year. But, you have a lot more work to do. So, you think you can do this on 4 million more? Or are—or, let me go to, really, the workforce. You have, I think, 413 people working for you?

Mr. COHEN. I have a slightly different calculation of the number of people working for me. What I—and it's a little complicated, because my——

Chairwoman MIKULSKI. Well, let me tell you where I'm heading.

Mr. COHEN. Okay.

Chairwoman MIKULSKI. It's not the number.

Mr. COHEN. Yes.

Chairwoman MIKULSKI. You have a great background. You worked for two Presidents. But, I know you also clerked for a beloved figure in Maryland——

Mr. COHEN. Yes.

Chairwoman MIKULSKI [continuing]. Judge Norman Ramsey.

Mr. COHEN. Right.

Chairwoman MIKULSKI. Someone I admired so much, and both his first wife and——

Mr. COHEN. Yes.

Chairwoman MIKULSKI [continuing]. When she passed away, his second wife.

Mr. COHEN. Yes.

Chairwoman MIKULSKI. And truly an inspirational, transformational leader. I get—tell me the categories of people who work for you. Are they accountants, are they lawyers, are they skill sets? Or can you just dial them up anytime we pass a new sanction and go to a temp agency?

Mr. COHEN. It's wonderful to be reminded of Norman Ramsey, who was a great man.

The people who work for me are a collection of lawyers, of economists, of people who hold advanced degrees in national security studies and international affairs, intelligence analysts who have backgrounds as varied as art history, hardcore economics, former bankers, and many former lawyers, like myself, who have made the shift over to working in Government. It's a very diverse collection of people, who, as I mentioned, are able to sort of reorient them-

selves to surge and to move into new areas as the need demands——

Chairwoman MIKULSKI. But, here goes to my question. I'm interested in recruitment, real retention, because, as—even if you can come with a great background, like in forensic accounting, a highly specialized field, and tremendous lucrative fields, where, if you know how to do this, there are a lot of other jobs that you could have, other than this. So, is recruitment and retention a problem, or is it that, if there's certainty in funding, in pay, and so on, with this 1-percent pay-raise deal that we get, what——

Mr. COHEN. There's no question that we're——

Chairwoman MIKULSKI. In other words, we want to make sure you get to be you, and that you get to implement the laws that the Congress authorizes——

Mr. COHEN. Right.

Chairwoman MIKULSKI [continuing]. In partnership with the President of the United States.

Mr. COHEN. I appreciate it. I think there's no question that retention is a challenge; in part, for the reasons that you identified, that I have people working for me who, on any given day, could walk out the door and increase their salary substantially. They have a skill set that is in demand, both domestically and, frankly, overseas, as well.

I'll be candid, it was not made any easier by the shutdown that we went through last fall. I think that created a question in people's mind about why they are coming to work every day, or wanting to come to work every day for the Federal Government, when they're not being paid, and being told to stay home. That did not make things any easier.

On the other side of the ledger, I will say, though, that we do benefit from, I think, a good reputation of being an organization where the work is incredibly interesting, where we are well supported, both within the Department, within the administration, and here in Congress, and you can come and work on——

Chairwoman MIKULSKI. So, certainty.

Mr. COHEN. Yes.

GOVERNMENT SHUTDOWN

Chairwoman MIKULSKI. So, one, if you come for the mission, and there's certainty of the funding, that at least you'll get paid for the work you do and not sent home as nonessential—I mean, of the 413, or whatever, people work for you, how many were sent home during the shutdown?

Mr. COHEN. The—a very large majority of the people who——

Chairwoman MIKULSKI. The implementors of the sanctions were sent home?

Mr. COHEN. We, in fulfilling our legal obligations under the Antideficiency Act, figured out how many people we could keep on board, and—in the expectation and the hope, frankly, that the shutdown would not last——

Chairwoman MIKULSKI. Was it 10——

Mr. COHEN [continuing]. For very long.

Chairwoman MIKULSKI [continuing]. Percent? Was it 80 percent?

Mr. COHEN. I think, initially, it was a little bit—it was about 10 percent that remained at work. And——

Chairwoman MIKULSKI. So, 90 percent of your workforce was sent home——

Mr. COHEN. Right.

Chairwoman MIKULSKI [continuing]. When shut down.

Mr. COHEN. Initially.

ORGANIZED CRIME

Chairwoman MIKULSKI. Well, let me, then, go to something else, because this hearing, I would hope, for other members, as for me, has been a wonderful tutorial on this. I know people like Senator Johnson's been involved in banking, is very familiar with this. But, you're really one of the big fighters against nuclear proliferators, weapons of mass destruction proliferators, and organized crime. Could you share with me—I think we're least familiar with the organized-crime sanctions. Could you tell us, quickly, in the few minutes that I have—and I do mean quickly——

Mr. COHEN. I will.

Chairwoman MIKULSKI [continuing]. In the spirit of cooperation—What is it that you do?

Mr. COHEN. Yes.

Chairwoman MIKULSKI. And what does it take to do that?

Mr. COHEN. Yes. About 3 years ago, now, the President issued a new executive order going after transnational organized crime, which allows us to identify transnational organized criminal groups and then apply sanctions to the people in the businesses that are supporting those criminal organizations. We've identified, I think, about five different transnational organized criminal groups, from the Yakuza in Japan to the Brothers' Circle in Eurasia to the Camorra in Italy, and then have built out, as—this is sort of the pattern that we follow in many of our sanctions programs—built out the individuals and the businesses that are working underneath the umbrella of these criminal organizations, imposing sanctions on them, freezing their assets, preventing them from using the U.S. financial system, and then going around the world and asking our counterparts to take complementary action.

Chairwoman MIKULSKI. I know my time's up.

Senator UDALL. Thank you, Chairwoman Mikulski.

Senator Moran.

Senator MORAN. Mr. Chairman, thank you much.

Mr. Secretary, thank you for joining us.

Let me—I have two questions, and one is just a—I come across the wire this afternoon.

POTENTIAL RUSSIAN OIL SALE

Reuters is reporting that Iran and Russia are close to a deal, swapping oil, bartering for other goods from Russia, indicating that—the deal is expected to be valued at about $20 billion, indicates would perhaps further undermine our efforts with the most recent negotiations in Iran. And I wondered what you—what your thoughts were, your concerns were.

"'The indications are that Iran and Russia have made progress toward an oil-for-goods deal,' sources said, 'that would be worth up

to $20 billion, which would enable Tehran to boost vital energy exports, in defiance of Western sanctions,' people familiar with the negotiations told Reuters." Thoughts?

Mr. COHEN. I haven't seen that most recent report, but I'm obviously familiar with this topic. There have been other reports about this.

You know, what I can say is this. Since this issue first became something that we were aware of, we have been crystal clear to the Russians that any such deal is not only contrary to the spirit of the P5+1 negotiations that we're involved in, but would also be plainly sanctionable under a number of different authorities that we have. Obviously, the purchase of oil from Iran by Russia would be sanctionable. If they sold that oil to anybody else, that transaction would be sanctionable. Whatever financial institution in Russia would be involved in the payment for that oil would be subject to sanctions. We have been very clear with the Russians that——

Senator MORAN. But, the sanctions would go both ways, to both countries? Additional——

Mr. COHEN. Sure.

Senator MORAN [continuing]. They would violate sanctions with Iran, violate—in violating that violation, it would cause us to be able to impose sanctions against Russia?

Mr. COHEN. Correct. And, frankly, I think it was clear at the outset that we were prepared, if necessary, to take action, given our long history of applying sanctions against those who violate our sanctions all around the world. Frankly, I think what has transpired in the last several weeks has only reinforced the point, I would think, for the Russians, that we're not unwilling to apply sanctions against Russian entities and Russian individuals if the facts dictate. So——

Senator MORAN. So, it would be surprising if Russia and Iran entered into this agreement?

Mr. COHEN. Look, I'm not going to predict what the Russians and the Iranians may do. We've been seeing reports about this sort of deal for many months now. It hasn't been consummated, to the best of my knowledge. I don't know that the report today really adds, necessarily, to the situation. I've seen reports like this, saying that they're close to this deal for many months now.

But, as I said, we've been very clear with the Russians, and, I should also say, very clear with the Iranians, that, in the course of these P5+1 negotiations, that any sort of deal like this would not be conducive to——

Senator MORAN. In your—I mean, I think what you're telling me is that such a deal would be significantly contrary to the agreements we've reached with Iran, and would be a significant setback to the desired outcome of those negotiations?

Mr. COHEN. Well, it certainly would not be a welcome development. And, as I said, it's one that we've told the Russians, from the highest levels of its Government on down, that we would look at with great disfavor.

TRADES BETWEEN TURKEY AND IRAN

Senator MORAN. Let me turn to Turkey. It—at least reported to me that there may be significant trades, in the billions of dollars,

gold, other trade activity, originating between Turkey and Iran. And that would be true, despite the sanctions regime that is imposed against Iran. How is this occurring? What are we doing about it? I guess the initial question would be, Is there truth to it?

Mr. COHEN. I will answer this question, to the extent that I can in this session, although I would make the same offer to you that I made to Senator Corker in another setting, which is, I'm happy to come in and talk about this in a classified setting, where I think we could——

Senator MORAN. Okay.

Mr. COHEN [continuing]. Talk about this in greater detail.

I think the short answer, and the answer that I can give you here, is that we have been aware of these allegations, have been watching very carefully the trade in gold between——

Senator MORAN. Yes.

Mr. COHEN [continuing]. Really any country and Iran, preceding the Joint Plan of Action, where we've—where that trade has been—is—the sanctions on trade in gold is suspended under the Joint Plan of Action. But, since the summer of 2012, when the President issued an executive order that forbade the sale of gold to the Government of Iran, we have been watching the gold trade, and—let me put it this way. I don't think we have demonstrated any reluctance to apply sanctions, where we've seen violations. And this is an issue that has been one that we've been looking at, there's obviously been others outside the Government who have been focusing on this issue and writing about this issue. And I think I would probably best stop there.

RUSSIA

Senator MORAN. Secretary Cohen, let me go back to Russia, before my 53, 52 seconds expire. How long ago did these negotiations begin between Russia and Iran? How long have we been monitoring this? When did we start expressing concern to Russia? Is this a matter of months, weeks? Did they predate the Ukraine and Crimea circumstance? When did this begin?

Mr. COHEN. I think I would rather address that question in a different setting.

Senator MORAN. Okay. Thank you very much.

Thanks, Mr. Chairman.

Senator UDALL. Thank you, Senator Moran.

Senator Coons.

Senator COONS. Thank you, Chairman Udall.

And I'd like to thank full-committee Chairwoman Mikulski and Chairman Udall for convening this hearing.

Mr. Under Secretary, thank you for your service. I want to thank you and the dedicated staff at the Office of Foreign Assets Control, and, in fact, all of TFI, for your tireless work.

ADDITIONAL BUDGETING RESOURCES

This is all about a credible threat, in my view. I am convinced, the only reason Iran is at the negotiating table with us today, and the only reason we have any chance at ending their illicit nuclear program through peaceful means, is because of the vigorous and

thorough enforcement of very tough sanctions enacted by Congress, enforced by the administration.

And so, I'm concerned if, in the decade from 2004 to 2014, as you mentioned, the number of sanctions programs has gone from 17 to 37. Further, as Senator Udall mentioned, if, in just recent weeks since the President's budget was submitted, you've been handed an even broader range of tasks to take on, and the implications of some of the previous questions, whether it's with Turkey or with the Russian oil deal with Iran or with, as I may ask about, other issues in Africa or Syria, you have a very full plate.

I admire that you say that the President's budget submission is sufficient, and that, through program efficiencies, effective management, and moving folks around, you can surge and meet whatever requirements there may be. But, I just want to suggest to you that it's at least this Senator's desire to give you an abundance of the resources to support the skills, the talent, and the ability in your workforce, not to move folks around in response to emerging challenges and threats, but to anticipate them.

One of my concerns is that, as the Joint Plan of Action has moved forward, there have been some trade delegations, both announced and real, to Iran. I'm concerned that there are some folks, our allies and our adversaries, who view Iran as potentially open for business. And I think it's only with a credible threat of, as you mentioned, as the President mentioned, coming down on folks who violate sanctions like a ton of bricks, that we can keep moving forward.

So, if we were to give you more resources, could you put them to effective use? Would they help deter those who think that they can evade sanctions, whether Russia or Assad in Syria or countries in Africa with whom Rouhani is conducting a charm offensive, or do you think they would be wasted? Could you effectively put to use additional resources in enforcing the sanctions regimes we have charged you with?

Mr. COHEN. Well, Senator, thank you for the question, and thank you for the letter that you sent a few weeks ago. It is very encouraging to my folks to know that their work is appreciated.

We do have sufficient resources, even as new issues come up, to continue to ensure that the Iran sanctions, for instance, are being fully implemented, full enforced. The designations we did in February, I think, reflect that. And, you know, we have not taken our eye off the ball at all with respect to Iran, even as we have surged in Ukraine.

We draw on resources outside of TFI, we draw on resources from others in Treasury, we draw on resources in the intelligence community and in other agencies in the executive branch, through all of our work, and including when we have a need to really surge. I think we do a good job of managing our resources. And so, I would not say that we would waste whatever resources are given to us.

And I think anyone would say that more is better than less. But, I do think that we are able to fulfill our mission, even as it expands and changes, some things rise to the top, others become less urgent, with the resources that have been appropriated and the resources that have been requested.

Senator COONS. Well, Mr. Under Secretary, if I might, the point of the letter was to compliment you and the folks at OFAC and more broadly in your entity for their terrific work, and to express my appreciation for the value of their work. But, as Senator Mikulski mentioned, there is no temp agency to which you can turn. You may be able to draw from other places in the Federal Government—from the intelligence community or from other departments—but I have to presume they're conducting vital and important work in their agencies, as well.

My concern is that I see no diminution in the scope and the importance of the issues for which you will need very technically skilled folks. I see no reduction in the number of our allies who need to be visited in person and whose business entities need to be convinced to not engage in sanctionable activities. In fact, as I mentioned, President Rouhani has been engaged in a charm offensive across Africa. There's, I think, a dozen African countries that, without some active engagement from the United States, may potentially engage in sanctionable behavior. The deal that's been contemplated, widely reported, both a deal to construct new nuclear facilities in Iran and to trade oil for other things with Russia, may also expand the scope of your work.

I think you need more resources. I think we need to make it credible to the Islamic Republic of Iran, and to any country and any company that thinks they will skirt our sanctions regime or somehow get through this, to know that we have moved sanctions from a sideshow in the American diplomatic and military arsenal to center stage. And I think we need to make certain that you are robustly and fully staffed and funded. I thank you for your leadership and making sure that that work gets done, done well, and done in a timely fashion.

Thank you.

Mr. COHEN. Thank you.

Senator UDALL. Senator Coons, thank you very much.

Senator Kirk.

Senator KIRK. Thank you, Mr. Chairman.

VISA FOR IRANIAN AMBASSADOR

I wanted to ask you about the recent decision of the administration to grant a visa to Hamid Aboutalebi, the proposed Iranian Ambassador to the U.N., to have the hostage-taker in chief safe in New York City, sipping his latte on Fifth Avenue, thinking—he's probably laughing directly at you, at how weak and feckless that you are, that he can put Americans in incarceration for 444 days, and he actually managed to get a position inside the United States. Have you seen the comments of the Americans that were all held hostage by this idiot?

Mr. COHEN. I have seen those comments, Senator, and share your concern with this individual taking up a position at the U.N.

Senator KIRK. The fascinating thing is, this guy admits that he was a hostage-taker, and the Iranians stick us with this guy, just to laugh at you.

Mr. COHEN. Well, Senator, as I'm sure you know, the question of whether or not to grant an individual a visa is not mine. I think, regardless of this particular individual——

Senator KIRK. You do understand the kind of shock that we all have that the administration would do this?

Mr. COHEN. Senator, I understand your position on this.

Chairwoman MIKULSKI. Visas are issued by the—which Department?

Mr. COHEN. The State Department, Madam Chairwoman.

One thing I can say is, the work that we will do—the work that we have been doing and the work that we're going to continue to do, is utterly unaffected by who sits in the chair for Iran at the United Nations. Frankly, a position that does not affect, I think, in any way, what——

Senator KIRK. I do remember the last guy who was in this position. He's now the Foreign Minister of Iran. Congressman Steve Israel and I went to see him for lunch one day in New York. He spent, like, an hour telling us how the Holocaust hadn't happened. And I said to him, "Don't cause diplomatic incident. I'm stunned that you're raising this topic about events which happened two generations ago, not in your country." And he said, "I was ordered to tell you the Holocaust didn't happen." That's the quality of the people that we are talking about, here.

Mr. COHEN. Right.

I—the—far be it from me to defend the quality of the people that Iran sends to the U.N.

Senator KIRK. Even if they are involved in incarcerating Americans illegally?

Mr. COHEN. You know, Senator, what I can tell you is that whoever Iran chooses for their Permanent Representative to the United Nations, the question of whether or not to grant that person a visa——

Senator KIRK. David, you're about to get a letter signed by 20 Senators, "Don't grant this visa."

Mr. COHEN. Yes.

Senator KIRK. Now that we have——

Senator UDALL. Senator Kirk, the—he doesn't grant the visa. It's over in the State Department. We're trying to——

Senator KIRK. I realize——

Senator UDALL. We're trying to——

Senator KIRK. I used to serve——

Senator UDALL [continuing]. Focus on——

Senator KIRK [continuing]. In the State Department.

Senator UDALL [continuing]. His duties. So——

Senator KIRK. Yes.

Senator UDALL [continuing]. His duties as the——

Senator KIRK. I do realize that.

Senator UDALL [continuing]. TFI head.

Senator KIRK. This is probably the only administration witness we have before the Congress after this announcement of Hamid Aboutalebi coming into the United States.

Senator UDALL. Well, the—Under Secretary Cohen, as you know, briefed the entire Senate, Democrats and Republicans——

Senator KIRK. Right.

Senator UDALL [continuing]. In a confidential——

Senator KIRK. David——

Senator UDALL [continuing]. Session, and every——

Senator KIRK [continuing]. And I have worked quite a bit——

Senator UDALL. Yes, and everything was able to be done there. So, I think we should try to focus on his duties and responsibilities. Because I don't think he has anything to do with the visa. I think that's the State Department's——

Mr. COHEN. That's correct.

Senator UDALL. You don't issue visas. Is that right?

Mr. COHEN. That's correct.

Senator UDALL. But, I don't want to interfere with your questioning of him if——

Senator KIRK. I would say——

Senator UDALL [continuing]. There is legitimate reason——

TEMPORARY SANCTIONS RELIEF

Senator KIRK [continuing]. David, you didn't highlight something in your testimony, that—you also said the sanctions that Congress unanimously supported were key to bringing the Iranians to the table, but what you didn't say was that you vigorously opposed the passage of the Menendez-Kirk sanctions. So, the irony of your position——

Mr. COHEN. Actually—Senator, if I might, the——

Senator KIRK. I actually have a copy of the letter you sent me on that.

Mr. COHEN. Right. And what that letter said was that the amendment, as it currently existed at that time, was one that we had concerns with in how it would be implemented. And what transpired after that hearing that day was that we worked with you, Senator, with Senator Menendez and others, to modify the provision that was ultimately enacted. As that provision was ultimately enacted, it addressed many of the concerns that animated that letter, and was ultimately crafted in a way that has proven to be extraordinarily successful in driving down Iran's ability to sell oil.

I think the concerns that were expressed in that letter on December 1 of 2011, I think it was, when that letter was sent, were concerns that were with respect to the version of the amendment, as it existed that day, and——

Senator KIRK. I would say, you know——

Mr. COHEN [continuing]. It changed, subsequently——

Senator KIRK [continuing]. If you remember——

Mr. COHEN [continuing]. In a way that was much more——

Senator KIRK [continuing]. If you remember, you and I were on the phone almost hourly at the time that we did that amendment, and we did make a number of changes to suit the administration.

Mr. COHEN. That's right.

Senator KIRK. At your request.

Mr. COHEN. I think that's right.

Senator KIRK. Yes. And when the Senate voted, it was unanimous. Not a single Senator stood with your position on this issue.

Mr. COHEN. Well, as I said, what ultimately was enacted and what ultimately has proven to be so effective—and I take nothing away from your efforts and the efforts of Senator Menendez and the others who voted for that provision—what ultimately proved to be tremendously effective was a modified version of that amendment that allowed us to work in a way to drive down Iran's ability

to sell its oil without roiling the international markets. And we've managed to, essentially, keep the price of oil at the same level that it was in December 2011, while taking off——

Senator KIRK. You briefly touched on a——

Mr. COHEN. Yes.

Senator KIRK [continuing]. On a point, here before the committee, saying up to $6 billion was released to the Iranians. That's about 50 years' support to Hezbollah.

Mr. COHEN. I'm sorry, Senator, I didn't——

Senator KIRK. If you look at the cost of Hezbollah to the Iranians, because they—on that organization—that killed the 243 marines in Lebanon and killed our station chief in Lebanon, if you look at the yearly cost of that operation, you have provided almost 50 years worth of money to the Iranians through this negotiation process.

Mr. COHEN. Well, Senator, what we agreed to in the Joint Plan of Action was to allow the Iranians access to $4.2 billion of their oil revenue that has been denied to them in overseas accounts over the course of the 6 months. The manner in which that money is being released by the banks that hold it to the Iranians—not American banks, banks overseas—is such that we have good visibility into where the money is going.

If the Iranians continue to fund Hezbollah, which the Iranians have done for many years now and which has been the focus of many of my actions and actions of others in the Government, that is conduct that is not facilitated by the Joint Plan of Action, but is conduct that we, if we see it, will continue to take action against. I have no hesitation whatsoever in continuing to pursue and to try and disrupt Iran's support for Hezbollah, and we'll continue to do that.

Senator UDALL. Thank you very much.

Now, Senator Kirk, your time's expired. I'm going to now move to Senator Johnson.

Senator JOHNSON. Thank you, Mr. Chairman.

And thank you, Under Secretary Cohen.

RESOURCES FOR EXPANDING RESPONSIBILITIES

I've been amazed at OFAC's capacity to absorb additional sanctions implementation responsibilities over the years. OFAC Director Adam Szubin and his team have done an extraordinary job. Given that TFI and OFAC, in particular, have had to take on expanding sanctions responsibilities, which you describe in your testimony, how long do you think you can maintain this current level of excellence without additional staff and other resources being made available to meet expanding duties?

Mr. COHEN. Well, thank you, Mr. Chairman, and thank you for your support over the years for our work.

My folks in OFAC, and, frankly, across TFI as a whole, are working very hard. I think I said, in a prior hearing, they're working flat out, and I think that's a fair description. I've got an extraordinarily dedicated and extraordinarily hardworking group of people who work in TFI.

I am comfortable that the current resources that we have appropriated this year and that the President has requested for next

year are sufficient for us to continue to do that work. But, you know, I do not have people who come to work in the morning without anything to do. I've got everybody quite gainfully employed.

ADDITIONAL FLEXIBILITY

Senator JOHNSON. The situations in Syria, Iran, Ukraine, and elsewhere, are all extremely complex and fluid, which makes flexibility a crucial element of Treasury's ability to respond. Are there things Congress should be doing now to provide you with additional flexibility to react nimbly to ongoing diplomatic challenges across the world?

Mr. COHEN. Well, Senator, I think one thing that Congress could do to allow us to continue to have the flexibility to react nimbly to challenges as they develop is—when Congress legislates new sanctions authority, to ensure that we have discretion in how to implement those authorities. I think we have demonstrated, over the years, that we will employ the authorities that are given to us in an aggressive fashion and, in a relatively smart fashion, as well. But, the greater flexibility that we have in determining how and when to apply these sanctions authorities, the better able we would be, and we will be, to respond to issues as they arise. The more that it is predetermined exactly what sorts of sanctions must be applied, the more that the legislation is prescriptive in that respect, the more difficult it is for us to react in a flexible fashion.

Senator JOHNSON. Under Secretary Cohen and Chairman, I will have to excuse myself. I have to chair another committee hearing. But, thank you.

Senator UDALL. Senator Johnson, thank you very much, and we very much appreciate your participation and the fact that we know you have another hearing going on. But, thank you for coming over.

Senator Graham, we're—you weren't here at the beginning, but we're trying to——

Senator JOHNSON. Thank you.

Senator UDALL [continuing]. Stick with 7 minutes——

Senator GRAHAM. Yes, sir.

Senator UDALL [continuing]: And get through everybody. We've had good, robust participation today, and really appreciate seeing you here. Thank you.

Senator GRAHAM. Well, thank you. Thank you for letting me come. I'm not on the subcommittee, but I really appreciate the invite. This is a well-run place around here.

Chairwoman MIKULSKI. You got it.

Senator GRAHAM. Yes.

Mr. Cohen, I want to compliment you and your team. I think you all have been very diligent in trying to enforce the sanctions, and—credit where credit's due. I think the sanctions have been implemented in a way to get the Iranians to the table.

BUSINESS DURING INTERIM AGREEMENT

After the interim deal, how many delegations have gone to Tehran—foreign delegations—to discuss potential business opportunities with the Iranians? Do we know?

Mr. COHEN. I think we know. I don't have that number right at hand. But, I'd—we obviously are——

Senator GRAHAM. Is it above or below 50, or do——

Mr. COHEN. Fifty, did you——

Senator GRAHAM. Yes.

Mr. COHEN. I—honestly, Senator, I don't——

Senator GRAHAM. Just provide it to us, if you could.

Mr. COHEN. I will.

Senator GRAHAM. Yes——

Mr. COHEN. Yes.

Senator GRAHAM [continuing]. That's fair. I think it's quite a lot.

Mr. COHEN. Yes.

Senator GRAHAM. Before the interim deal, were there delegations going to Iran, talking about potential business?

Mr. COHEN. Certainly not to the extent that we saw——

Senator GRAHAM. If you could——

Mr. COHEN [continuing]. After the interim deal.

Senator GRAHAM [continuing]. Give us before the interim deal and after the interim deal, in terms of international engagement, I think it would be helpful, because I think there's a perception out there, true or not, that now's the time to think about doing business with Iran. And we want to make sure that doesn't go too far.

Mr. COHEN. Okay.

[The information follows:]

TRADE DELEGATIONS TO IRAN

In support of the President's dual-track strategy towards Iran of pressure and diplomacy, the Department of the Treasury has engaged in extensive outreach to companies, financial institutions, and governments around the world to make clear the broad scope of our sanctions and our intention—which we have consistently demonstrated—to actively enforce them.

We continued these active efforts following the November 2013 announcement of the Joint Plan of Action. Since that time, Treasury officials have spoken to hundreds of companies and traveled extensively to make clear that Iran is not open for business. As part of this campaign we have kept a close eye on countries from which we have seen trade delegations visit Iran to explore possible post-sanctions opportunities. Where we saw any risk to the pressure we built, we met with the governments of these countries and had frank conversations to express our concerns. We have not hesitated to take action against entities that have violated our sanctions. Indeed, since November 2013 we have designated nearly 100 entities and levied almost half a billion dollars in civil penalties for Iranian sanctions evasion. At least partially as a result, we have not seen these delegations lead to significant new business for Iran. Indeed, as we expected, the economic benefits to Iran under the JPOA have been contained, and entirely insufficient to overcome the deep economic difficulties Iran continues to face.

In response to the committee's request, please see the below list of countries we have observed sending trade delegations visiting Iran in the 2 years preceding or during the JPOA period (including to the present). Please note that this list is not intended to be exhaustive, and is based on open-source reporting.

Afghanistan	Lebanon
Austria	Netherlands
Azerbaijan	Oman
China	Romania
Czech Republic	Singapore
France	South Korea
Georgia	Sweden
Germany	Thailand
India	Tunisia
Iraq	Turkey
Ireland	UAE
Italy	Uzbekistan
Kazakhstan	

NORTH KOREAN SANCTIONS

Senator GRAHAM. North Korea is still being sanctioned by the United States. Is that true?

Mr. COHEN. Yes, sir.

Senator GRAHAM. Have our sanction efforts deterred their nuclear program?

Mr. COHEN. I think our sanctions, which are largely——

Senator GRAHAM. Can I help you?

Mr. COHEN [continuing]. Focused——

Senator GRAHAM. No.

Mr. COHEN. Yes.

Senator GRAHAM. No, it hasn't.

Mr. COHEN. Yes. Well——

Senator GRAHAM. Well, since not—you're not a CIA-type person, but—I don't mean to interrupt—the truth of the matter is, the North Koreans are building—they have nuclear capability. So, I'll shut up and let you answer. Do you think the sanctions are deterring their nuclear program?

Mr. COHEN. I don't think they're deterring their nuclear program. I think our sanctions have disrupted, to some extent, North Korea's progress in acquiring the material and acquiring the hard currency that they need to buy the material for their nuclear program.

But, I quite agree with you that the North Koreans have been pursuing a nuclear program, and have done so notwithstanding our sanctions and sanctions that have been in place against North Korea for many years.

Senator GRAHAM. I would just invite subcommittee members to maybe get briefed up. It's pretty astonishing what they're doing, in spite of our best efforts. They're going down the plutonium track now.

There was a reactor that was basically somewhat dismantled. Plutonium-producing reactors, part of—the last round of negotiations, is supposedly coming back online. So, I just want us to remember the North Korean model, that we tried sanctions that didn't work there.

GOAL OF NEGOTIATIONS WITH IRAN

Now, the goal in Iran is to get the Iranians to dismantle their nuclear program. Is that the stated goal of the administration?

Mr. COHEN. The goal with respect to our sanctions in Iran, I think, is twofold. One is to disrupt their ability to continue to develop a nuclear program, as well as to put pressure on the Iranian Government so that, as part of the dual-track strategy, where we have been offering the Iranians the opportunity to negotiate in a credible fashion with the international community with regard to their nuclear program, to create the incentives so the Iranians will actually come to the——

Senator GRAHAM. Right. But, what's the——

Mr. COHEN [continuing]. Negotiating table——

Senator GRAHAM [continuing]. End game? What are we trying to accomplish in Iran?

Mr. COHEN. We are trying to ensure that Iran does not, and cannot, develop a nuclear weapon.

Senator GRAHAM. Okay. So, one of the goals would be to dismantle the plutonium-producing reactor at Arak. Is that correct?

Mr. COHEN. Senator, as you know, I am not the negotiator.

Senator GRAHAM. No.

Mr. COHEN. My colleagues at the State Department are responsible for negotiating the deal. And I think just last week we had a classified session, where——

Senator GRAHAM. Wouldn't it help——

Mr. COHEN [continuing]. We went into some of these issues.

Senator GRAHAM. Wouldn't it help you to know the goal? Because you're the guy driving the sanctions regime. I mean, you know, what are you trying to accomplish——

Mr. COHEN. Right.

Senator GRAHAM [continuing]. With these sanctions? Which is to keep them from developing a nuclear weapon.

Mr. COHEN. Right. The ultimate goal is what I said, which is to prevent Iran from developing a nuclear weapon.

Senator GRAHAM. Fair enough.

Mr. COHEN. I am not——

Senator GRAHAM. Fair enough. Fair enough. I——

Mr. COHEN. I'd leave it there.

Senator GRAHAM. Yes, fair enough.

The Congress is debating among itself the idea of imposing sanctions under the following conditions: that, at the end of the 6 months, the Iranians haven't met the benchmarks that we all hope, which is a dismantling of their program, that sanctions would continue. Because the goal of the sanctions is to reach a result. And the new round of sanctions are tailored to meeting the goal. The sanctions would continue if the nuclear program is not substantially dismantled, I think is the way the new language reads.

IMPACT OF ADDITIONAL LEGISLATION

Do you believe, if they violate the interim deal, a new round of sanctions will apply? Those are the two things. Do you think it would hurt your effort if the Congress got on record reinforcing the sanctions, in terms of the goal we're trying to achieve, and to deter them from cheating? Do you think that hurts or helps your effort?

Mr. COHEN. Senator, the judgment of those who were involved in the negotiations—my colleagues at the State Department, and, frankly, the judgment of the President, who said he would veto any such legislation—is that it would not be——

Senator GRAHAM. Yes, I don't want to——

Mr. COHEN [continuing]. Helpful to the——

Senator GRAHAM [continuing]. Get you on the wrong side of the President, but you're the guy dealing with the sanctions.

Mr. COHEN. And I don't need this piece of legislation.

Senator GRAHAM. Okay, that's fair enough. You don't think you need any reinforcement, is what you're saying.

Mr. COHEN. What I need is what we have, which is a very, very robust sanctions architecture that is in place, that we're enforcing, as well as the absolutely unquestioned credible threat that if the Iranians don't come to an agreement in——

Senator GRAHAM. I'm not going to get your comment on military policy, if that's where——

Mr. COHEN. No, no. No, no. I'm not talking military policy. That if the Iranians are unable to, or unwilling to, reach a comprehensive solution, that this Congress and this administration will work together to impose additional sanctions.

Senator GRAHAM. The——

Mr. COHEN. There is no one in Iran who, for a second, thinks that we would be unable to implement more stringent sanctions if the——

COMPARISON OF SANCTIONS AGAINST IRAN AND NORTH KOREA

Senator GRAHAM. In 7 seconds, are the sanctions against Iran as robust as the sanctions against North Korea?

Mr. COHEN. Well, the sanctions against Iran are broader and deeper than the sanctions against North Korea.

Senator UDALL. Thank you, Senator Graham. Thank you very much.

Is—I assume there's an interest in a second round. I—Senator Mikulski, you—I would—yes, I——

Chairwoman MIKULSKI. Senator Graham—if I could comment to Senator Graham before you——

Senator UDALL. Oh, please. Chairwoman Mikulski, please.

Chairwoman MIKULSKI. First of all, I'm so glad you came.

Senator UDALL. Yes, thank you for coming.

Senator GRAHAM. No one's ever invited me to anything, almost. I really——

Chairwoman MIKULSKI. Well, it's a different——

Senator GRAHAM [continuing]. Appreciate it.

Chairwoman MIKULSKI. But, just—this is——

Senator GRAHAM. Even my own caucus won't invite me to lunch.

Chairwoman MIKULSKI. So, this is exact—well, that's a different thing. We're not going to go that far.

Senator GRAHAM. Okay, yes.

Chairwoman MIKULSKI. Seriously——

Senator GRAHAM. Yes.

Chairwoman MIKULSKI [continuing]. This is kind of the different kind of tone that Senator Shelby and I are trying to set.

Senator GRAHAM. And great.

Chairwoman MIKULSKI. One is that many of these issues cut across a variety of subcommittees; and, within the various subcommittees, there's different expertise. So, you, sir, are the ranking member on State Department Foreign Ops. That's the authorizing committee. And your work on the Department of Defense, of course, is well known and almost legendary. So, you come——

Senator GRAHAM. At least in my own mind, yes.

Chairwoman MIKULSKI. No, but, you see, you bring it to the table. And——

Senator GRAHAM. Thank you.

Chairwoman MIKULSKI [continuing]. This is just great. And I could say this for us here, the fact that this was robust bipartisan participation, a couple of different committees. We had the banking authorizer here. This is great, because I think we had a tutorial,

really, on what this office is—413 people, they enforce 37 different sanctions. This testimony is a teaching——

Senator GRAHAM. Mr. Cohen is doing a good job. I just——

Chairwoman MIKULSKI. And what I wanted——

Senator GRAHAM [continuing]. Want to recognize that I know you're trying very——

Chairwoman MIKULSKI. And what I just wanted to say is that, if the Joint Plan of Action falls apart, and the Congress then moves to take needed action, I will—because this is in July—make sure that we, as appropriators, would accommodate whatever it takes to up the game for them to be able to implement whatever we do.

So, I think if we all—that I want us to think that we're all in this together to protect the United States, to protect treasured allies. And I think this has just been the kind of hearing where we look at the resources and look at the cause. And I'm glad that you came.

Senator GRAHAM. Thank you very much.

Chairwoman MIKULSKI. And I really want to——

Senator GRAHAM. Thank you both.

Chairwoman MIKULSKI [continuing]. Thank both you and Senator Johanns for this very content-rich conversation here.

Senator UDALL. Thank you very much, Senator Mikulski.

And we will invite you again when we need your expertise. We appreciate it. We appreciate it very much.

But, what—yes, what——

Chairwoman MIKULSKI. And I like being ex officio. I just invite myself.

Senator UDALL. But, we—and I very much appreciate your work, and I think everybody does, here. I couldn't emphasize enough—and you've seen it, from both the Republican side and Democrat side, echoed here. We know—need to know the resources you need in order to do your very important job, and it's just—you need to let us know and be in touch with us as we move down the road and we get into these crisis situations, where we're trying to move from Russia to Ukraine to a variety of sanctions.

TEMPORARY SANCTIONS RELIEF

And I wanted to come back to—because I think one of the members raised this issue of the narrow window and the idea—Senator Graham raised this in his question, in terms of visits to Tehran and all of that. You said that the number, in terms of—the prediction was $6 billion to $7 billion, and you said the number's actually lower. And I was wondering, Why is that? What—the prediction was going to be up in that range, and it's actually been much lower. What has caused that?

Mr. COHEN. The estimate—the $6 billion to $7 billion estimate included a number of different components that, together, added up to $6 billion or $7 billion, including the essential value of transactions involving auto parts, which was one of the suspended sanctions, and potential transactions involving petrochemical sales. And, thus far, we have seen very little pickup in either of those two areas.

I think that is, in part, due to the fact that the Joint Plan of Action is in effect for 6 months, which means these sanctions are sus-

pended for 6 months, and the international business community and the international financial community knows that, for the transaction to be nonsanctionable, it needs to be completed, from, order to manufacture to shipment to payment, within that 6-month period. That's not a very long period of time. I think it has dissuaded, frankly, some from taking advantage of that.

Now, I should say, the lion's share of the $6 billion to $7 billion is this $4.2 billion in Iran's own assets, its own funds overseas that are going to be released over the course of the 6 months. We have fulfilled, in good faith and completely, our obligations, thus far, to release—or to allow the release of, I think, three of the tranches. And we'll continue to do that over the course of the 6 months.

Senator UDALL. Thank you for that answer.

COMPARISON OF SANCTIONS AGAINST IRAN AND NORTH KOREA

The issue here was raised of North Korea and sanctions working, in terms of North Korea. And the thing that seems to me—I mean, looking at sanctions on North Korea and sanctions in Iran—is, we—the difference is the large number of countries—the P5+1—that are participating, and the actual robust ability for them to engage in this sanctionable activity.

The problem we have in North Korea is China, which—that's my sense. They seem to, when it gets to the point that North Korea needs to be rescued, you have economic rescue packages that occur, and those numbers have been going up. And that's a much more difficult one, I guess, for us to deal with.

But, I—those are my thoughts on that. I'm wondering what—and things that I've read and heard about—what are your thoughts there, in terms of the—comparing—if you had a comparison of North Korea and the Iranian situation?

Mr. COHEN. Yes. Well, there's no question that Iran, before we embarked on the sanctions effort, was much more integrated into the global economy than North Korea is today or ever has been. I mean, North Korea is quite isolated, for reasons unrelated to sanctions, related to the government that they have there. So, the same techniques and the same sanctions that we've applied to Iran are not, sort of, easily just translated into the North Korea context.

That being said, there's no question that North Korea is also susceptible to sanctions, and we have applied sanctions against North Korea. And I would—and would cite one sanction, in particular, which is, about 9 months ago now, we imposed sanctions on something called the Foreign Trade Bank in North Korea, which was their major foreign exchange financial institution. It was the principal way in which all the banks in North Korea would be able to transact with banks outside of North Korea. We saw Chinese banks cut off the Foreign Trade Bank. Some of the major Chinese banks that had held accounts with the Foreign Trade Bank severed those accounts.

So, I think that was, in part, a response to what we did; it was, in part, a response to some of the outreach that we made to the Chinese; and it was, I think, in large part, a dividend from years of effort to spread the word about financial integrity and financial transparency and the major Chinese banks recognizing that their

reputation for financial integrity is something that is important to them as they interact with the rest of the world.

And so, it is absolutely true that the majority of North Korea's relationship is with China, but we've also had some success with China in applying pressure to North Korea.

IMPROVING SANCTIONS AGAINST NORTH KOREA

Senator UDALL. Yes. Are—what could Treasury do to make sanctions more impactful against North Korea under the current sanctions regimens that——

Mr. COHEN. Yes. Well, we're going to continue——

Senator UDALL. What tools are——

Mr. COHEN. Yes.

Senator UDALL. You know, what tools are missing to make them more effective?

Mr. COHEN. Mr. Chairman, I'm not sure that we have any tools that are missing. What we are going to continue to do is to implement the sanctions programs that we have in place, which are focused on North Korea's efforts to develop its nuclear program as well as North Korea's other illicit activity. You know, this is an issue that gets a great deal of attention in the Treasury Department as well as, across the national security community, and we're going to continue to pressure North Korea.

Senator UDALL. Yes. Thank you very much.

Senator Coats, you haven't had a chance to question, here. And so—we all have, and so you're still in your first round. So, then we'll come to you and then I'll come back to my Ranking Member, the distinguished Senator Johanns, here.

Senator COATS. Okay, thank you, Mr. Chairman.

I just want to follow up on a parochial question, if you don't mind, and that is—the Indiana delegation sent to Pentagon, Under Secretary Hale, a letter, dated March 24, asking some questions about the AMFO initiative. That's the Army Financial Management Optimization Program. Number one, I want to commend you, because, you know, unprecedented in my career, we received a letter back on March 26 of the same year. So, I'm very impressed with that. So, I want to—a word of thanks, there, in terms of response.

But—and I was just looking through that letter. It actually went to Congressman Carson. There are a number of us, both Senators and members of our congressional delegation.

And the question is, on this—your—the review of this new system. It potentially involves your—and I quote from the letter, "possibly including reductions in numbers of DFAS personnel at certain locations. We will make every effort to accommodate any changes through attrition." I'm not here to get a specific answer from you, but to better understand what is happening and how—and I think there's probably a trial plan that's going to be put in place, if that rings a bell. What is it you're trying to accomplish? And what are some of the consequences of that going to be to the current DFAS system—locations personnel, et cetera?

Senator UDALL. Mr. Secretary—Under Secretary Cohen, I just wanted to——

Senator COATS. I just got a note saying I'm at the wrong hearing.

Senator UDALL. Oh, okay.

Senator COATS. This is—I've got the right room number, but the wrong hearing.

Mr. COHEN. Well, that would explain why I didn't——

Senator COATS. I appreciate——

Mr. COHEN [continuing]. Know anything about this letter.

Senator COATS. Well, this is the first time this has ever happened to me, but I hope it's not a precursor of what may——

Senator UDALL. You're always welcome in our committee, and you——

Senator COATS. Well, thank you. I saw some familiar faces, and I thought this is where I should be.

Well, I'm going to let you off the hook on this one.

Mr. COHEN. Thank you, Senator.

Senator COATS. All right. I hope you're able to respond as quickly as the Under Secretary of the Army has been able to respond. I'll go to try to find out where I'm supposed to be.

Mr. COHEN. Okay.

Senator COATS. Thank you.

Senator UDALL. Thank you.

Senator Johanns.

OIL EXPORTS

Senator JOHANNS. Mr. Secretary, I think you can tell from the—maybe, the line of questioning on both sides of the aisle, that what we're searching for here is—we want to make sure that whatever we're doing here, from a policy and a funding standpoint, doesn't interfere with work that you're doing. I don't detect any dissatisfaction whatsoever, again, on either side of the aisle, with the work of you and your folks. And I just want to emphasize that.

But, the success of sanctions with Iran, I believe, has been built over a period of time. It was, "Try this." That wasn't working so well. "Try that." While, at the same time, your group was discovering, learning, trying various things that we were authorizing you to try, until finally we got Iran's attention, and all of a sudden there's discussions that they want to sit down and negotiate.

My worry—and, I think, the worry of many of us—is that, if we pull one string out of the sweater of sanctions, the sleeve comes off, and then all of a sudden you folks are sitting out there, saying, "My goodness, we had them where we needed to be, and this is falling apart." We don't want that to happen.

So, let me follow up, if I might, on a question that Senator Moran asked you about, the agreement with—or potential agreement with Russia, or discussions, whatever else is going on there. Isn't it true that, since the sanction agreement was reached with Iran, that their oil exports have, in fact, climbed and they are over the level that was permitted by that interim agreement?

Mr. COHEN. Senator, the interim agreement looks at oil sales over the course of the 6-month period. It's not a month-by-month——

Senator JOHANNS. Right.

Mr. COHEN [continuing]. Analysis. Our assessment—and I'd say "our," in the sense of the administration, because it's actually the State Department that tracks the oil sales——

Senator JOHANNS. Right.

Mr. COHEN [continuing]. Not the Treasury Department——

Senator JOHANNS. Right.

Mr. COHEN. But, I think the sense is that, over the course of this 6-month period of the Joint Plan of Action, we are comfortable that Iran will stay—or actually, more specifically, the purchasers will stay within the level that was agreed to in the Joint Plan of Action. There are fluctuations, month to month. I would encourage you to have the State Department's oil experts come and talk to you about this. But, I think the sense is that we're not alarmed by some of the reports that have been in the public press.

Senator JOHANNS. Yes. And I'm certainly not saying that the Joint Plan calls for a day-by-day assessment, and if you sold more one day, then you've got to sell less the next day and——

Mr. COHEN. Right.

Senator JOHANNS [continuing]. Square up the books or true up the books. But, what I am saying is, if you look at the period of time between now and when the Joint Plan started, it appears to me that they're on the wrong course.

Mr. COHEN. Yes. And, I don't mean not to answer your question directly, but I don't track the oil figures with that specificity. I know that my colleagues at the State Department are comfortable that, even if there has been some slight uptick, that it's nothing that is going to call into question the fundamental nature of the Joint Plan of Action.

IMPROVING NORTH KOREA SANCTIONS

Senator JOHANNS. Well, let me, if I might, just ask a question or two about North Korea. North Korea, I think, is a—just a source of concern for everybody, and a source of frustration, because—I'll just be honest with you, I think North Korea, from time to time, shakes the world down. They need resources, they need money, and all of a sudden we're off to the races. It's almost as predictable as Christmas arriving.

Are we missing something with North Korea? Is it time to do a more thorough assessment of the sanctions that are in place, and ask ourselves, Are these the right sanctions at this time? Are there additional approaches that we should be employing?

I guess what I'm asking is, Are we at a stage where Congress should be looking at a more comprehensive approach to what's transpiring, relative to sanctions, in North Korea?

Mr. COHEN. Well, what I can tell you is that we are constantly reevaluating what we have been doing with respect to North Korea. I was going to say "in every one of our programs," but I think it is especially true with respect to North Korea, because in answer to a prior question, I think it is—it is unavoidable, the conclusion that we have not deterred North Korea from the path that it's been on. And it's a very, very worrisome path.

So, I can tell you that this is a topic that is actively under consideration within the administration, how—not just through sanctions, but all of the ways that we have to project power and to address this issue, thinking about how to, frankly, change the course that North Korea is on, because, a denuclearized Korean Peninsula, particularly a denuclearized North Korea, is something that we are completely committed to achieving.

Senator JOHANNS. Final comment. I only have 30 seconds, here.

HUMAN RIGHTS ISSUES IN NORTH KOREA

The nuclear capability of North Korea in such an unstable regime is of concern to everybody. But, if one-tenth of the claims about human rights violations in North Korea turn out to be verifiable someday—and someday they will be verifiable—this is outrageous, it's shocking. I mean, it's appalling what this regime is doing to its people. And I just think, unless we figure out a better way forward with North Korea, this will visit upon humanity a tragedy that is nearly unspeakable, if one-tenth of it's true. It's just unbelievable.

Mr. COHEN. I agree. I have nothing other to say than that I agree with that.

Senator UDALL. Thank you, Senator Johanns.

I know that you have the—an appointment; you were trying to leave at 3:30.

Mr. COHEN. Yes.

Senator UDALL. We just have one more questioner here for 7 minutes. Would that be—is that going to be okay, or are we going to really——

Mr. COHEN. Absolutely.

Senator UDALL. Okay.

Now, Senator Moran.

Senator MORAN. Thank you, Mr. Secretary. And I only have one question.

Senator UDALL. Good.

Senator MORAN. Although my preface may be longer than the question.

APPROPRIATIONS FOR TFI

It's—something that's transpired here in our hearing, I think, is unique. It seems to be that many members of this committee, and some who joined us, have been interested in providing more money to you. I think the message has been, we want to make certain that you have the necessary resources to accomplish your mission. That is—and then you had the chairperson of our full committee describe the tutorial that we were receiving today, and then your testimony—there's a sentence in there that I wanted to highlight. When you talk about resources, "We've been able to increase our sanction programs and other output by generating program efficiencies"—no one would say that anything but good comes from efficiency—"effective management"—we're all for that—"and"—this is the part that I wanted to highlight—"and transferring funds, when needed, among organizations and programs within TFI." And what the tutorial that I received today included was a reminder that, when we appropriate money, we're appropriating money broader—more broadly than just your office.

Mr. COHEN. Right.

Senator MORAN. That money goes to departmental offices. And while the President's request for Terrorism and Financial Intelligence is $105.9 million, that's really of a—that's a portion of a larger amount of money that would be appropriated that's about $309 million to departmental offices.

Mr. COHEN. Right.

Senator MORAN. The transfer—so, first of all, I would suggest to my colleagues who are interested in providing more money, to make certain that you accomplish your mission, we ought to be very interested in making certain that that money goes to you, to your office, to accomplish those goals.

And then, second, the—your testimony about transferring funds. I was interested in knowing, or being assured, that the transfer works to you, not that you're transferring money out of your office to any of the other departmental offices. Is that true?

Mr. COHEN. Senator, the transfer is within my deputate, as it were. So, in——

Senator MORAN. Within TFI.

Mr. COHEN. Within the Office of Terrorism and Financial Intelligence (TFI), from Terrorist Financing and Financial Crimes (TFFC) to the Office of Foreign Assets Control (OFAC) or to the Office of Intelligence and Analysis (OIA), that's where we're able to shift——

Senator MORAN. So, not transfers from—the departmental offices that make up this broad allocation of money are Executive Direction, your office, Tax Policy, Domestic Finance, Economic Policy, International Affairs, Treasurywide Management.

Mr. COHEN. Right.

Senator MORAN. And so, my question is, Do you ever transfer money from TFI to any of those other offices within the departmental offices?

Mr. COHEN. So, my understanding is that the—although the funds are appropriated to departmental offices, which includes TFI, there is a presumptive amount that is for TFI, and those are my funds. Those are my funds to use, and they do not get transferred away. The other——

Senator MORAN. So, the Treasury Secretary doesn't come to you and say, "Secretary Cohen, we need more money in Tax Policy. Can you—we need to transfer money from TFI to Tax Policy." That doesn't happen.

Mr. COHEN. Right.

Senator MORAN. Okay.

Mr. COHEN. Right.

Senator MORAN. Am I missing—is there——

Mr. COHEN. No. No, I was just going to say, I think all those other offices at Treasury do important work, as well. But, the funds that are earmarked for TFI are TFI's funds.

Senator MORAN. Well, I—you—while they may do important work, it is pretty unusual for a number of my colleagues here to be trying to offer more money than you're requesting. And I think, in this tutorial that we're having today, it's useful, at least for me and perhaps others, to understand that this money is not—I don't—sacrosanct within those departmental offices.

Mr. COHEN. Right.

Senator MORAN. It's a broader allocation than just you—your office.

Mr. COHEN. It's a broader allocation, but the funds that are—I mean, "earmarked" is probably not the correct term, but the funds that are——

Senator MORAN. It's a word I would not use.

Mr. COHEN. Yes, I'm sorry. I should—I want to revise and extend my remarks on that.

The funds that are identified as going to TFI are funds that are for TFI's use.

Senator MORAN. Okay. Thank you, Mr. Secretary.

Mr. COHEN. Thank you.

Senator MORAN. Thank you, Mr. Chairman.

Senator UDALL. Thank you. And thank you for closing a little early, here, and we'll get him on the road.

Let me thank everybody who participated in this hearing. Appreciate hearing from you, Under Secretary Cohen, as the top official of TFI, about resource needs and the sanctions program.

ADDITIONAL COMMITTEE QUESTIONS

Today's discussion, I think, has provided helpful insights into TFI's operations and challenges. This information will be instructive as Congress moves forward with our work on fiscal year 2015 funding.

The hearing record will remain open until next Wednesday, April 9th, at 5 p.m., for subcommittee members to submit statements and/or questions to be submitted to the witnesses for the record.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO HON. DAVID S. COHEN

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

NORTH KOREA

Question. Sanctions against North Korea have not been successful at preventing proliferation and other activities that threaten our national security. What could Treasury do to make sanctions more impactful under the current sanctions regime? What tools or elements are missing to make sanctions more effective?

Answer. Sanctions are an important part of our overall North Korea policy and the broad and ongoing international effort to achieve the denuclearization of the Korean Peninsula. U.S. and international sanctions are intended to raise the cost to North Korea of continuing to pursue its nuclear, ballistic missile, and other prohibited programs, and to restrict its financing of these programs and it proliferation activities, and we have seen some successes.

To more effectively address the threat posed by North Korea, it is essential to secure the commitment of other countries to take action to prevent funds being redirected to North Korea's illicit programs and proliferation activities. This is particularly true of China, North Korea's largest trading partner. The United States has urged China to escalate pressure on North Korea, including through the effective enforcement of United Nations (U.N.) sanctions against North Korean proliferation activities, and Treasury will continue to engage China and other countries in the region to restrict North Korea's ability to finance its illicit nuclear, ballistic missile, and proliferation programs.

IRAN

Question. The Government Accountability Office (GAO) and other entities have opined that the use of economic sanctions against Iran since 2010 have successfully disrupted the Iranian economy. Why have sanctions against this nation been more successful than other sanctions regimes? What in particular has made these sanctions so impactful? What lessons has the Treasury Department learned from the success of sanctions against Iran that could be applied more generally to other sanctions programs?

Answer. The Treasury Department coordinates and implements approximately two dozen distinct financial sanctions programs, including jurisdiction-specific and conduct-based programs. In each instance where sanctions have been applied, they have been one tool among many deployed. Current sanctions programs are diverse and tailored to meet particular national security and foreign policy circumstances and the goals and mechanics of how sanctions affect specific targets may differ in each instance.

The United States, working with its international partners, has imposed the world's most comprehensive and far reaching set of sanctions on Iran. This robust and coordinated multilateral effort has been critical to creating leverage for diplomacy. Sanctions have slashed and curtailed Iran's access to its oil revenues, isolated it from the international financial system, and led to economic contraction. U.S. sanctions on Iranian financial institutions, coupled with our broad outreach campaign to warn the international financial community of the risks associated with doing business with Iran, contributed to a sustained downturn in Iranian economic activity.

Treasury has learned many lessons from our Iran sanctions, including the power of coordinated action and the importance of tailoring sanctions to best pressure and exploit a target's financial vulnerabilities. These lessons are readily applied across the sanctions programs we implement.

DIPLOMACY

Question. The Treasury Department and State Department have complementary roles in sanctions policy. Please explain how the departments work together and with other Federal entities to develop and implement sanctions. What are the roles and responsibilities of each entity? How do the departments coordinate with each other? How can these intergovernmental relationships be improved? How is the effectiveness of economic sanctions improved by diplomatic efforts?

Answer. The Treasury and State Departments are close partners in the administration's development and implementation of sanctions. At the most senior levels and throughout our agencies, Treasury and State regularly confer on sanctions strategy, policy, and enforcement, and frequently undertake joint actions employing our respective authorities.

Treasury and State also work closely with other relevant agencies. On April 29, 2014, for example, the Departments of Treasury, State, Commerce, and Justice undertook joint action against the network of serial proliferator Karl Lee. Since 2005, Lee and firms with which he has been associated have been subject to nonproliferation sanctions pursuant to a variety of U.S. authorities. In this recent set of actions, Treasury designated eight of Lee's companies; Commerce added nine entities (eight companies and one Chinese national) to its Entity List, a compilation of foreign persons determined to have acted contrary to the U.S.'s national security or foreign policy interests and who are subject to special export licensing requirements; Justice unsealed an indictment of Lee; and State offered a $5 million reward for information leading to his arrest or conviction.

As you observe, State and Treasury authorities are complementary, and vary across our complex array of sanctions regimes. While there naturally exists some overlap because of the broad and flexible nature of our sanctions, Treasury focuses extensively, though by no means exclusively, on the financial sector, while also targeting agents, material supporters, and facilitators of terrorism, proliferation, human rights abuses, and other illicit conduct. State identifies and targets individuals and entities for primary designation as Specially Designated Global Terrorists and as Foreign Terrorist Organizations; identifies and sanctions individuals and entities engaged in proliferation; works extensively on U.N. sanctions; and focuses more on underlying commercial activity and human rights violations and abuses of foreign persons and entities.

Both Treasury and State actively engage in diplomatic outreach as an integral part of our sanctions efforts. Officials from both departments regularly meet with foreign counterparts and businesses to explain our sanctions programs, to demarche them on activities of concern, and to coordinate joint action. Such activity is quieter than undertaking public designations, but can be equally if not sometimes more effective in deterring and disrupting sanctionable conduct.

State and Treasury—along with the rest of the administration—will continue our joint efforts and close cooperation to advance U.S. national security and foreign policy objectives.

RUSSIA

Question. As events in Ukraine continue to unfold, please explain Treasury's ongoing workload requirements. What resources are being utilized to implement sanctions against Russia? What additional resources, if any, are needed?

Answer. To craft sanctions against Russia, we have relied upon experts from throughout the Office of Terrorism and Financial Intelligence (TFI) and Treasury's departmental offices. Despite the recent growth in our sanctions programs, the $102 million provided for TFI in the fiscal year 2014 departmental offices appropriation is sufficient to allow us to accomplish our mission, as is the President's budget request of fiscal year 2015. We have been able to increase our sanctions programs and other output by generating program efficiencies, effective management, and the reallocation of internal TFI resources to address new and emerging trends and issues.

VENEZUELA

Question. There have been calls to sanction Venezuelan officials as a result of violence linked to the protests and reactions by the Maduro government. Does the Treasury Department believe that sanctions would be helpful or harmful with regards to finding a political solution? Is it possible that sanctions in this case could be counterproductive?

Answer. As we have seen in certain contexts, targeted financial measures, including sanctions, can be an effective tool when used in concert with diplomatic efforts to advance specific U.S. foreign policy goals. The administration is currently studying a range of options to respond to the violence linked to the protests in Venezuela. We defer to our colleagues at the State Department on the U.S. Government's overall approach to the current political situation in Venezuela.

QUESTIONS SUBMITTED BY SENATOR MARK KIRK

CENTRAL BANK OF IRAN

Question. On November 21, 2011, the Treasury Department identified the Islamic Republic of Iran as a jurisdiction of primary money laundering concern under section 311 of the USA PATRIOT Act. In that finding, you wrote that the Central Bank of Iran (CBI) played a central role in facilitating Iran's illicit conduct, including its support for terrorism. Based in part on that finding, on December 1, 2011, the Senate voted 100–0 in favor of a bipartisan amendment to the fiscal year 2012 National Defense Authorization Act (NDAA) to impose sanctions on the Central Bank of Iran. There is no doubt that sanctions against the CBI remain the most powerful point of pressure on the regime—and it's something Iran wants suspended more than anything.

Putting aside the nuclear program—given Iran's continued support for terrorism and its involvement in a range of illicit activities—by definition, does the Central Bank of Iran continue to be a primary money laundering concern?

So regardless of what happens on the nuclear front, if the Central Bank continues to play a role in terrorism and illicit activities, can we have your assurance that the administration will continue to fully enforce the CBI sanctions until Iran has ceased all such activities?

Answer. The section 311 finding under the USA PATRIOT Act of Iran as a jurisdiction of primary money laundering concern was, and continues to be, based on a range of illicit conduct that Iranian financial institutions, including the CBI, were found to have engaged in. This activity included Iranian financial institutions' support for terrorism and facilitation of Iran's pursuit of nuclear and ballistic missile capabilities.

Treasury is aggressive in our enforcement of TFI authorities and continuously evaluates and assesses the role of any Iranian financial institution, including the CBI, in illicit conduct and will not hesitate to enforce existing sanctions or take action in appropriate circumstances now and in the future.

IRAN HUMAN RIGHTS

Question. Despite President Hassan Rouhani's rhetoric after his election in June 2013, there has been no concrete improvement regarding rights and freedoms in Iran. In fact, in his latest report to the United Nations Human Rights Council on the situation of human rights in the Islamic Republic of Iran, released in March 2014, UN Secretary-General Ban Ki-Moon stated that "[t]he new administration has not made any significant improvement in the promotion and protection of freedom of expression and opinion, despite pledges made by the President during his cam-

paign and after his swearing-in," and that "[t]here have been no improvements in the situation of religious and ethnic minorities, who continue to suffer severe restrictions in the enjoyment of their civil, political, economic, social and cultural rights." Yet since May 2013, the administration has not designated any Iranian officials or entities as human rights abusers.

In a July 2012 letter to me, the Department of State pledged that "[t]he Departments of State and Treasury will continue to work together to implement both the Comprehensive Iran Sanctions and Divestment Act of 2010 and Executive Order 13553." Since June 2013, what has the Department of Treasury done to implement section 105 of the Comprehensive Iran Sanctions and Divestment Act (CISADA), Executive Order 13553 and Executive Order 13606?

Answer. The U.S. Government is armed with a variety of authorities that authorize Treasury to target the Iranian Government's human rights abuses and censorship activities. Taken together, these authorities provide Treasury with the flexibility to pursue human rights abuses vigorously. Most recently, on May 23, 2014, the Department designated Morteza Tamaddon, an Iranian Government official, under Executive Order 13628 for his censorship-related activities. To date, Treasury has designated 19 Iranian individuals and 17 Iranian entities for human rights abuses and censorship under various authorities, including CISADA, and Executive Orders 13553, 13628, and 13606. Treasury continuously evaluates potential targets for designation for human rights abuses and will not hesitate to take action in appropriate circumstances.

TURKEY

Question. On December 17, 2013, businessman Reza Zarrab was arrested as part of a wide ranging corruption investigation in Turkey. Four Turkish ministers resigned, allegedly as a result of the revelations relating to their connections to Zarrab. Despite the evidence against him, Zarrab was released in February 2014.

As you know, according to reports, Zarrab played an integral role as part of Turkey's "gas-for-gold" scheme, where he transported gold as payment by Turkey for Iranian gas, valued at upwards of $28 billion. Moreover, reports in Turkey have linked Zarrab to Yasin Al Qadi, the Saudi Arabian businessman with ties to Al Qaeda, the Turkish Humanitarian Relief Foundation (IHH) which organized Mavi Marmara, and Mansour Arbabsiar, who was sentenced in May 2013 for participating in a plot to murder the Saudi Arabian Ambassador to the United States, and possibly of being a member of the Iranian al-Quds Force.

Has Zarrab been considered for designation as part of the Treasury's Special Designated Nationals List (SDN)?

Has the Turkish Government shared with you or any other U.S. Government agency the evidence that allegedly ties Reza Zarrab to terrorism finance?

Has the U.S. Government asked—and if so, has the Turkish Government agreed—to provide access to Mr. Zarrab?

Is the Treasury Department coordinating with European allies or other authorities to investigate any corruption tied to Turkey and concerns relating to Turkey serving as a conduit for terrorist funding?

Answer. We are aware of the media reports you cite. The Treasury Department does not comment on potential designations and ongoing investigations. However, we regularly coordinate with our international partners, including Turkey and our other European allies, with respect to Iran sanctions and terrorism finance. We will not hesitate to take action in appropriate circumstances and continue to actively target sanctions evasion.

CYBER CRIME

Question. Recent high profile data breaches in the United States have demonstrated that cyber crimes have a massive impact on individual American consumers and the broader economy, and even threaten national security. These cyber crimes are transnational crimes, and the world's leading nations must work together to protect their citizens through international coordination. We have a joint responsibility to ensure that specific foreign countries do not become safe havens for cyber criminals.

What is your office currently doing to identify these transnational threats, and what coordination is occurring with your international counterparts, particularly in geographical areas where these cyber criminals are known to exist, such as Ukraine?

Answer. TFI targets cyber threats that could impact the U.S. financial sector or pose a threat to national security. These threats may include financial fraud, money laundering, terrorist financing, and attacks on critical infrastructure. TFI has spe-

cific tools it has used to combat cyber threats, including section 311 of the USA PATRIOT Act and civil enforcement actions. TFI will continue to use its authorities as appropriate.

TFI directs financial institutions to report suspicious activity related to cyber crime to support law enforcement identification of cyber threats and our efforts to identify significant cyber criminals and suspect financial institutions. In addition, TFI works with intelligence and law enforcement partners to identify cyber threats and provide analysis of the threat environment. TFI also engages with international partners to gather information and support operational and strategic analyses of cyber threats.

SUBCOMMITTEE RECESS

Senator UDALL. The subcommittee hearing is hereby adjourned.

[Whereupon, at 3:35 p.m., Wednesday, April 2, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2015

WEDNESDAY, APRIL 30, 2014

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Tom Udall (chairman) presiding.

Present: Senators Udall, Coons, Johanns, and Moran.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF HON. JACOB LEW, SECRETARY

OPENING STATEMENT OF SENATOR TOM UDALL

Senator UDALL. Good afternoon. The subcommittee will come to order. I am pleased to convene this hearing of the Financial Services and General Government Subcommittee to consider the fiscal year 2015 funding needs of the Department of the Treasury and the Internal Revenue Service. I welcome my distinguished ranking member, Senator Mike Johanns, and other colleagues who I think will be joining us as we go on today.

And let me go to my opening statement here. Okay. Senator Johanns, good to have you here.

Senator JOHANNS. Thank you.

Senator UDALL. Always a pleasure to work with you. And with us today are three distinguished witnesses to present testimony about the resource needs of the Treasury and the IRS. I welcome Secretary Jacob Lew, the Internal Revenue Service Commissioner, John Koskinen, and Treasury Inspector General for Tax Administration, J. Russell George. Thank you for your service, and thank you for accepting your leadership posts in these challenging times.

I welcome the opportunity today to conduct critical oversight of the Treasury Department and its programs and to have a candid discussion of where the Department is today, where it needs to be, and how we can make sure it has the necessary resources to fulfill its important and wide-ranging responsibilities.

PREPARED STATEMENTS

Congress probably exercises its most effective oversight of agencies and programs through the appropriations process. It allows an annual checkup and review of operations and spending. The IRS also has a cadre of important watchdogs to monitor and evaluate its operations and to complement congressional oversight. These include the National Taxpayer Advocate, the IRS Oversight Board, the U.S. Government Accountability Office, and the National Treasury Employees Union. I appreciate their efforts to help critique, promote, and improve the work of the IRS. I invited the top officials of each of these organizations to submit written materials to support the subcommittee's work and to augment the record of these proceedings today, and I would ask unanimous consent that the statements and materials received by the subcommittee from these organizations be made a part of the hearing record. And, no objection, so ordered.

[The statements follow:]

PREPARED STATEMENT OF SENATOR TOM UDALL

Good afternoon. I am pleased to convene this hearing to consider the fiscal year 2015 funding request of the Department of the Treasury and the Internal Revenue Service (IRS). I am joined by my distinguished ranking member, Senator Mike Johanns, and other members of the subcommittee.

With us today are three distinguished witnesses to present testimony about the resource needs of the Department of the Treasury and the Internal Revenue Service. I welcome the Secretary of the Treasury, Jacob Lew, the Internal Revenue Service Commissioner, John Koskinen, and the Treasury Inspector General for Tax Administration, J. Russell George. Thank you for your service and for accepting your key leadership posts in these challenging times.

I welcome the opportunity today to conduct critical oversight of the Treasury Department and its programs, and to have a candid discussion of where the Department is today, where it needs to be, and how we can make sure that it has the necessary resources to fulfill its important and wide-ranging responsibilities.

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TREASURY REQUEST

Most of the $13.8 billion dollars gross funding request for the Treasury Department is for the IRS. The President's budget requests $1.3 billion dollars to fund the other bureaus and offices of the Department, a decrease of $22 million dollars, or about 2 percent less than fiscal year 2014. These bureaus and offices cover a wide variety of activities for the Department, from implementing financial sanctions against our enemies to forecasting economic indicators, and managing the Federal Government's books.

I was pleased to see that the President's budget included robust funding for the Community Development Financial Institutions (CDFI) fund. The budget also proposes to increase the CDFI bond guarantee program to $1 billion dollars, to expand access to capital for community development organizations across the country at no cost to taxpayers. However, the request also includes worrisome cuts for several critical bureaus including the Alcohol and Tobacco, Tax and Trade bureau, which protects consumers, prevents smuggling, and collects revenue to reduce the deficit. I

look forward to hearing from you about why Treasury is requesting cuts for this important bureau.

IRS REQUEST

The Internal Revenue Service administers the tax laws and collects the revenues for funding over 95 percent of Federal Government operations and public services. The IRS has nearly 90,000 employees. Each year, they make hundreds of millions of contacts with American taxpayers and businesses. The IRS is the face of Government to more U.S. citizens than any other agency.

For fiscal year 2015, the President's budget requests $11.997 billion dollars in base appropriated funding for the IRS. This is an increase of $706 million dollars, or a 6 percent boost above the fiscal year 2014 enacted level of $11.291 billion dollars. Another $480 million dollars is sought through a program integrity budget cap adjustment, raising the appropriations request to $12.477 billion dollars.

The fiscal year 2015 funding forecast is not encouraging. Budgetary constraints remain in place. This subcommittee faces challenging funding decisions balancing many competing demands for the ensuing fiscal year. It will be helpful to hear Secretary Lew and Commissioner Koskinen's frank appraisals of the minimum resource needs to ensure that the Treasury Department can fulfill its stewardship responsibilities for U.S. economic and financial systems. Moreover, we will be carefully assessing what resources are required to deliver top quality service to taxpayers, and enforce the law with integrity and fairness to all.

I look forward to hearing more about the particular challenges the Department and the IRS face, the consequences of funding shortfalls, and how this subcommittee can be helpful in supporting the Department's vital mission.

PREPARED STATEMENT OF THE INTERNAL REVENUE SERVICE OVERSIGHT BOARD

INTRODUCTION AND EXECUTIVE SUMMARY

Chairman Udall and Ranking Member Johanns, the IRS Oversight Board thanks the subcommittee for this opportunity to present its views and recommendations on the President's fiscal year 2015 budget request for the Internal Revenue Service (IRS).

First, the Board would like to make some broad observations regarding the context in which the current budget debate is taking place and the possible ramifications for the IRS, taxpayers and our Nation.

Last summer's controversy regarding the IRS' use of inappropriate criteria to review certain organizations applying for tax exempt status and the agency paying for large conferences and questionable training videos with taxpayer dollars still cast a long shadow over the IRS' budget.

The IRS was one of only a few Government agencies that did not have its funding restored to pre-sequestration levels under the *Consolidated Appropriations Act of 2014*. In fact, the IRS' fiscal year 2013 post-sequestration funding level was the lowest since fiscal year 2009. For fiscal year 2014, the IRS received approximately $11.3 billion—approximately $1.6 billion less than the President's budget request and $1.8 billion less than the Board's recommendation. The Board believes that this budgetary path is unsustainable.

The Oversight Board hoped the management controls and risk management tools put in place last year by then Acting Commissioner Werfel, coupled with the proven leadership skills of newly appointed Commissioner John Koskinen would dispel any lingering concerns about the IRS' ability to effectively manage taxpayer-provided resources and fairly administer Federal tax laws. Often lost in the discussion is the fact that the IRS accepted and implemented every recommendation contained in the Treasury Inspector General for Tax Administration's reports on the aforementioned incidents and then took additional steps to institute even more safeguards than proposed by TIGTA.

However, in spite of these corrective actions, there are still those who want to punish the IRS and believe the best way to do so is to slash its budget. Last year, the House Appropriations Subcommittee on Financial Services and General Government voted for a drastic 24 percent cut in the IRS' budget. Although largely symbolic, it was indicative of a sentiment that has carried over into 2014 and the fiscal year 2015 budget cycle.

The Board believes we need to have a rational and nonpartisan dialogue about the IRS' budget and the effects—good or bad—appropriated funding levels could have on customer service, enforcement, Business Systems Modernization and

human capital. In spite of the often heated rhetoric, we should not shy away from the simple fact that there is a choice about the future of tax administration at the IRS.

The Oversight Board has long contended that attempting to punish the IRS by cutting its budget only punishes honest taxpayers who play by the rules and expect their neighbors and business competitors to do the same.

These taxpayers—and their return preparers—expect the IRS to answer their questions about an ever-changing and complex tax code and resolve their individual tax issues; process their returns efficiently; and promptly issue a refund if they are legally due one.

They also expect the IRS to vigorously and fairly enforce the tax laws—whether it's a tax cheat claiming illegal deductions or refunds, an identity thief engaged in refund fraud, or taxpayers not disclosing money and assets hidden in tax havens.

Taxpayers also expect a variety of customer service channels and Web-based tools tailored to their needs. And increasingly, they want to be able to communicate and conduct transactions with the IRS electronically—much as they already do with other large financial institutions and commercial enterprises.

This begs the question, "How can the IRS meet these basic taxpayer expectations without adequate funding?" The inescapable conclusion is, "The IRS can't."

We are already witnessing an alarming erosion in both customer service and enforcement that shows no signs of abating. Although the 2014 filing season proceeded smoothly, projections show that telephone level of service on the IRS toll-free lines will fall to 60.5 percent by the end of 2014—exactly the same level as last year. In other words, 4 out of 10 taxpayers will be unable to reach an IRS assistor. Average telephone wait times are expected to more than double, according to current IRS estimates.

IRS customer service problems are not limited to phone service. Long lines greeted taxpayers at IRS walk-in centers this filing season. Commissioner Koskinen testified before the House Appropriations Subcommittee on Financial Services and General Government that people were lining up outside the Taxpayer Assistance Centers (TACs) before they opened in the morning to make sure they got service the same day, and once inside, may have had to wait 90 minutes or more for help from an IRS representative.

Tax compliance is also suffering due to the budget cuts and sequestration. The individual audit coverage has now dropped to below 0.9 percent—the lowest in a decade. Business return audits have plummeted by 13 percent. Audit revenues are at their lowest point in a decade. Core enforcement activities, such as liens, levies and seizures are also on the decline. Additionally, although progress has been made, tax-related identity theft and tax refund fraud are still major challenges for the IRS.

The effects of budget cuts go beyond the IRS workforce—the agency's biggest expense. After a successful launch of the initial phase of the Customer Account Data Engine (CADE) 2, the IRS' Information Technology (IT) Program is threatened yet again with insufficient funding to address pressing infrastructure needs.

Meanwhile, the IRS is legally bound to implement the tax-related portions of two major pieces of legislation—the *Foreign Account Tax Compliance Act* (FATCA) and the *Affordable Care Act* (ACA). Due to budget cuts, these duties have become unfunded mandates. Commissioner Koskinen warned that to meet these statutory responsibilities with a flat or reduced budget, he will have no choice but to pull people from both IRS customer service and enforcement functions with serious repercussions in both areas. Congress must realize that robbing Peter to pay Paul is not a viable solution to the IRS' budget problems.

Again, the Board believes we have a choice: stay mired in the past or make the fiscal year 2015 budget debate about the future of the IRS, taxpayers and the integrity of our tax administration system. In this regard, we believe that it is time to invest in the IRS and our country's future. With taxpayer service suffering and appropriate risk management tools in place, it makes little sense to underfund the IRS. This is the time to restore funding so the IRS can improve service, increase enforcement, and continue to modernize its systems and processes.

To this end, in July 2013, the IRS Oversight Board recommended to the Secretary of the Treasury a fiscal year 2015 budget request of $13.590 billion for the IRS. The *IRS Restructuring and Reform Act of 1998* (RRA 98) requires the Board to make such an annual budget submission. Although $1.14 billion higher than the President's budget request of $12.477 billion due to different baselines as starting points, the Board supports the administration's IRS fiscal year 2015 budget request.

The Board believes that the President's recommended funding is sufficient for the IRS to carry out both its dual mission and new statutory responsibilities. It makes targeted and wise investments in many of the same areas suggested by the Over-

sight Board, such as improving telephone level of service and improving audit coverage.

Finally, the Oversight Board notes that enforcement initiatives are paid through a $475 million program integrity cap adjustment with more than a $4-to-$1 return on investment when enforcement initiatives, such as new hires of revenue officers, are fully realized.

The Board is concerned over the recent track record of such adjustments. Although some discretionary cap adjustments were approved during then IRS Commissioner Everson's tenure, none have been passed over the past 4 years. Cap or no cap adjustment, the IRS simply needs additional funding to conduct more enforcement activities which help to deter non-compliance and close the tax gap, while generating much needed revenue for our country.

THE PRESIDENT'S BUDGET REQUEST

Upon taking office, Commissioner Koskinen said adequate funding for the IRS was probably the most "intractable" and "difficult" issue he would face during his tenure. That is no overstatement, in the Board's view. The IRS is now operating with a budget at close to pre-sequestration levels; the lowest since fiscal year 2009, and when indexed against the rate of inflation, the lowest in history. As the agency notes, its budget has been cut by 7 percent since 2010 while the total number of individual and business tax filers has grown by 4 percent over the same time span.

The IRS has done its best to deal with the underfunding by wringing out as many efficiencies and cost savings as possible. These include employee buy-outs, an exception-only hiring freeze, consolidation of office space, all but case-related travel bans, and steep cuts in training. But this budget strategy is not sustainable. The IRS is now left with no other choice but to make cuts to core programs.

The President's budget seeks to reverse this trend by restoring some of the funding lost over the past 3 years and putting the IRS back on a path of sustained and reliable funding. This is a reasonable and honest budget with a suite of smart, forward-thinking initiatives that address head on areas of concern that the Board has pointed out in customer service, enforcement, IT and human capital. The budget request also supports and is aligned with the IRS Strategic Plan and Treasury Department Priority Goals.

CUSTOMER SERVICE

Customer service is both a great opportunity and challenge for the IRS. Helping taxpayers navigate an increasingly complex and changing tax code and answering tax law and account questions is a major component of the IRS' balanced mission; and taxpayers use and value this service.

The Oversight Board's 2013 Annual *Taxpayer Attitude Survey* showed that 84 percent of respondents said they are likely to call the IRS toll-free telephone line for assistance; 83 percent said they are likely to visit IRS.gov for help; and 74 percent said they are likely to visit an IRS walk-in site (TAC) for help. Moreover, 89 percent of respondents said the tax advice and information provided by an IRS representative was "very or somewhat valuable." This is equal to paid tax professionals. Such an accolade is a great tribute to the dedication, determination and professionalism of the IRS workforce.

In addition to providing traditional customer service channels, the IRS is trying to migrate taxpayers to Web-based, self-serve tools, such as "Where's My Refund?" And in recognition of a diverse and evolving taxpayer base that may not be getting its tax information from traditional media sources, the IRS has been employing social media, such as YouTube and Twitter to push out important service and compliance messages. The IRS also offers a smartphone app, IRS2Go, where users can receive tax news updates and check the status of their refunds.

Although it is difficult to assign a dollar value for customer service return-on-investment, we do know that if taxpayers get their returns right from the start, both the IRS and taxpayers can avoid costly back-end audits. For example, eligibility for tax credits can be extremely confusing and frustrating for taxpayers. Speaking to an IRS representative before claiming a credit could prevent an audit for the taxpayer and potentially costly back taxes, interest and penalties down the road. However, while the overall IRS customer service program is comprised of several components, the funding level for IRS taxpayer assistance, education and outreach decreased by nearly 34 percent from fiscal year 2012 to fiscal year 2013.

Commissioner Koskinen has also testified that the IRS had 11,000 fewer employees working during the 2014 filing season than it had in 2010, while at the same time processing a record number of returns.

The end results of these, and other factors were unacceptable telephone levels of service (LOS), and long lines and wait times at IRS walk-in centers. The projected 60.5 telephone LOS falls far short of the 80 percent the Board believes is the minimum toll-free LOS that taxpayers deserve to help them meet their tax responsibilities.

The IRS is also facing increased backlogs in its written taxpayer correspondence inventory. This is particularly worrisome since the IRS conducts about 75 percent of all examinations by mail, and sends out millions of additional notices each year to taxpayers.

The IRS faces other customer service challenges that may come as a surprise to many. For example, while the number of visits to IRS.gov continued to increase in fiscal year 2013 to more than 456 million Web page visits, customer satisfaction with the Web site has actually declined.

According to the American Customer Satisfaction Index (ACSI), the score for IRS.gov has steadily ebbed, from 73 in 2011 to 69 in 2013. IRS.gov also received lower scores than those of other Federal Web sites overall and those of Internet-based retail and brokerage companies; another downward trend suggesting the IRS is not keeping pace with online advances achieved by the Federal Government and the private sector.

The Board also heard from the annual *Taxpayer Attitude Survey* and its listening sessions at the IRS Nationwide Tax Forums that taxpayers, employees and practitioners are frustrated they can't communicate and conduct more transactions electronically with the IRS.

Given these factors, the Board believes it is critical to fund the IRS so it can deliver a higher level of service to taxpayers who need its assistance in complying with an increasingly complex tax code. Underfunding this critical function endangers not only the IRS' mission, but could ultimately imperil voluntary compliance.

The Oversight Board believes that the President's budget will help provide the resources to bring IRS customer service back to a level where it can meet taxpayer needs and expectations both today and in an ever changing and challenging tax environment.

The President's budget request would provide a total of $211 million for customer service, including resources from the new *Opportunity, Growth and Security Initiative*. This will allow the IRS not only to make up for the lost ground in customer service but will allow the IRS to answer an additional 12 million phone calls from taxpayers seeking answers to their tax law and account questions. This includes a projected high number of calls from taxpayers related to implementation of the *Affordable Care Act*. Overall telephone level of service could rise from today's unacceptable 60.5 percent to exceeding the aforementioned 80 percent goal set by the Board.

The request also includes investments in advanced technology and communications infrastructure at IRS toll-free telephone centers. One welcomed initiative would give taxpayers the option to be called back rather than waiting on hold. Another, dealing with high-speed Internet connection would allow customer service representatives to call up immediately displays of taxpayer information, much as a bank or brokerage house could do.

ENFORCEMENT

To achieve its balanced mission and help ensure overall compliance across taxpayer groups and income brackets, the IRS must run a fair yet vigorous enforcement program. According to the Board's 2013 *Taxpayer Attitude Survey*, approximately 96 percent of respondents cite personal integrity as the main reason for honestly reporting and paying what they legally owe. However, 60 percent also cited the fear of an audit as a reason behind their compliance.

Our tax system is based on self-assessment, also known as voluntary compliance. It depends largely on honest taxpayers believing their neighbors and business competitors are playing by the rules and not trying to game the system. The integrity of our tax administration system would be seriously threatened if compliant taxpayers thought tax cheats were getting away with their crimes.

That is why it is so important to maintain reasonable audit coverage for all taxpayer income classes and to create initiatives, such as the Offshore Voluntary Disclosure Program (OVDP), which act as strong incentives for bringing taxpayers into full compliance with Internal Revenue laws.

Moreover, although the overwhelming majority of gross revenue collected by the IRS comes in voluntarily—through withholding and estimated tax payments, for example—it is important that we do not discount the importance of enforcement revenue. It can help reduce budget deficits and narrow the tax gap.

Enforcement revenue totaled $53.3 billion in fiscal year 2013, and since its inception in 2009, OVDP has brought in $6.5 billion in back taxes, penalties and interest. It also bears noting that there is a high return of investment for enforcement activities. Every dollar invested in IRS enforcement returns four dollars and as much as six dollars and higher for some initiatives. Every dollar not provided for enforcement initiatives means tax evasion grows, refund fraud persists, and the tax gap widens.

However, IRS enforcement has taken some heavy budget blows over the past 3 years. By the end of 2013, the number of revenue officers was the lowest in at least 10 years; the number of revenue agents was the lowest in 9 years. Overall, there has been a 14 percent decline in key enforcement personnel since 2010.

While audits of individuals topped one million for the 7th year in a row, that figure can be misleading. The overall coverage rate fell below 1 percent for the first time since fiscal year 2006. And the audit coverage rate for taxpayers in the highest income bracket—$1 million and higher—showed a steady 13 percent decline since 2011. Tax refund fraud, particularly as it relates to identity theft remains a major challenge for the IRS and the honest taxpayers who have been victimized. In 2013, the IRS identified over 3.5 million identity theft "incidents" as compared 247,000 in 2011.

The President's fiscal year 2015 budget request contains a suite of proposed enforcement initiatives that aggressively address many of these challenges. The initiatives are expected to generate almost $2.1 billion in additional enforcement revenue annually once the new hires reach their full potential in fiscal year 2017. Some of the more prominent programs include:

—*Address International and Offshore Compliance*.—This initiative would help the IRS to ramp up its efforts to identity U.S. taxpayers not disclosing money and assets in bank secrecy jurisdictions. In addition to increasing criminal investigations of international and financial crimes, the additional funding will allow the IRS to expand data and information gathering that will help the agency root out the promoters of these abusive tax avoidance schemes.

—*Expand Audit Coverage of Individuals*.—Audit coverage for individuals now hovers below 1 percent for the first time since fiscal year 2006. The funding would help reverse the drain of key enforcement personnel, including revenue agents, and allow the IRS to perform an estimated 243,000 additional individual examination cases, including correspondence audits. It would also allow for greater document matching to uncover unreported or misreported income.

—*Expand Audit Coverage of High-Wealth Taxpayers and Enterprises*.—Many of these global high net-worth taxpayers are not your typical filers. Some use a web of highly sophisticated and complex financial and cross border tax arrangements. Many of these arrangements are perfectly legal; others hide abusive tax avoidance schemes. The IRS projects that the additional funding will allow it to close an additional 325 of these cases.

—*Prevent Tax-Related Identity Theft and Refund Fraud*.—The additional funding will help the IRS address the increased workload associated with ID theft and tax refund fraud and bring down the ID theft case backlog. The IRS will be able to better assist victims while protecting the revenue through investing in new technology that will help verify potentially fraudulent returns and reduce erroneous payments.

—*Improve Audit Coverage of Partnerships and Flow-Through Entities*.—According to the IRS, partnerships are the fastest growing segment of all tax returns filed. One of the reasons is that many taxpayers believe they can escape audits by choosing to operate as large, widely-held partnerships. The additional funding will allow the IRS to hire examiners with specialized knowledge in partnerships and close an additional 2,800 cases.

—*Enhance Collection Coverage*.—The President's budget would provide additional funding so the IRS can hire new staff, primarily revenue officers, to collect back taxes owed. With these resources, the IRS also wants to reach out taxpayers earlier in the collection process. The IRS projects that it will be able to close an additional 244,000 collection cases. The collection initiative will also provide additional funding to hire the staff to deal with the increasing number of cases involving unpaid employment taxes.

—*Enhance Return Preparer Compliance*.—The President's budget contains a legislative proposal that would explicitly authorize the IRS to regulate all paid tax return preparers, thereby dealing with the legal objections that formed the basis of the *Loving v. IRS* decision. However, while awaiting congressional action on the proposal, the fiscal year 2015 budget request contains additional funding to bolster audits of return preparers and increase monitoring and pur-

suit of unscrupulous preparers engaged in fraudulent activities, including filing false EITC claims for their clients.

HUMAN CAPITAL AND BUSINESS SYSTEMS MODERNIZATION (BSM)/IT

Human Capital

The IRS confronts a number of serious human capital issues. Commissioner Koskinen has remarked on numerous occasions that he must not only rebuild public trust in the agency, but also employee morale which has suffered greatly over the past 3 years. The *Best Places to Work in Government* survey of Federal employees reported an almost eight point drop for the IRS between 2012 and 2013—from 66 to 54.3.

The decline in morale is due to a number of factors, some of which are directly related to lean budgets and the sequestration, such as the furloughs, exception-only hiring freeze, increased workload, and drastic reductions in training. The Board thought the cuts to training budgets were extreme and unwarranted.

Last year's heated 501(c)(4) tax exempt controversy also took a heavy toll on employee morale. Although it actually involved very few employees, the entire workforce felt it was being blamed and under fire. Employees told the Board at its listening sessions at the Nationwide Tax Forums that they were subject to disparaging remarks by taxpayers, and in some instances, felt physically threatened.

The cuts in training were a major issue for IRS employees, practitioners, and ultimately taxpayers. According to the National Taxpayer Advocate's *2013 Annual Report to Congress*, the IRS training budget was cut by more than 85 percent from fiscal year 2009 to fiscal year 2013. In 2013, less than $250 was spent per-employee on training versus $1,450 in 2009. In some divisions, the training budget cuts were staggering. The Small Business/Self Employed operating division saw its training budget cut by 93 percent over the same timeframe; Appeals was cut by 96 percent.

With travel-related training virtually non-existent, many employees are left with no other option than online training. Managers and employees told the Board at the Nationwide Tax Forums that this new approach to training is not working well for most people.

Many employees felt rushed to complete their online training in light of the increased and more complex workload. Some said that they had not received the training needed to do their jobs; others expressed concern about the quality of the training. They said that new hires especially need face-to-face training; classroom work is critical to their success, as is mentoring.

Employees also said they have limited opportunities to learn from one another and there is no peer networking. Without travel funding, teams of IRS employees working together across operating divisions may never meet each other and managers may not see their subordinates.

The Board is deeply concerned by the state of training at the IRS. The IRS simply cannot build a highly talented, knowledgeable and proficient workforce without quality training; nor can it achieve its strategic goals. Inadequate training means that employees cannot provide quality service for both taxpayers and practitioners, or compete with well-financed tax professionals in adversarial proceedings. The President's budget allows the IRS to invest once again in training. The agency must take full advantage of it.

BSM/IT

The IRS Business Systems Modernization program is a major area of concern, and one which the Government Accountability Office (GAO) placed on its "high-risk" list for almost two decades. However, the GAO recently removed BSM from the list, noting the progress the IRS made in addressing significant IT weaknesses.

The successful delivery of the initial phase of CADE2 and plans for the second phase to address financial material weaknesses involving unpaid tax assessments were cited as reasons behind GAO's actions.

Another major IT milestone occurred in 2014 when the Form 1040 Modernized e-file (MeF) system received and processed 100 percent of individual e-filed returns, enabling the IRS to retire the legacy e-file system.

However, in spite of these and other IT successes, Commissioner Koskinen warned in testimony before the House Appropriations Subcommittee on Financial Services and General Government that fiscal year 2014 funding is inadequate "to address critical technology infrastructure needs." These include improvements to IRS.gov, new tools to combat identity theft, and upgrades to IRS basic computer software.

The Board supports the President's budget request for BSM because it provides a solid commitment to build and deploy IT systems to improve efficiency, enhance

productivity, and better serve taxpayers. For example, it would continue the expansion of CADE2 and begin the development of Form 1040X (*Amended U.S. Individual Income Tax Return*) so it can be accepted and processed electronically.

In 2014, the IRS moved the Return Review Program (RRP) and Office of Online Services (OLS) under BSM. Aimed at detecting and preventing tax refund fraud, and using cutting edge technology and data analytics, RRP is one of most promising programs in the IRS' compliance toolbox. The President's budget request would allow BSM to fully develop and deploy RRP and enable the retirement of the outmoded Electronic Fraud Detection System (EFDS).

The President's budget would also allow the development of OLS projects that will build on existing service capabilities to improve the taxpayer's online experience, provide secure digital communications, and add more interactive capabilities to existing self-serve options.

CONCLUSION

The IRS Oversight Board believes that attempting to punish the IRS for past mistakes only hurts taxpayers and the integrity of our tax administration. With significant risk management tools and safeguards now in place, it is time to move beyond controversy to collaboration and consensus. All interested parties must work together and take steps together to give the IRS the resources it needs to carry out at an acceptable level its balanced mission of customer service and enforcement. In this regard, the Oversight Board strongly supports the President's fiscal year 2015 budget request for the IRS. It is forward thinking and reverses years of shortsighted budget cuts to the IRS and puts it on a path of stable funding and continuous improvement. We thank the subcommittee for this opportunity to present our views and recommendations.

PREPARED STATEMENT OF THE GOVERNMENT ACCOUNTABILITY OFFICE

APRIL 21, 2014.

Hon. RON WYDEN, *Chairman,*
Hon. ORRIN HATCH, *Ranking Member,*
Committee on Finance, U.S. Senate, Washington, DC.

Hon. TOM UDALL, *Chairman,*
Hon. MIKE JOHANNS, *Ranking Member,*
Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate, Washington, DC.

Hon. CHARLES W. BOUSTANY, JR., *Chairman,*
Hon. JOHN LEWIS, *Ranking Member,*
Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Washington, DC.

INTERNAL REVENUE SERVICE: ABSORBING BUDGET CUTS HAS RESULTED IN SIGNIFICANT STAFFING DECLINES AND UNEVEN PERFORMANCE

This letter transmits briefing slides based on our work to date in response to your requests for information on our ongoing reviews of the 2014 tax filing season and fiscal year 2015 budget request for the Internal Revenue Service (IRS). See the enclosed briefing slides that include the information used to brief your staff on April 10, 2014. We subsequently updated the briefing slides to reflect more current information.

Our briefing objectives were to (1) analyze IRS funding, staffing, and performance trends for fiscal years 2009 through 2014, including an assessment of IRS's 2014 filing season to date; (2) describe IRS's fiscal year 2015 budget request and workload; and (3) describe IRS's actions to absorb budget cuts and cite opportunities that could help IRS more strategically manage operations.

To conduct this work, we analyzed funding, staffing, and performance trends, including the 2014 filing season to date, and summarized the President's budget requests for IRS from fiscal years 2009 through 2014. We analyzed the fiscal year 2015 justification and other IRS data, including performance data for key IRS operations and full-time equivalents (FTE) for priority programs. We reviewed our prior work and interviewed IRS officials in the Office of the Chief Financial Officer and the Information Technology organization, the National Taxpayer Advocate, and representatives from tax preparation firms.

We conducted this performance audit from January to April 2014 in accordance with generally accepted Government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We interviewed IRS officials and determined that the data presented in this report were sufficiently reliable for our purposes.

In summary, we found:

—IRS's appropriations have declined to below fiscal year 2009 levels and FTEs have been reduced by about 8,000 since fiscal year 2009. Planned performance in enforcement and taxpayer service has decreased or fluctuated; for example, in the fiscal year 2014 congressional justification the audit coverage target for individual examinations was 1.0 percent for fiscal year 2014, however, the target was lowered to 0.8 percent in the fiscal year 2015 congressional justification. Amidst lower demand, IRS's telephone level of service performance (the percentage of callers seeking live assistance and receiving it) was 73 percent from January 1 through March 15, 2014 compared to 69 percent during the same period last year. However, between fiscal years 2009 and 2013, IRS's telephone level of service fluctuated between 61 percent and 74 percent. Average wait times have almost doubled since fiscal year 2009—from 8.8 minutes to 16.8 minutes as of mid-March 2014.

—Not including other budgetary resources such as user fees, the fiscal year 2015 budget request for IRS is $12.5 billion, which is an increase of 10.5 percent ($1.2 billion) in funding and 8.3 percent in staffing (6,998 FTEs) over fiscal year 2014. According to the President's budget, of the requested $1.2 billion, $480 million is predicated on a cap adjustment—funding above the discretionary spending limit—and largely covers enforcement and infrastructure initiatives. IRS's workload has increased as a result of legislative mandates and priority programs, such as work related to the Patient Protection and Affordable Care Act and identity theft.

—IRS has absorbed approximately $900 million in budget cuts since fiscal year 2010 through savings and efficiencies and by reducing, delaying, or eliminating services. For example, IRS delayed two information technology projects (Information Reporting and Document Matching and Return Review Program) and substantially reduced employee training. To help improve operations, the President requested a large budget increase for IRS in fiscal year 2015. However, additional funding is not the only solution. We have open recommendations on IRS's operations that may help it achieve efficiencies over time, such as developing a long-term plan to improve Web services.

AGENCY COMMENTS

On April 16, 2014, IRS provided technical comments on our findings, which we have incorporated where appropriate.

We plan to send copies of this report to the Chairman and ranking members of other Senate and House committees and subcommittees that have appropriation, authorization, and oversight responsibilities for IRS. We are also sending copies to the Commissioner of Internal Revenue, the Secretary of the Treasury, and the Chairman of the IRS Oversight Board. The report is available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staffs have any questions about this report, please contact us at (202) 512–9110 or mctiguej@gao.gov or whitej@gao.gov. Contact points for our offices of Congressional Relations and Public Affairs are on the last page of this report. GAO staff members who made major contributions to this report were Libby Mixon, Assistant Director, and Joanna Stamatiades, Assistant Director, and Jehan Chase, Pawnee A. Davis, Mary Evans, Charles Fox, Suzanne Heimbach, LaKeshia Allen Horner, Natalie Maddox, Paul Middleton, Ed Nannenhorn, Sabine Paul, Amy Radovich, Mark Ryan, Erinn L. Sauer, Cynthia Saunders, and Tamara Stenzel.

James R. McTigue Jr

JAMES R. MCTIGUE, JR.,
Director, Tax Issues
Strategic Issues.

James R White

JAMES R. WHITE,
Director, Tax Issues
Strategic Issues.

Enclosure—1

ENCLOSURE: BRIEFING SLIDES

INTERNAL REVENUE SERVICE: ABSORBING BUDGET CUTS HAS RESULTED IN SIGNIFICANT STAFFING DECLINES AND UNEVEN PERFORMANCE

Prepared for Congressional Committees
April 10, 2014
(Updated April 18, 2014)

OBJECTIVES

Our objectives are to provide interim information on the Internal Review Service's (IRS) fiscal year 2015 budget request and its 2014 filing season performance. This briefing:

—analyzes IRS funding, staffing, and performance trends for fiscal years 2009 through 2014, including an assessment of IRS's 2014 filing season to date;
—describes IRS's fiscal year 2015 budget request and workload; and
—describes IRS's actions to absorb budget cuts and cites opportunities that could help IRS more strategically manage operations.

SCOPE AND METHODOLOGY

—To analyze funding, staffing, and performance trends, including the 2014 filing season, we summarized the President's budgets and IRS's congressional justifications (CJ) from fiscal years 2009 through 2014, and interviewed IRS officials in the Office of the Chief Financial Officer (CFO); analyzed IRS data including full-time equivalents (FTE) and performance data for key IRS operations; and interviewed IRS officials and other stakeholders such as representatives from tax preparation firms on filing season performance and challenges.
—To describe IRS's fiscal year 2015 budget request and workloads, we reviewed the fiscal year 2015 CJ and other budget documents; analyzed FTE data on IRS identified priority programs; and interviewed officials from IRS's Offices of Corporate Budget and the National Taxpayer Advocate.
—To describe IRS's actions to absorb budget cuts and cite opportunities for IRS to more strategically manage operations, we reviewed Office of Management and Budget (OMB) and Department of Treasury guidance on sequestration; interviewed officials from IRS's Office of the CFO and Information Technology organization; and reviewed our prior work.

We conducted this performance audit from January to April 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We interviewed IRS officials and determined that the data presented in this briefing were sufficiently reliable for our purposes.

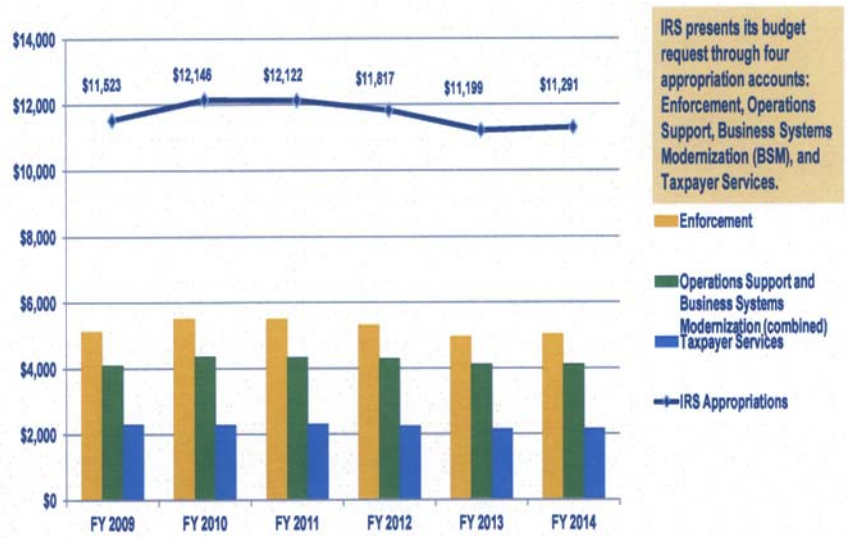
RESULTS IN BRIEF

—IRS's appropriations have declined to below fiscal year 2009 levels. IRS FTEs have been reduced by about 8,000 FTEs since fiscal year 2009. Performance in enforcement and taxpayer service has decreased or fluctuated. IRS is providing a better level of telephone service in 2014 amidst lower demand.
—Not including other budgetary resources such as user fees, the fiscal year 2015 budget request for IRS is $12.5 billion, which is an increase of 10.5 percent ($1.2 billion) in funding and 8.3 percent in staffing (6.998 FTEs) over fiscal year 2014. IRS's workload is dedicated to legislative mandates and priority programs.
—IRS has absorbed budget cuts through savings and efficiencies and by reducing, delaying, and eliminating some services. To improve operations, IRS has requested a large budget increase for 2015. However, additional funding is not the only solution for IRS. We have open recommendations that may help IRS to more effectively manage its operations and achieve some savings over time.

FUNDING TRENDS: IRS'S APPROPRIATIONS HAVE DECLINED TO BELOW FISCAL YEAR 2009 LEVELS

Figure 1: IRS's Appropriations, Fiscal Years 2009 Through 2014

(Dollars in Millions)



Legend: FY = fiscal year.

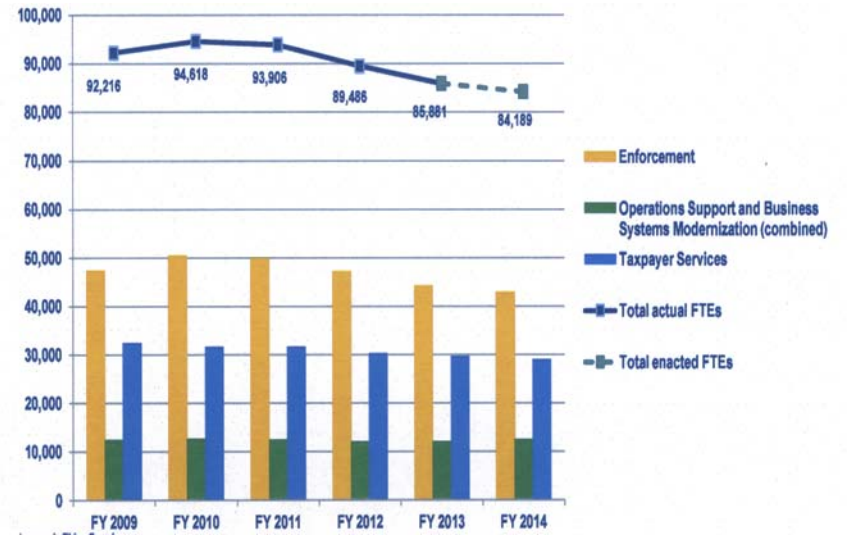
Source: Fiscal years 2009 through 2014 congressional justification for IRS.

Notes: The fiscal year 2013 levels represent an across the board rescission and reductions required by sequestration. In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million). Amounts shown do not include other budgetary resources, such as user fees.

See appendix I for more information on IRS budget trends, including other budgetary resources.

STAFFING TRENDS: IRS HAS REDUCED FTES BY ABOUT 8,000 (9 PERCENT) SINCE FISCAL YEAR 2009

Figure 2: IRS Full-Time Equivalents (FTE) Funded Through Appropriations, Fiscal Years 2009 Through 2013 Actual and Fiscal Year 2014 Enacted



Legend: FY = fiscal year.

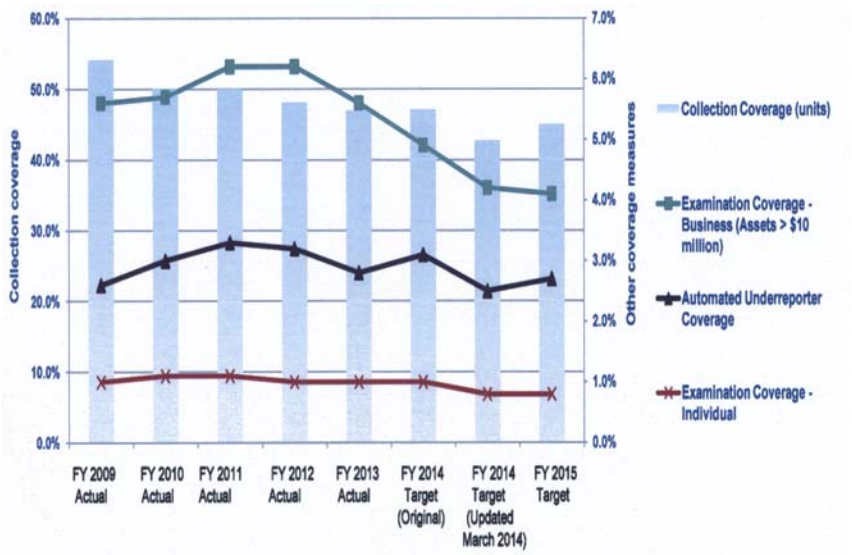
Source: Fiscal years 2009 through 2014 congressional justification for IRS.

Notes: The fiscal year 2013 level represents an across-the-board rescission and reductions required by sequestration. In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million). Amounts shown do not include FTEs funded with other budgetary resources, such as user fees.

See appendix II for more information on IRS budget trends, including other budgetary resources.

PERFORMANCE TRENDS: RETURN EXAMINATION AND COLLECTION COVERAGE MEASURES SHOW DECLINE

Figure 3: IRS Return Examination and Collection Coverage Measures, Fiscal Years 2009 Through 2013 Actual and Fiscal Year 2014 and 2015 Targets



Source: GAO analysis of fiscal years 2009 through 2014 congressional justification for IRS.
For more information on coverage measures, see appendix III.

PERFORMANCE TRENDS: ELECTRONIC FILING CONTINUES TO INCREASE IN 2014

Table 1: Tax Returns Processed, 2009 Through 2014 Filing Seasons (in Thousands)

	2009	2010	2011	2012	2013	2014	Percentage change from 2013 to 2014
Number of individual tax returns processed	89,215	85,210	87,595	96,556	93,103	98,170	5.4
Electronic	70,705	71,153	76,664	85,904	84,443	90,333	7
Paper	18,510	14,057	10,932	10,653	8,660	7,837	−9.5
Percentage electronically filed [a]	79.3	83.5	87.5	89.0	90.7	92.0	n/a
Free File [b]	2,416	2,498	2,344	2,431	2,337	2,573	10.1
Number of refunds issued (millions)	77.7	74.1	75.2	80.4	77.8	78.8	1.2
Amount of refunds (billions)	$210.2	$219.4	$219.8	$224.7	$214.5	$219.9	2.5

Legend: n/a = not applicable.
Source: GAO analysis of IRS data.
Notes: Unless otherwise noted, data are from January 1 of each year through April 3, 2009; April 2, 2010; April 1, 2011; April 6, 2012; April 5, 2013; and April 4, 2014. Numbers may not add due to rounding.
[a] The percentage of returns filed electronically early in the filing season is likely to decline before the filing season is over. Taxpayers filed about 84 percent of all individual returns electronically in 2013. The numbers for electronic filing that we are reporting are for returns processed versus returns received.
[b] IRS offers Free File software for eligible taxpayers to prepare and e-file their federal tax returns online for free at IRS.gov. Free File 2013 and 2014 data are from January 1 through April 8, 2013 and April 7, 2014.

PERFORMANCE TRENDS: IRS IS PROVIDING BETTER TELEPHONE SERVICE IN 2014 AMIDST LOWER DEMAND WHICH IRS ATTRIBUTES IN PART TO FEWER TAX LAW CHANGES

Table 2: Interim IRS Call Volume, Level of Service, and Average Wait Times, 2009 Through 2014 Filing Seasons

	Interim Filing Season [a]					Truncated Interim Filing Season		
	2009	2010	2011	2012	2013	2013 (March 16)	2014 (March 15)	Percent change from March 2013 to March 2014 [b]
CALL VOLUME (IN MILLIONS)								
Total calls to IRS [c]	52.4	48.7	53.3	65.1	59.0	51.1	39.6	−23
Automated calls answered	19.6	23.1	26.8	36.4	32.4	28.7	21.5	−25
Assistor answered calls	14.9	12.6	12.8	10.6	11.2	9.3	6.7	−28
Abandoned, busies, and disconnects	17.9	13.0	13.7	18.1	15.4	13.1	11.5	−13
ACCESS MEASURES								
Level of Service (LOS)—Percentage of callers seeking live assistance who receive it	64	75	75	68	69	69	73	7
Average wait time (in minutes)	8.8	9.9	9.7	15.9	13.8	13.7	12.4	−9

Source: GAO analysis of IRS data.

[a] Unless otherewise noted, data for filing season to date are cumulative for IRS from January 1 of each year to April 4, 2009; April 3, 2010; April 2, 2011; March 31, 2012; and March 30, 2013. Because of time lags in data reporting, to compare this year to last, we used data from January 1 of each year to March 16, 2013, and March 15, 2014, for the truncated interim filing season column.

[b] The numbers in the table are rounded, but the percent change was calculated using exact values.

[c] The numbers in the table include the total automated, assistor answered, abandoned, busy and disconnected account calls, taxpayer account-related and tax law calls, but do not reflect the total number of attempted calls to IRS, nor do they represent total call volume to all IRS functions such as enforcement.

PERFORMANCE TRENDS: IRS IS PROVIDING BETTER TELEPHONE SERVICE IN 2014 AMIDST LOWER DEMAND WHICH IRS ATTRIBUTES IN PART TO FEWER TAX LAW CHANGES (CONTINUED)

Table 3: IRS Key Telephone Actual Performance Compared to its Goals, Fiscal Years 2009 Through 2014

		Fiscal Year (October 1 through September 30) [a]					
		2009	2010	2011	2012	2013	2014
Level of Service (LOS)—Percentage of callers seeking live assistance who receive it	Goal	[b] 77	71	71	61	70	61
	Actual	70	74	70	68	61	[c] 67
Average wait time (in minutes)	Goal	10.4	11.6	11.6	19	14.6	22.0
	Actual	8.8	10.8	13.0	16.7	17.6	[c] 16.8

Source: GAO analysis of IRS data.

[a] Unless otherwise noted, the goals listed are for the entire fiscal year.

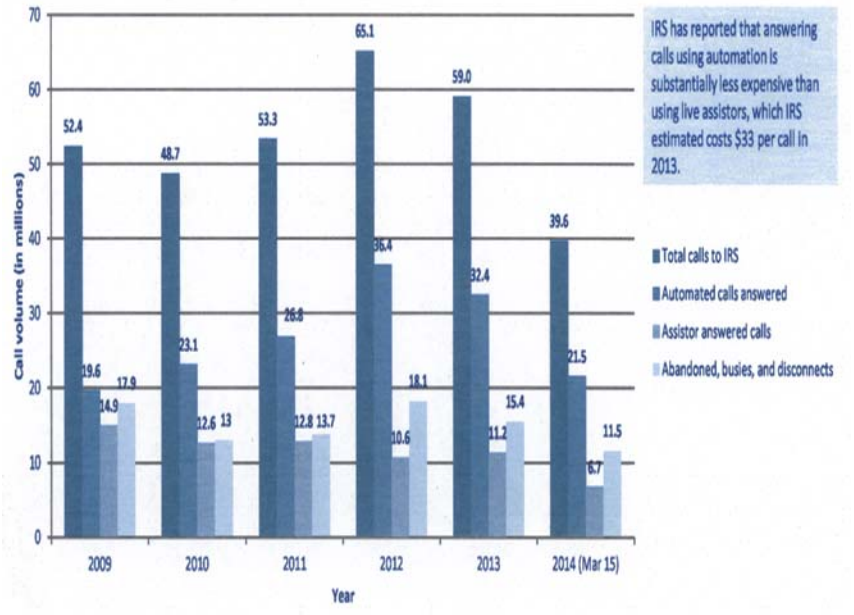
[b] IRS revised its original fiscal year goal of 77 percent down to 70 percent because of high call volume from taxpayers requesting electronic filing authentication information and asking stimulus-related questions.

[c] Unlike the level of service and wait time information reported in Table 2 for 2014, which is from January 1 through March 15, 2014, the corresponding data shown for 2014 in this table are fiscal year to date—October 1, 2013, through March 15, 2014.

PERFORMANCE TRENDS: IRS CONTINUES TO ANSWER MORE AUTOMATED THAN ASSISTOR ANSWERED CALLS IN 2014

(NOTE: Data for Figure 4 is in chart and table format.)

Figure 4: IRS Call Volume (in millions), 2009 Through 2014 Filing Seasons



Source: GAO analysis of IRS data.

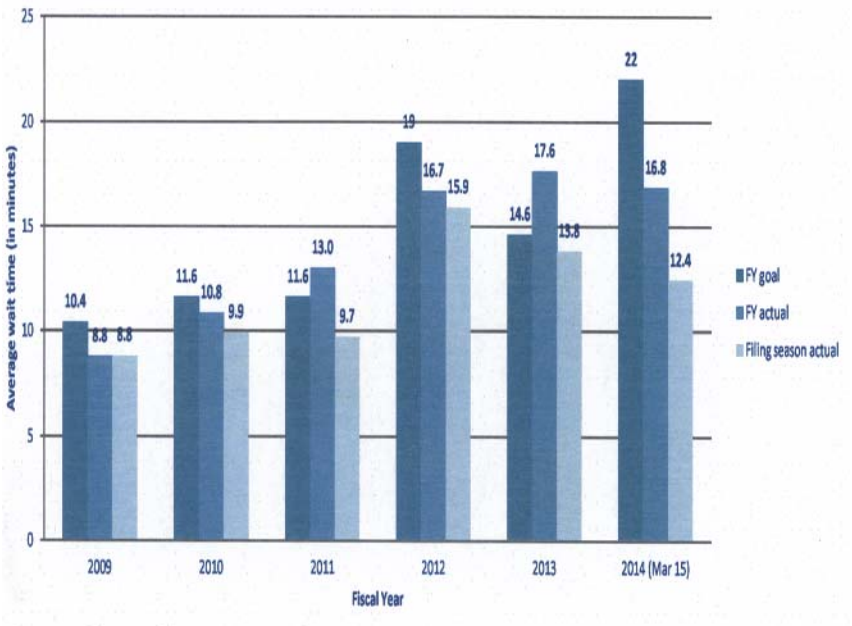
Notes: Unless otherwise noted, data are cumulative for IRS from January 1 of each year to April 4, 2009; April 3, 2010: April 2, 2011; March 31, 2012; and March 30, 2013. For 2014, data are from January 1 through March 15, 2014. The numbers in the graphic include the total automated, assistor answered, abandoned, busy and disconnected taxpayer account-related and tax law calls, but do not reflect the total number of attempted calls to IRS, nor do they represent total call volume to all IRS functions such as enforcement.

Year	Total calls to IRS	Automated calls answered	Assistor answered calls	Abandoned, busies, and disconnects
IRS has reported that answering calls using automation is substantially less expensive than using live assistors, which IRS estimated costs $33 per call in 2013.				
2009	52.4	19.6	14.9	17.9
2010	48.7	23.1	12.6	13
2011	53.3	26.8	12.8	13.7
2012	65.1	36.4	10.6	18.1
2013	59.0	32.4	11.2	15.4
2014 (March 15)	39.6	21.5	6.7	11.5

PERFORMANCE TRENDS: AVERAGE WAIT TIMES HAVE GENERALLY INCREASED SINCE 2009

(NOTE: Data for Figure 5 is in chart and table format.)

Figure 5: Average Wait Time (in minutes), Fiscal Years 2009 Through 2014



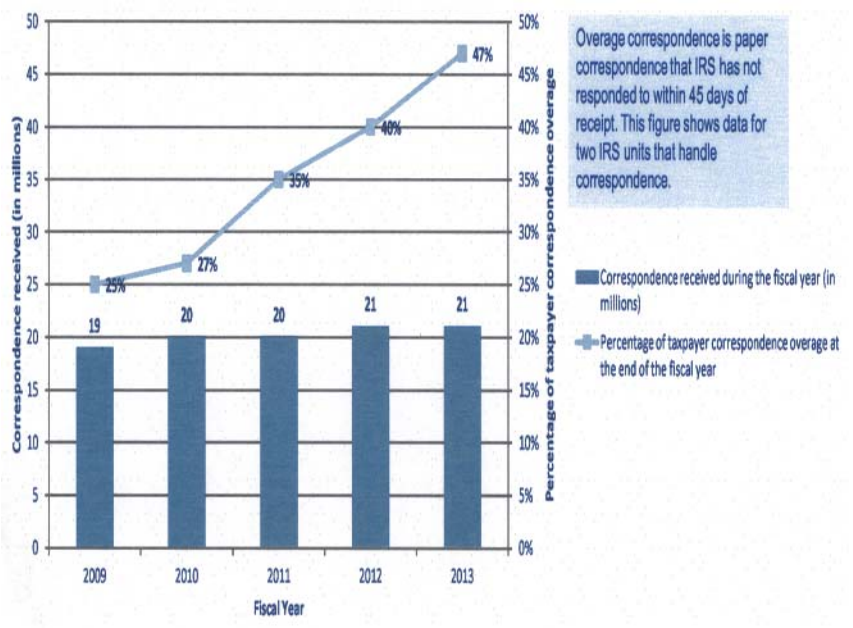
Legend: FY = fiscal year.
Source: GAO analysis of IRS data.
Notes: Unless otherwise noted, data are cumulative for IRS from January 1 of each year to April 4, 2009; April 3, 2010; April 2, 2011; March 31, 2012; and March 30, 2013. For 2014, data are from January 1 through March 15, 2014.

Fiscal year	Fiscal year goal	Fiscal year actual	Filing season actual
2009	10.4	8.8	8.8
2010	11.6	10.8	9.9
2011	11.6	13.0	9.7
2012	19	16.7	15.9
2013	14.6	17.6	13.8
2014 (March 15)	22	16.8	12.4

PERFORMANCE TRENDS: OVERAGE CORRESPONDENCE HAS INCREASED SIGNIFICANTLY SINCE 2009

(NOTE: Data for Figure 6 is in chart and table format.)

Figure 6: IRS Taxpayer Correspondence Performance, Fiscal Years 2009 Through 2013



Source: GAO analysis of IRS data.

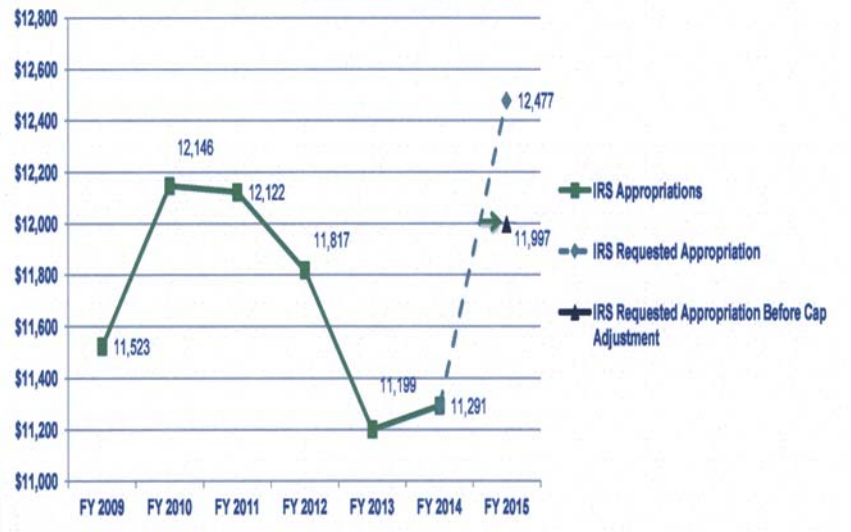
Notes: Aggregate data are from two IRS units that jointly handle taxpayer correspondence. The same employees that provide telephone service are also responsible for responding to correspondence from taxpayers. Data cover equivalent periods for each fiscal year with slight variation in the exact dates depending on the year and data source.

Fiscal year	Correspondence received during the fiscal year (in millions)	Percentage of taxpayer correspondence overage at the end of the fiscal year
Overage correspondence is paper correspondence that IRS has not responded to within 45 days of receipt. This figure shows data for two IRS units that handle correspondence.		
2009	19	25
2010	20	27
2011	20	35
2012	21	40
2013	21	47

FISCAL YEAR 2015 REQUEST: IRS IS REQUESTING $12.5 BILLION IN APPROPRIATIONS, AN INCREASE OF 10.5 PERCENT ($1.2 BILLION) OVER FISCAL YEAR 2014

Figure 7: IRS Enacted Appropriations, Fiscal Year 2009 through 2014, and Fiscal Year 2015 Request

(Dollars in millions)



Legend: FY = fiscal year.

Source: Fiscal years 2009 through 2015 congressional justifications for IRS.

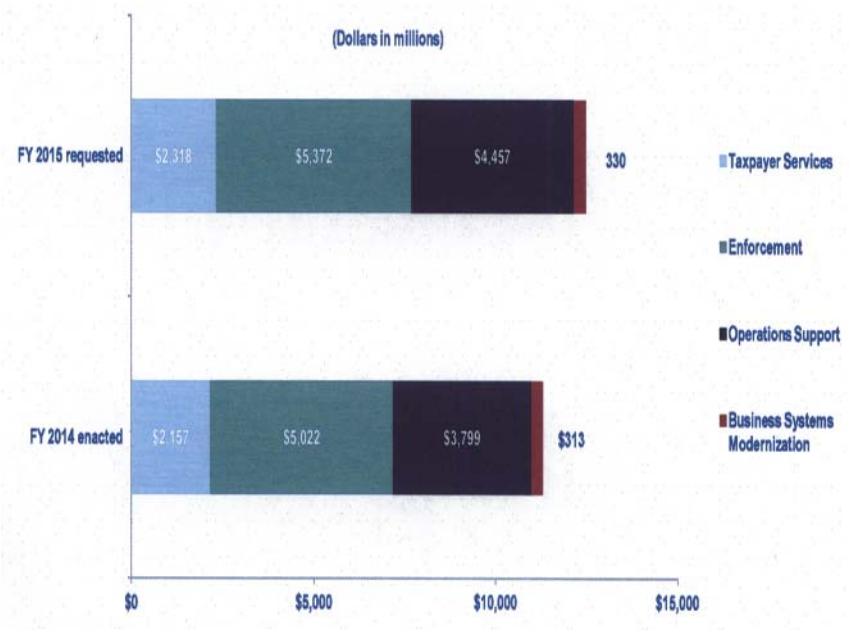
Notes: Fiscal year 2013 levels represent an across-the-board rescission and reductions required by sequestration. In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million). Amounts shown do not include other budgetary resources, such as user fees.

See appendix I for more information on the fiscal year 2015 budget request for IRS, including other budgetary resources.

FISCAL YEAR 2015 REQUEST: IRS'S LARGEST REQUESTED INCREASE IS $658 MILLION FOR OPERATIONS SUPPORT [1]

(NOTE: Data for Figure 8 is in chart and table format.)

Figure 8: Fiscal Year 2015 Budget Request by Appropriation Compared to Fiscal Year 2014 Enacted Appropriation for IRS



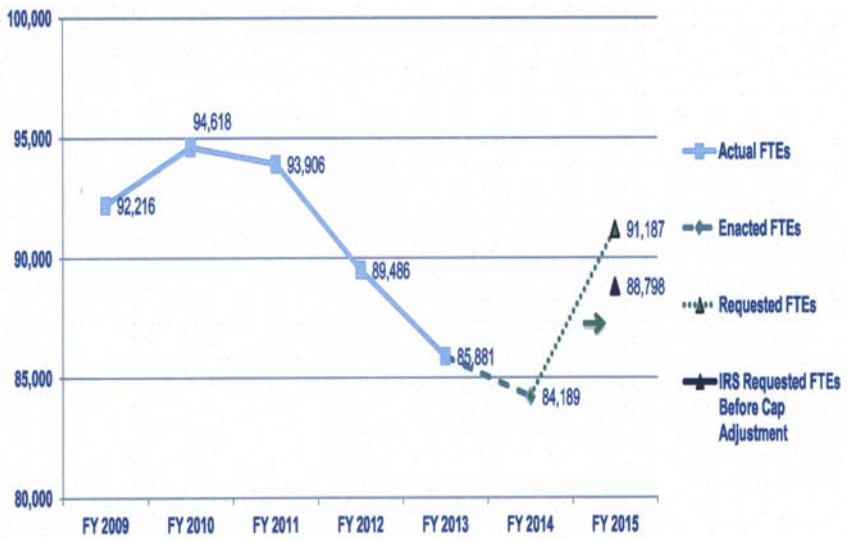
Legend: FY = fiscal year.
Source: Fiscal years 2014 through 2015 congressional justifications for IRS.
Notes: Request includes 22 program initiatives totaling more than $1.1 billion (see appendixes IV through VIII). Amounts shown do not include other budgetary resources, such as user fees.
[1] Operations Support includes IRS's information systems and overall planning, direction, and support for the IRS.
See appendix I for more information on IRS budget trends, including other budgetary resources.

(Dollars in millions)

	Fiscal year 2015 requested	Fiscal year 2014 enacted
Taxpayer Services	2,318	2,157
Enforcement	5,372	5,022
Operations Support	4,457	3,799
Business Systems Modernization	330	313
Totals	12,477	11,291

FISCAL YEAR 2015 REQUEST: IRS PROPOSED INCREASING STAFFING TO ABOUT FISCAL YEAR 2012 LEVELS

Figure 9: IRS Full-Time Equivalents Funded Through Appropriations, Fiscal Years 2009 Through 2013 Actual, 2014 Enacted, and 2015 Request



Legend: FY = fiscal year. FTE = full-time equivalent.

Source: Fiscal years 2009 through 2015 congressional justification for IRS.

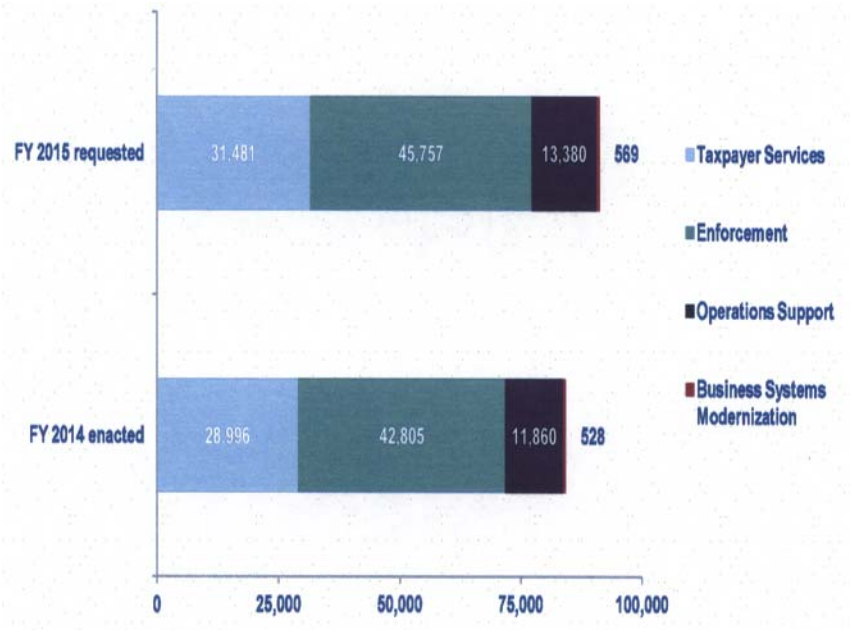
Notes: Fiscal year 2013 levels represent the across-the-board rescission and reductions required by sequestration. In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million). Amounts shown do not include FTEs funded with other budgetary resources, such as user fees. The FY 2015 initiatives were developed with most FTE costed assuming a January 1 hire date.

See sppendix II for more information for FTEs in the Fiscal Year 2015 budget request for IRS, including other budgetary resources.

FISCAL YEAR 2015 REQUEST: THE LARGEST STAFFING INCREASE IS ABOUT 3,000 FTES FOR ENFORCEMENT

(NOTE: Data for Figure 10 is in chart and table format.)

Figure 10: Fiscal Year 2015 Full-Time Equivalents, Budget Request by Appropriation Compared to Fiscal Year 2014 Enacted Appropriation for IRS



Legend: FY = fiscal year.
Source: Fiscal years 2015 congressional justification for IRS.
Notes: The FY 2015 initiatives were developed with most FTE costed assuming a January 1 hire data.
See appendix II for more information on FTEs in the fiscal year 2015 budget request for IRS, including other budgetary resources.

	Fiscal year 2015 requested	Fiscal year 2014 enacted
Taxpayer Services	31,481	28,996
Enforcement	45,757	42,805
Operations Support	13,380	11,860
Business Systems Modernization	569	528
Totals	91,187	84,189

WORKLOAD: STAFF DEDICATED TO LEGISLATIVE MANDATES AND PRIORITY PROGRAMS

Table 4: Full-Time Equivalents to Implement New Laws and Priority Programs, Fiscal Years 2013 Actual, 2014 Planned, and 2015 Requested

Legislative Mandate/Priority Program	Fiscal year 2013 actual	Fiscal year 2014 enacted	Fiscal year 2015 requested [a]
Refund fraud including identity theft	4,146	4,146	4,603
International and offshore tax administration	2,135	1,819	2,151
Patient Protection and Affordable Care Act [b]	701	[c] 1,954	2,046
Merchant card/cost basis reporting [d,e]	90	128	450
Foreign Account Tax Compliance Act [f]	40	50	394
Return Review Program/Electronic Fraud Detection System	104	137	137
Return preparer oversight	167	80	186
Total FTEs	7,383	8,314	9,967

Legend: FY = fiscal year. FTE = full-time equivalent.

Source: IRS Office of Corporate Budget.

Notes: [a] The FY 2015 initiatives were developed with most FTE costed assuming a January 1 hire date. [b] PPACA, Pub. L. No. 111–148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act (HCERA), Pub. L. No. 111–152, 124 Stat. 1029 (Mar. 30, 2010). All references to PPACA include amendments by HCERA.

[c] According to IRS officials, this reflects the number of FTEs requested in the Fiscal Year 2014 President's Budget.

[d] Housing Assistance Tax Act of 2008, Pub. L. No. 110–289, div. C, § 3091, 122 Stat. 2654, 2908–2911 (July 30, 2008).

[e] Energy Improvement and Extension Act of 2008, Pub. L. No. 110–343, div. B, § 403, 122 Stat. 3765, 3854–3860 (Oct. 3, 2008).

[f] Hiring Incentives to Restore Employment Act, Pub. L. No. 111–147, Title V, 124 Stat. 71, 97–117 (Mar. 18, 2010).

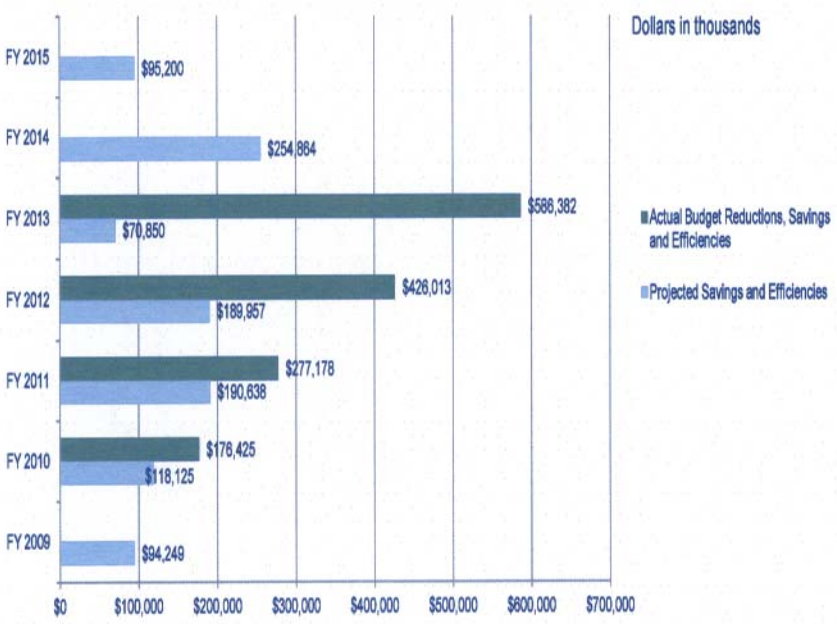
See eppendices IX and X for more information on PPACA spending.

ABSORBING CUTS: REDUCTIONS TO IRS'S BUDGET GREATER THAN PROJECTED SAVINGS

(NOTE: Data for Figure 11 is in chart and table format.)

—IRS has absorbed approximately $900 million in budget cuts since fiscal year 2010.

Figure 11: IRS Projected and Actual Savings and Efficiencies, Fiscal Year 2009 Through 2015 [a]



Legend: FY = fiscal year.
Source: GAO analysis of fiscal year 2009 through fiscal year 2015 IRS congressional justifications for the IRS.
Note: [a] IRS began calculating actual savings and efficiencies in fiscal year 2012, based on our recommendation.

(Dollars in thousands)

Fiscal Year	Actual Budget Reductions, Savings and Efficiencies	Projected Savings and Efficiencies
2015	—	95,200
2014	—	254,864
2013	586,382	70,850
2012	426,013	189,957
2011	277,178	190,638
2010	176,425	118,125
2009	—	94,249

ABSORBING CUTS: IRS REDUCED OR ELIMINATED SOME SERVICES IN 2014

In 2014, IRS reduced or eliminated services, consistent with our finding in December 2012 that IRS needed to dramatically revise its strategy for providing telephone and correspondence services, and that incremental efficiency gains would not be enough to reverse service declines. IRS:

—limited inquiries to answer only basic tax law questions during the filing season and reassigned assistors to work account-related inquires;
—launched the "Get Transcript" tool, which allows taxpayers to obtain a viewable and printable transcript on www.irs.gov, and redirected taxpayers to automated tools for additional guidance;
—redirected refund-related inquiries to automated services and did not answer refund inquires until 21 days after the tax return was filed electronically or 6 weeks after the return was filed by paper (unless the automated service directed the taxpayer to contact IRS);
—limited access to the Practitioner Priority Services line to only those practitioners working tax account issues;
—limited live assistance and redirected requests for domestic employer identification numbers to IRS's online tool; and
—eliminated free return preparation and reduced other services at IRS's walk-in sites.

ABSORBING CUTS: IRS HAS DELAYED TWO IT PROJECTS IN PART DUE TO BUDGET REDUCTIONS

IRS put two major IT projects, Information Reporting and Document Matching (IRDM) and the Return Review Program (RRP), on hold due to a lack of funding and technical issues (See appendix XI).[1]

—During the hold, IRS will determine the best case management tool to use to meet IRDM's program requirements. It plans to leverage an off-the-shelf solution because IRS believes it will be more cost effective than building one.
—IRS initially planned to release all of RRP by March 2015. The first phase, Transition State 1.0 (TS1), was split into two releases: R1.0 and R1.1. Testing of TS1 R1.0 has been ongoing, and will continue for the remainder of the calendar year. IRS put the next two phases, TS1.5 and TS2.0 on hold until it has analyzed and resolved how to design RRP's architecture more efficiently.
  —IRS is working to develop a plan to move beyond the hold on RRP, and expects to complete the plan in the summer of 2014, and will initiate the plan after that time. Moving forward, this plan will help inform IRS's funding needs for RRP.

[1] Information Reporting and Document Matching (IRDM): IRDM is intended to be used to improve business taxpayer compliance by matching business information (e.g., 1099–K) tax returns with individual tax returns to identify potential income under reporting. Return Review Program (RRP): When RRP is fully deployed it is expected to make use of leading-edge technology to detect, resolve, and prevent fraud.

ABSORBING CUTS: IRS SUBSTANTIALLY REDUCED EMPLOYEE TRAINING

—According to IRS Commissioner Koskinen, since 2010 IRS has reduced training costs by 83 percent and training-related travel costs by 87 percent by limiting employee travel and training to mission-critical projects.
—For fiscal year 2013, IRS reported a savings of $56.2 million by reducing agency-wide, non-technical training and non-case related travel.
—In its fiscal year 2013 Report to Congress, the National Taxpayer Advocate lists training cuts as one of IRS's most serious problems. From fiscal years 2009 through 2013, per-employee spending dropped from $1,450 per full-time equivalent to less than $250.

Table 5: Percentage of Training Reduction for Selected IRS Divisions, Fiscal Years 2009 Through 2013

Division	Percent reduction
Appeals	96
Tax Exempt and Government Entities	96
Small Business/Self-Employed	93
Large Business and International	92
Taxpayer Advocate Service	78
Wage and Investment	74

Source: National Taxpayer Advocate: 2013 Annual Report to Congress, Volume I, (Dec. 31, 2013).

OPPORTUNITIES EXIST TO MORE STRATEGICALLY MANAGE OPERATIONS

Funding is one component of improving operations. Legislative proposals and our prior work provide options to improve IRS operations (see appendixes XII and XIII). For example, the administration proposes legislative changes such as providing IRS with greater flexibility to address correctable errors (broaden math error authority).

In addition, we recommended that IRS:

—outline a strategy that defines appropriate levels of telephone and correspondence service and wait times and lists specific steps to manage service based on an assessment of time frames, demand, capabilities, and resources (GAO–13–156).[1] IRS did not agree or disagree with this recommendation, stating that it already had an objective of providing taxpayers with access to accurate services while managing demand by improving efficiency. However, in recent years, because IRS has not kept up with the demand for its services we maintain our recommendation is valid; a strategy to reverse the trends may require difficult tradeoffs.
—review disparities in the ratios of direct revenue yield to costs across different enforcement programs and across different groups of cases within programs and determine whether this evidence provides a basis for adjusting IRS's allocation of enforcement resources each year. We noted that the better empirical basis IRS planners have for making such judgments, the more confident they can be that they are allocating their limited resources to the best effect (GAO–13–151).[2] IRS agreed with our recommendation. Given the time to develop additional key data, IRS is considering how to apply interim methods, findings, or approximations. They are unsure when this work will be completed; we believe our recommendation remains valid.
—develop a long-term strategic plan for its web services. We noted that a long-term strategy could help managers have a common understanding of IRS's plans, and better assist Congress in understanding what it is being asked to fund and holding IRS accountable for progress (GAO–13–435).[3] In April 2014, IRS reported that a long-term online strategy for improving web services will be completed in February 2015.

[1] GAO, *2012 Tax Filing: IRS Faces Challenges Providing Service to Taxpayers and Could Collect Balances Due More Effectively,* GAO–13–156 (Washington, D.C.: Dec. 18, 2012).
[2] GAO, *Tax Gap: IRS Could Significantly Increase Revenues by Better Targeting Enforcement Resources,* GAO–13–151 (Washington, D.C.: Dec. 5, 2012).
[3] GAO, *IRS Website: Long-Term Strategy Needed to Improve Interactive Services,* GAO–13–435 (Washington, D.C.: Apr. 16, 2013).

CONCLUDING OBSERVATIONS

IRS has absorbed budget cuts since fiscal year 2010, and the resulting imbalance between service and demand has adversely affected operations. To address this imbalance, IRS has requested a large budget increase for 2015. However, additional funding is not the only solution for IRS. We have open recommendations that may help IRS to more effectively manage its operations and achieve some savings over time.

APPENDIX I: DOLLARS BY APPROPRIATION ACCOUNT, FISCAL YEARS 2009 THROUGH 2015

Table 6: Fiscal Years 2009 Through 2014 Enacted and Fiscal Year 2015 Budget Request for IRS by Appropriation Account

(Dollars in Millions)

Appropriation account	Fiscal year 2009 enacted	Fiscal year 2010 enacted	Fiscal year 2011 enacted	Fiscal year 2012 enacted	Fiscal year 2013 enacted [a]	Fiscal year 2014 enacted [b]	Fiscal year 2015 requested	Dollar change fiscal year 2014 enacted compared to fiscal year 2015 requested	Percent change fiscal year 2014 enacted compared to fiscal year 2015 requested
Enforcement	5,117	5,504	5,493	5,299	4,949	5,022	5,372	350	7.0
Operations support	3,867	4,084	4,057	3,947	3,801	3,799	4,457	658	17.3
Taxpayer services	2,293	2,279	2,293	2,240	2,136	2,157	2,318	161	7.5
Business Systems Modernizaton	230	264	263	330	313	313	330	17	5.5
Health Insurance Tax Credit Administration (HITCA) [c]	15	16	15	0	0	0	0	0	0
Subtotal	11,523	12,146	12,122	11,817	11,199	11,291	12,477	1,186	10.5
Other resources, such as user fees	390	539	655	695	855	815	785	−30	−3.7
Total funding available for obligations	11,913	12,686	12,777	12,512	12,053	12,106	13,261	1,156	9.6

Legend: FY = fiscal year.

Source: Fiscal years 2011 through 2015 congressional justifications for IRS.

Notes: Dollars are nominal and not adjusted for inflation, and numbers may not add due to rounding.

[a] Fiscal year 2013 enacted represents the operating level after applying across-the-board rescisson and reductions required by sequestration and an interappropriation transfer of $73 million transferred from the Enforcement appropriation to the Taxpayer Services ($13 million) and Operations Support ($60 million) appropriations.

[b] In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million).

[c] In fiscal year 2012, administrative resources for HITCA were moved to the Taxpayer Services appropriation under the Consolidated Appropriations Act, 2012, Pub. L. No. 112–74, 125 Stat. 786 (Dec. 23, 2011).

APPENDIX II: STAFFING BY APPROPRIATION ACCOUNT, FISCAL YEARS 2009 THROUGH 2015

Table 7: Fiscal Years 2009 Through 2013 Actual, 2014 Enacted, and 2015 Requested Full-time Equivalents by Appropriation Account

Appropriation account	Fiscal year 2009 actual	Fiscal year 2010 actual	Fiscal year 2011 actual	Fiscal year 2012 actual	Fiscal year 2013 actual [a]	Fiscal year 2014 enacted [b]	Fiscal year 2015 requested [c]	FTE change fiscal year 2014 enacted compared to fiscal year 2015 requested	Percent change fiscal year 2014 enacted compared to fiscal year 2015 requested
Enforcement	47,361	50,400	49,920	47,189	44,174	42,805	45,757	2,952	6.9
Operations support	12,101	12,262	12,103	11,499	11,610	11,860	13,380	1,520	12.8
Taxpayer services	32,422	31,607	31,574	30,236	29,646	28,996	31,481	2,485	8.6
Business Systems Modernizaton	322	337	309	562	451	528	569	41	7.8
Health Insurance Tax Credit Administration (HITCA) [d]	10	12	0	0	0	0	0	0	0
Subtotal	92,216	94,618	93,906	89,486	85,881	84,189	91,187	6,998	8.3
Other resources, such as user fees	1,153	752	1,003	2,185	1,884	1,503	1,503	0	0
Total	93,369	95,370	94,909	91,671	87,765	85,692	92,690	6,998	8.2

Legend: FY = fiscal year.

Source: Fiscal years 2011 through 2014 congressional justifications for IRS.

Notes: [a] Fiscal year 2013 actual represents the operating level after applying across-the-board rescission and reductions required by sequestration and an interappropriation transfer of $73 million transferred from the Enforcement appropriation to the Taxpayer Services ($13 million) and Operations Support ($60 million) appropriations.

[b] In fiscal year 2014, IRS received $92 million for the improvement of services to taxpayers, refund fraud and identity theft, and international and offshore compliance issues. The operating plan, which has not been approved as of April 11, 2014, proposes allocating $34 million to Taxpayer Services and $58 million to Operations Support. In addition, IRS has proposed to transfer $69.2 million from Enforcement to Operations Support for information technology infrastructure ($40 million) and a program reclassification ($29.2 million).

[c] The fiscal year 2015 initiatives were developed with most FTE costed assuming a January 1 hire date.

[d] The administrative resources for HITCA were moved to the Taxpayer Services appropriation under the Consolidated Appropriations Act, 2012, Pub. L. No. 112–74, 125 Stat. 786 (Dec. 23, 2011).

APPENDIX III: IRS ADJUSTED ENFORCEMENT COVERAGE AND EFFICIENCY TARGETS DOWNWARD

Table 8: IRS Enforcement Coverage Measures Fiscal Years 2009 Through 2013 Actual and 2014 and 2015 Targets

	Fiscal year 2009 actual	Fiscal year 2010 actual	Fiscal year 2011 actual	Fiscal year 2012 actual	Fiscal year 2013 actual	Fiscal year 2014 target [a] (Original)	Fiscal year 2014 target (March 2014)	Fiscal year 2015 target [b]
Selected Examination Measures								
Examination Coverage—Individual	1.0%	1.1%	1.1%	1.0%	1.0%	1.0%	0.8%	0.8%
Examination Efficiency—Individual	138	140	139	142	142	145	133	124
Examination Coverage Business (Assets > 10 mil)	5.6%	5.7%	6.2%	6.2%	5.6%	4.9%	4.2%	4.1%
Automated Underreporter Coverage	2.6%	3.0%	3.3%	3.2%	2.8%	3.1%	2.5%	2.7%
Automated Underreporter Efficiency	1,905	1,924	2,007	2,041	2,025	2,001	1,931	1,950
Selected Collections Measures								
Collection Coverage	54.2%	50.1%	50.0%	48.1%	47.0%	47.1%	42,7%	45.0%
Collection Efficiency	1,845	1,822	1,952	1,997	2,057	2,039	2,007	1,900
Automated Collection System Accuracy	94.3%	95.9%	94.9%	94.7%	94.4%	94.5%	94.0%	94.0%

Source: GAO analysis of fiscal years 2014 and 2015 congressional justifications for IRS.

Notes: Coverage measures generally are the number of closed examinations by the number of filings for the prior year. Efficiency measures are generally the total number of cases closed divided by total full-time equivalents used. Automated Collection System Accuracy refers to the percent of taxpayers who received the correct answer to their question.

[a] The fiscal year 2014 target was based on the fiscal year 2014 budget request.

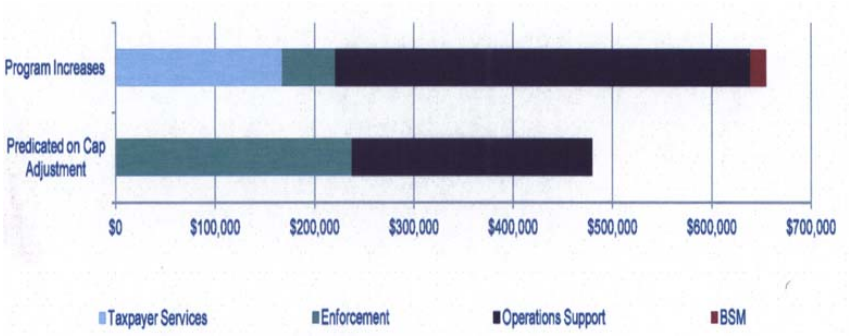
[b] The fiscal year 2015 target was based on the fiscal year 2015 budget request.

APPENDIX IV: OF REQUESTED $1.2 BILLION FOR FISCAL YEAR 2015, $480 MILLION PREDICATED ON A CAP ADJUSTMENT [1]

The fiscal year 2015 request includes 22 new program initiatives—17 of which are predicated on a cap adjustment—with total requested funding of more than $1.1 billion.[2] This includes:

—13 for enforcement ($535 million),
—6 for Infrastructure ($376 million),
—1 for taxpayer service ($221 million), and
—1 for BSM ($17 million).

Figure 12: Funding Requested for New Initiatives Predicated on a Cap Adjustment (Dollars in Thousands)



Source: GAO analysis of fiscal year 2015 congressional justification for IRS.

[1] Congress passes cap adjustments to allow for additional funding above discretionary spending lists for certain activities.

[2] One of the new program initiatives predicated on a cap adjustment is a funding transfer to the Alcohol Tobacco Trade Bureau.

APPENDIX V: IRS PROPOSED 17 INITIATIVES PREDICATED ON A CAP ADJUSTMENT TOTALING $480 MILLION

Table 9: Funding Requested for New Initiatives Predicated on a Cap Adjustment

(Dollars in Thousands)

Description of budget adjustments	Fiscal year 2015 funding requested, by appropriation account				Total	Projected Enforcement ROI for fiscal year 2017	Projected Protected Revenue ROI for fiscal year 2017
	Taxpayer services account	Enforcement account	Operations support account	Business Systems Modernization			
Enforcement Initiatives							
Address International and Offshore Compliance Issues	—	49.037	7,773	—	56,810	4.8	—
Expand Coverage of High Wealth Individuals and Enterprises	—	17,684	3,273	—	20,957	11.3	—
Expand Audit Coverage	—	53,581	44,198	—	97,779	7.1	20.5
Enhance Collection Coverage	—	41,692	25,070	—	66,762	8.5	—
Improve Coverage of Partnerships and Flow-Through Entities	—	28,690	7,849	—	36,539	6.8	—
Expand Compliance Coverage in the Tax-Exempt Sector	—	13,364	2,731	—	16,095	—	—
Pursue Fraud Referrals, Employment Tax, and Abusive Tax Schemes	—	9,275	8,537	—	17,812	—	—
Build Out Tax Return Preparer Compliance and Professional Responsibility Activities	—	14,765	2,772	—	17,537	—	—
Implement Information Technology (IT) Changes to Deliver the Foreign Account Tax Compliance Act (FATCA)	—	—	32,223	—	32,223	—	—
Leverage Digital Evidence for Criminal Investigation	—	698	3,674	—	4,372	—	—
Leverage Data to Improve Case Selection	—	4,052	32,741	—	36,793	[a] 2.0	—
Infrastructure Initiatives							
Implement Information Technology (IT) Services	—	—	10,000	—	10,000	—	—
Implement Campus Consolidation and Revitalization Strategy	—	—	10,000	—	10,000	—	—
Implement e-Government and Other Administration Priorities	—	—	31,011	—	31,011	—	—
Maintain Integrity of Revenue Financial Systems	—	—	12,136	—	12,136	—	—
Expand Virtual Service Delivery (VSD)	—	—	7,701	—	7,701	—	—
Alcohol and Tobacco Tax and Trade Bureau Program Integrity Transfer							
Transfer to TTB for High-Return on Investment (ROI) Tax Enforcement Activities	—	5,000	.....	.....	5,000	—	—

Table 9: Funding Requested for New Initiatives Predicated on a Cap Adjustment—Continued

(Dollars in Thousands)

Description of budget adjustments	Fiscal year 2015 funding requested, by appropriation account				Total	Projected Enforcement ROI for fiscal year 2017	Projected Protected Revenue ROI for fiscal year 2017
	Taxpayer services account	Enforcement account	Operations support account	Business Systems Modernization			
Total Fiscal Year 2015 Cap Adjustment	.....	$237,838	$241,689	.....	$479,527	n/a	—

Legend: n/a = not applicable. Note: Numbers may not add due to rounding.
Source: Fiscal year 2015 congressional justification for IRS.
Note: [a] IRS considers leveraging data to improve case selection a revenue-enhancing initiative.

APPENDIX VI: FIVE PROPOSED INITIATIVES FOR $654 MILLION ARE NOT PREDICATED ON A CAP ADJUSTMENT

Table 10: Funding Requested for New Initiatives Not Predicated on a Program Integrity Cap Adjustment

(Dollars in Thousands)

Description of budget adjustments	Appropriation Account				Total	Projected enforcement revenue ROI for fiscal year 2017	Projected protected revenue ROI for fiscal year 2017
	Taxpayer services account	Enforcement account	Operations support account	Business Systems Modernization			
New Initiatives	$167,382	$53,545	$417,780	$15,679	$654,386	n/a	.....
Improve Taxpayer Services and Return Processing	153,482	—	57,776	—	211,258	—	—
Prevent Identity Theft and Refund Fraud	13,900	16,971	34,005	—	64,876	—	22.4
Continue Migration from Aging Tax Administration Systems—Enhance Online Services	—	—	829	15,679	16,508	.....	.....
Address Impact of Patient Protection and Affordable Care Act (PPACA) Statutory Requirements	—	36,574	19,525	—	56,099	2.3	14.0
Implement Information Technology (IT) Changes to Deliver Tax Credits and Other Requirements	—	—	305,645	—	305,645	.....	—
Non-Recur Fiscal Year 2014 Additional Appropriation	−34,000	—	−58,000	.....	−92,000	n/a	—
Maintaining Current Levels	46,483	105,719	69,382	1,593	223,177	n/a	—
Base Adjustment	.....	−29,221	29,221	.....	.....	.....	—
Savings and efficiencies, net reinvestment	−18,786	−18,233	−42,156	.....	−95,200	n/a	—
Total Request Before Cap Adjustment	$2,317,633	$5,133,988	$4,215,169	$330,210	$11,997,000	n/a	—

Legend: n/a = not applicable. ROI = return on investment. FY = Fiscal Year.
Source: Fiscal year 2015 congressional justification for IRS.
Note: Numbers may not add due to rounding.

APPENDIX VII: IRS CONTINUES TO REPORT ACTUAL RETURN ON INVESTMENT (ROI) DATA FOR THREE ENFORCEMENT PROGRAMS

Table 11: Actual Return on Investment (ROI) for Major IRS Enforcement Programs
(Dollars in Millions)

	Fiscal year 2010			Fiscal year 2011			Fiscal year 2012			Fiscal year 2013		
Enforcement program	Cost	Revenue	ROI	Cost	Revenue	ROI	Cost	Revenue	ROI	Cost	Revenue	ROI
Examination	$4,371	$23,563	5.4	$4,333	$18,924	4.4	$4,232	$14,476	3.4	$3,965	$16,662	4.2
Collection	1,948	29,105	14.9	1,939	31,060	16.0	1,742	30,442	17.5	1,660	31,396	18.9
Automated Under-reporter	262	4,924	18.8	270	5,245	19.4	267	5,269	19.7	258	5,287	20.5
IRS total	$6,581	$57,592	8.8	$6,543	$55,229	8.4	$6,242	$50,187	8.0	$5,883	$53,345	9.1

Source: Fiscal year 2015 congressional justification for IRS.
Note: Numbers may not add due to rounding.

—For the fiscal year 2015 congressional justification, IRS continued to calculate direct actual ROI for the Examination, Collection, and Automated Under-reporter programs, but has not completed this calculation fro other programs or at lower levels.

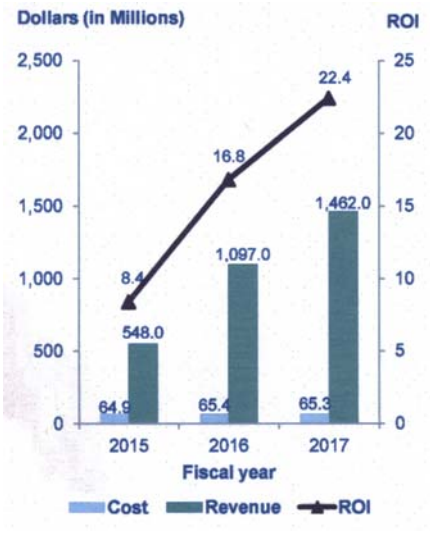
—IRS is not yet able to calculate average or marginal direct actual ROI of new enforcement program initiatives, but is in the process of completing a feasibility study to identify steps necessary to measure actual revenue and ROI for new enforcement initiatives.

—IRS will continue to use revenue protection and revenue enhancement ROI projections.

APPENDIX VIII: IRS ESTIMATED FUTURE ROI FOR NEW ENFORCEMENT INITIATIVES

(NOTE: Data for Figure 13 is in chart and table format.)

Figure 13: Prevent Identity Theft and Refund Fraud (Protected Revenue)



Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	64.9	548.0	8.4
2016	65.4	1,097.0	16.8
2017	65.3	1,462.0	22.4

(NOTE: Data for Figure 14 is in chart and table format.)

Figure 14: Address Impact of Affordable Care Act Statutory Requirements (Protected Revenue)

Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	4.4	22.2	5.0
2016	5.1	57.2	11.2
2017	5.1	71.5	14.0

(NOTE: Data for Figure 15 is in chart and table format.)

Figure 15: Expand Audit Coverage (Protected Revenue)

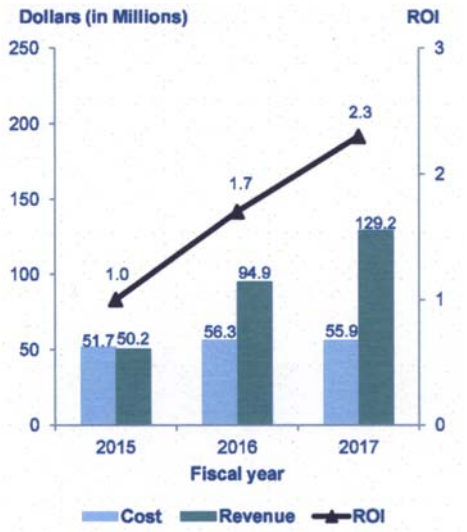
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	4.5	33.8	7.5
2016	5.2	85.3	16.4
2017	5.2	106.6	20.5

(NOTE: Data for Figure 16 is in chart and table format.)

Figure 16: Address Impact of Affordable Care Act Statutory Requirements (Enforcement Revenue)



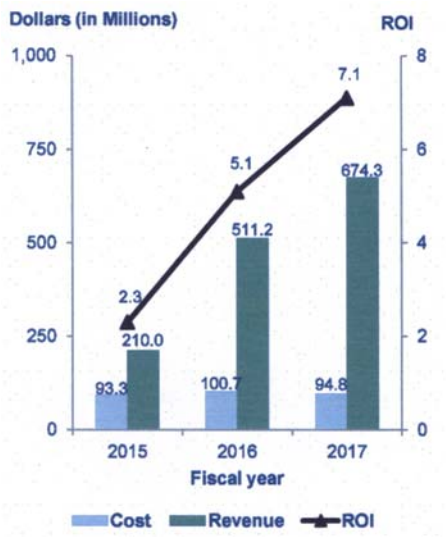
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	51.7	50.2	1.0
2016	56.3	94.9	1.7
2017	55.9	129.2	2.3

(NOTE: Data for Figure 17 is in chart and table format.)

Figure 17: Expand Audit Coverage (Enforcement Revenue)



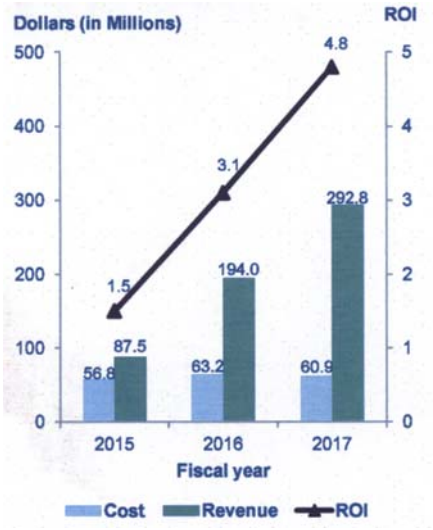
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	93.3	210.0	2.3
2016	100.7	511.2	5.1
2017	94.8	674.3	7.1

(NOTE: Data for Figure 18 is in chart and table format.)

Figure 18: Address International and Offshore Compliance Issues (Enforcement Revenue)



Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	56.8	87.5	1.5
2016	63.2	194.0	3.1
2017	60.9	292.8	4.8

(NOTE: Data for Figure 19 is in chart and table format.)

Figure 19: Expand Coverage of High Wealth Individuals and Enterprises (Enforcement Revenue)

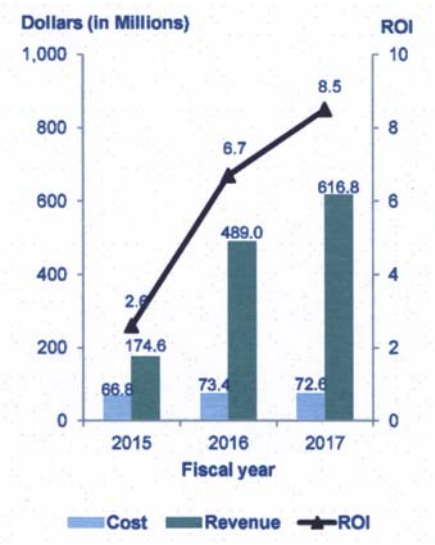
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	21.0	78.5	3.7
2016	23.0	159.9	7.0
2017	21.6	243.9	11.3

(NOTE: Data for Figure 20 is in chart and table format.)

Figure 20: Enhance Collection Coverage (Enforcement Revenue)



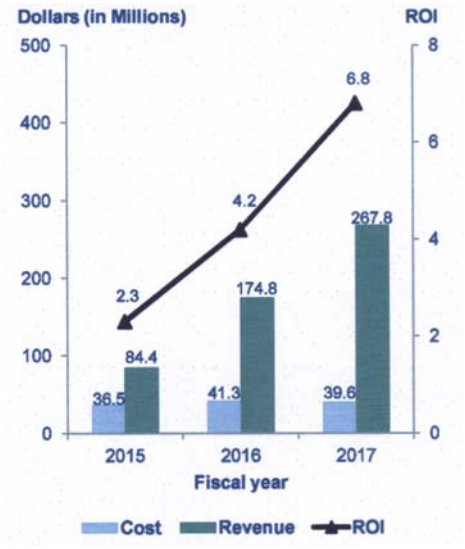
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	66.8	174.6	2.6
2016	73.4	489.0	6.7
2017	72.6	616.8	8.5

(NOTE: Data for Figure 21 is in chart and table format.)

Figure 21: Improve Coverage of Partnerships and Flow-Through Entities (Enforcement Revenue)



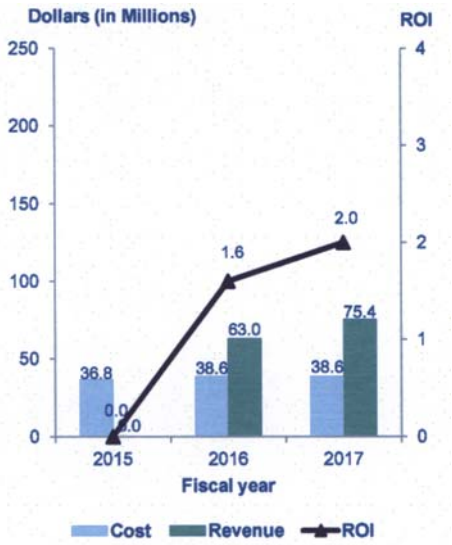
Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	36.5	84.4	2.3
2016	41.3	174.8	4.2
2017	39.6	267.8	6.8

(NOTE: Data for Figure 22 is in chart and table format.)

Figure 22: Leverage Data to Improve Case Selection (Enforcement Revenue)



Source: GAO analysis of IRS data.

(Dollars in Millions)

Fiscal year	Cost	Revenue	ROI
2015	36.8	0.0	0.0
2016	38.6	63.0	1.6
2017	38.6	75.4	2.0

APPENDIX IX: PATIENT PROTECTION AND AFFORDABLE CARE ACT (PPACA)[1] SPENDING, FISCAL YEARS 2010 THROUGH 2012

Table 12: Patient Protection and Affordable Care Act (PPACA) Spending, Fiscal Years 2010 Through 2012 (in Millions)

PPACA Initiatives	Fiscal year 2010 actual	Fiscal year 2011 actual	Fiscal year 2012 actual	Total
Administer new fees on drug manufacturers and health insurers	$0.3	$0.7	$1.1	$2.1
Strengthen oversight of exempt hospitals	0.4	4.5	4.0	9.0
Promoting compliance with other new provisions	0.8	11.6	8.3	20.8
Program management	0.1	8.4	17.9	26.4
Support of implementation of taxpayer issues (e.g. Counsel, Appeals)	2.4	5.0	5.2	12.5
Customer service support (outreach, phones, and other support)	1.3	6.0	4.7	12.0
Information technology, operations, and support and infrastructure, deliver new tax credits and individual coverage requirement	15.3	131.9	258.0	405.2
Total	$20.7	$168.2	$299.2	$488.1

Legend: FY = fiscal year.
Source: Fiscal year 2014 congressional justification for IRS.
Notes: PPACA was enacted on March 23, 2010. IRS received funding for PPACA implementation activities from the Department of Health and Human Services' Health Insurance Reform Implementation Fund in fiscal years 2010 to 2012. Numbers may not add due to rounding.
[1] PPACA, Pub. L. No. 111–148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care and Education Reconciliation Act (HCERA), Pub. L. No. 111–152, 124 Stat. 1029 (Mar. 30, 2010). All references to PPACA include amendments by HCERA.

APPENDIX X: PPACA SPENDING AND REQUEST BY ACCOUNT AND INITIATIVES, FISCAL YEARS 2013 THROUGH 2015

Table 13: PPACA Spending and Request by Account and Initiative (in Millions)

	Taxpayer Services			Enforcement			Operations Support			Total		
PPACA Initiatives	Fiscal year 2013 actual	Fiscal year 2014 requested	Fiscal year 2015 requested	Fiscal year 2013 actual	Fiscal year 2014 requested	Fiscal year 2015 requested	Fiscal year 2013 actual	Fiscal year 2014 requested	Fiscal year 2015 requested	Fiscal year 2013 actual	Fiscal year 2014 requested	Fiscal year 2015 requested
Improve taxpayer service and meet increased demand (PPACA portion of initiative)	$3.8	$70.3	$58.2	$0	$3.2	$0	$0	$16.0	$15.7	$3.8	$89.5	$73.9
Address impact of PPACA statutory requirements	0.5	1.1	0	19.3	26.1	36.6	11.8	17.2	19.5	31.6	44.4	56.1
Implement IT changes to deliver tax credits and other requirements	0	0	0	0	0	0	248.6	305.6	305.6	248.6	305.6	305.6
Expand telecom infrastructure to handle increased demand	0	0	0	0	0	0	0	0	16.0	0	0	16.0
Total PPACA budget request	$4.3	$71.4	$58.2	$19.3	$29.3	$36.6	$260.4	$338.8	$356.9	$284	[a] $439.6	$451.7

Source: IRS data on PPACA spending for fiscal year 2013 and fiscal years 2014 and 2015 congressional justifications for IRS.
Notes: IRS did not receive funding for PPACA implementation activities in fiscal years 2013 or 2014. IRS received funding from the Department of Health and Human Services in fiscal years 2010 to 2012. Numbers may not add due to rounding.
[a] Actual total fiscal year 2014 PPACA spending through February 28, 2014 is $59.2 million.

Total funding for all investments from fiscal years 2009 to 2015 is about $11 billion.

Table 14: Summary of IRS's Major IT Investments (in Millions)

Investment name	Fiscal year 2014 appropriation [a]	Actual obligations to date [b]	Fiscal year 2015 projected life-cycle cost	Projected useful life (year)
Account Management Services (AMS)				
Enhances customer support by providing applications that enable IRS employees to access, validate, and update individual taxpayer accounts on demand	$17	$11	$204	2017
Patient Protection and Affordable Care Act (PPACA) [c]				
Encompasses the planning, development and implementation of IT systems needed to support IRS's tax administration responsibilities associated with the act [d]	345	651	1,987	2018
Customer Account Data Engine 2 (CADE 2)				
Provides timely access to authoritative individual taxpayer account information and enhances IRS's ability to address technology, security, financial material weaknesses, and long-term architectural planning and viability	165	687	1,022	2020
Electronic Fraud Detection System (EFDS)				
Assists in detecting fraud at the time that tax returns are filed in order to eliminate the issuance of fraudulent tax refunds	16	111	162	2021
e-Service (e-SVS)				
Comprises several web-based self-assisted services that are intended to allow authorized individuals to do business with the IRS electronically	11	173	207	2019
Foreign Account Tax Compliance Act (FATCA)				
Intended to implement provisions of the Foreign Account Tax Compliance Act regarding financial institutions reporting to IRS information about financial accounts held by U.S. taxpayers, or foreign entitites in which U.S. taxpayers hold a substantial ownership interest	47	17	162	2020
Implement Return Review Program (RRP) (Replaces EFDS)				
Currently under development, is intended to maximize fraud detection at the time that tax returns are filed to eliminate issuance of questionable refunds	68	103	253	2020
Individual Master File (IMF)				
Represents the authoritative data source for individual tax account data. All other IRS information systems that process IMF data depend on output from this source. This investment is a critical component of IRS's ability to process tax returns	14	82	166	2019
Information Reporting and Document Matching (IRDM)				
Intended to establish a new business information matching program in order to increase voluntary compliance and accurate income reporting	23	70	186	2019
Integrated Customer Communication Environment (ICCE)				
Includes several projects that are intended to simplify voluntary compliance using voice response, internet, and other computer technology such as the Modernized Internet Employee Identification Number, which allows third parties to act on the behalf of taxpayers	15	482	524	2019
Integrated Data Retrieval System (IDRS)				
Intended to provide systemic review, improve consistency in case control, alleviate staffing needs, issue notices to taxpayers, and allow taxpayers to see status of refunds. It is a mission-critical system used by 60,000 IRS employees	18	202	336	2020
Integrated Financial System/CORE Financial System (IFS)				

Table 14: Summary of IRS's Major IT Investments (in Millions)—Continued

Investment name	Fiscal year 2014 appropriation [a]	Actual obligations to date [b]	Fiscal year 2015 projected life-cycle cost	Projected useful life (year)
Used by IRS for budget, payroll, accounts payable/receivable, general ledger functions, and financial reporting; also used to report on the cost of operations and to manage budgets by fiscal year	15	414	494	2019
Integrated Submission and Remittance Processing System (ISRP)				
Processes paper tax returns, and updates tax forms to comply with tax law changes	10	143	188	2019
IRS End User Systems and Services (EUSS)				
Supports products and services necessary for daily functions for over 100,000 IRS employees at headquarters and field sites	182	705	1,933	2019
IRS Main Frames and Servers Services and Support (MSSS)				
Intended to support the design, development, and deployment of server storage infrastructures, software, databases, and operating systems	406	4,094	7,317	2019
IRS Telecommunications Systems and Support (TSS)				
Supports IRS's broad and local network infrastructure such as servers, and switches for voice, data, and video servicing of about 1,000 IRS sites	302	1,007	2,388	2019
IRS.Gov—Portal Environment				
Provides web-based services such as tax filing and refund tracking, to internal and external users, such as IRS employees and other government agencies, taxpayers, and business partners	16	487	651	2017
Modernized e-File (MeF)				
Provides a secure web-based platform for electronic tax filing of individual and business tax and information returns by registered Electronic Return Originators	40	376	639	2020
Service Center Recognition/Image Processing System (SCRIPS)				
Used as a data capture, management, and image storage system using high-speed scanning and digital imaging to convert data from the 940, 941, K–1, and paper returns from Information Returns Processing, into electronic format	9	157	203	2019

Source: GAO's analysis of fiscal year 2015 congressional justification for IRS.
[a] Fiscal year 2014 appropriation is the amount IRS plans to fund out of its own accounts (e.g., user fees and other budget accounts).
[b] Actual obligations to date through fiscal year 2013.
[c] IRS uses the acronym ''ACA'' to refer to the Patient Protection and Affordable Care Act in its reports.
[d] In this report, we are not evaluating the healthcare.gov initiative headed by the Centers for Medicare and Medicaid Services.

APPENDIX XII: GAO CONDUCTED ANALYSES RELATED TO 12 OF 38 LEGISLATIVE PROPOSALS IN THE FISCAL YEAR 2015 BUDGET REQUEST

Table 15: Legislative Proposals Related to Prior GAO Work (in Millions)

IRS legislative proposals related to prior GAO work	Projected revenues over 10 years	Projected costs over 3 years	Related GAO reports
Modify reporting of tuition expenses and scholarships of Form 1098–T, Tuition Statement.	$606	$0.2	GAO–10–225
Authorize the Department of Treasury to require additional information to be included in electronically filed Form 5500 annual reports and electronic filing of certain other employee benefit plan reports.	No revenue effect	11.2	GAO–05–491
Increase certainty with respect to worker classification.	9,610	1.9	GAO–09–717
Require taxpayers who prepare their returns electronically, but file their returns on paper, to print their returns with a scannable code.	No revenue effect	14.6	GAO–12–33
Allow IRS to absorb credit card processing fees for certain tax payments.	19	9.6	GAO–10–11
Provide IRS with greater flexibility to address correctable errors.	173	1.4	GAO–11–481
Provide whistleblowers with protection from retaliation.	Negligible revenue effect	0	GAO–11–683
Provide stronger protection from improper disclosure of taxpayer information in whistleblower actions.	No revenue effect	0	GAO–11–683
Add tax crimes to the Aggravated Identity Theft statute.	Negligible revenue effect	0	GAO–13–132T
Impose a civil penalty on tax identity theft crimes	Negligible revenue effect	2.7	GAO–13–132T
Explicitly provide that the Department of Treasury and IRS have authority to regulate all paid return preparers.	Negligible revenue effect	Not available	GAO–14–467T, GAO–08–781
Rationalize tax return filing due dates so they are staggered.	2,581	Not available	GAO–13–515

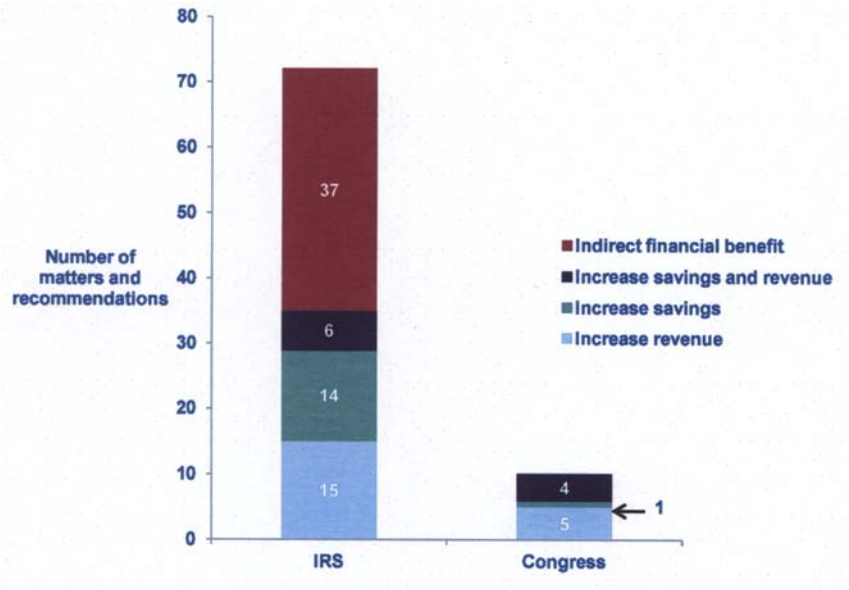
Source: GAO analysis based on IRS fiscal year 2015 congressional justification and Department of the Treasury, General Explanations of the Administration's Fiscal Year 2015 Revenue Proposals (Washington, D.C.: March 2014).

—We highlighted several areas where IRS could achieve cost savings and revenue enhancements in our reports on duplication, overlap, and fragmentation.[1]
—As of March 2014, 37 GAO products contain 10 matters for Congress and 72 recommendations to IRS with a potential financial benefit. In addition, we have made multiple recommendations that could improve IRS operations if implemented.
—Since March 2013, 34 recommendations were implemented.

[1] See GAO, GAO, 2014 Annual Report: Additional Opportunities to Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits, GAO–14–343SP (Washington, D.C.: Apr. 8, 2014).

(NOTE: Data for Figure 23 is in chart and table format.)

Figure 23: Recommendations to IRS and Open Matters for Congress With a Financial Benefit



Source: GAO analysis of GAO open recommendations.

	Number of matters and recommendations			
	Indirect financial benefit	Increase savings and revenue	Increase savings	Increase revenue
IRS	37	6	14	15
Congress	.....	4	1	5

PREPARED STATEMENT OF NINA E. OLSON, NATIONAL TAXPAYER ADVOCATE

Chairman Udall, Ranking Member Johanns, and distinguished members of this subcommittee:

Thank you for inviting me to submit this statement regarding the proposed budget of the Internal Revenue Service for fiscal year 2015.[1]

As you know, the IRS's budget has been cut substantially since fiscal year 2010, and because of sequestration, the cuts last year were the most substantial to date. As a result of these resource reductions, the IRS's ability to meet the service needs of the taxpaying public has been severely impaired, and the agency has made unprecedented and disturbing changes to its delivery of taxpayer service.

The 16-day Government shutdown compounded the impact of these budget cuts and affected the IRS's ability to prepare for the 2014 tax filing season. As a result, the agency delayed the start of the filing season by 10 days, requiring early filers to wait additional time to receive their tax refunds. During the shutdown, moreover, thousands of taxpayers were exposed to IRS enforcement actions but had no ability to contact IRS employees, including the Taxpayer Advocate Service, all of whose employees were furloughed and unable to assist taxpayers who experienced emergencies caused by ongoing enforcement.[2]

On top of all this, the revelations by the Treasury Inspector General for Tax Administration (TIGTA) that the IRS's Exempt Organizations unit had used a "Be on the Lookout" (or "BOLO") list to select applicants with the words "tea party" and other political-sounding names for further review undermined public trust in the fairness and impartiality of the IRS, and led to multiple investigations that are still underway. Getting the IRS back on track requires not merely strong leadership within the agency, but helpful oversight and support from Congress and other key stakeholders. For that reason, I appreciate your holding today's hearing.

In my view, the IRS is often so focused on resolving immediate crises that it is not able to devote sufficient time to setting long-term goals and developing approaches to achieve those goals. In the preface to my most recent annual report to Congress, I attempted to provide my vision of what a 21st century tax administration system should look like.[3]

As a foundational matter, tax administration in the 21st century should be premised on a thematic, principle-based Taxpayer Bill of Rights.[4] If taxpayers believe they are treated, or can be treated, in an arbitrary and capricious manner, they will mistrust the system and be less likely to comply voluntarily. If taxpayers have confidence in the fairness and integrity of the tax system, they will be more likely to comply.

The good news on this front is that the Internal Revenue Code provides dozens of taxpayer rights. The bad news is that most taxpayers have no idea what their rights are and therefore often cannot take advantage of them. That is because taxpayer rights are scattered throughout the code and are not presented in a coherent way. Not surprisingly, in response to a taxpayer survey conducted for our office in

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[1] The views expressed herein are solely those of the National Taxpayer Advocate. The National Taxpayer Advocate is appointed by the Secretary of the Treasury and reports to the Commissioner of Internal Revenue. However, the National Taxpayer Advocate presents an independent taxpayer perspective that does not necessarily reflect the position of the IRS, the Treasury Department, or the Office of Management and Budget. Congressional testimony requested from the National Taxpayer Advocate is not submitted to the IRS, the Treasury Department, or the Office of Management and Budget for prior approval. However, we have provided courtesy copies of this statement to both the IRS and the Treasury Department in advance of this hearing.

[2] During the shutdown from October 1 through October 16, 2013, taxpayers were subject to the following compliance and enforcement actions: 3,902 levies on Social Security benefits; 5,455 levies on financial or other accounts; 7,025 wage levies; 4,099 Notices of Federal Tax Lien issued; 180,095 Automated Underreporter Statutory Notices of Deficiency; and 102,231 Collection Due Process Levy Hearing Notices issued by the Automated Collection System. Preliminary information from IRS Office of Taxpayer Correspondence, Individual Master File (IMF), and Automated Lien System.

[3] National Taxpayer Advocate 2013 Annual Report to Congress [hereinafter "NTA 2013 Annual Report"], at x.

[4] *See* NTA 2013 Annual Report 5–19 (Most Serious Problem: *Taxpayer Rights: The IRS Should Adopt a Taxpayer Bill of Rights as a Framework for Effective Tax Administration*); NTA 2011 Annual Report 493–518 (Legislative Recommendation: *Enact the Recommendations of the National Taxpayer Advocate to Protect Taxpayer Rights*); NTA 2007 Annual Report 478–489 (Legislative Recommendation: *Taxpayer Bill of Rights and De Minimis "Apology" Payments*).

2012, less than half of all U.S. taxpayers said they believed they have rights before the IRS, and only 11 percent said they knew what those rights are.[5]

We can and must do a better job of making taxpayers aware of their rights and enabling them to assert them. Since 2007, I have repeatedly recommended adoption of a Taxpayer Bill of Rights that takes the multiple existing rights embedded in the code and groups them into ten broad categories, modeled on the U.S. Constitution's Bill of Rights.[6] Just as the Constitution's Bill of Rights sets out the relationship between the Federal Government and U.S. citizens and imposes limits on the Federal Government's power, I believe a thematic, principle-based list of core taxpayer rights would provide a foundational framework for taxpayers and IRS employees alike that would promote effective tax administration.

I am very pleased the House of Representatives passed my proposal verbatim last year, with bipartisan support, on a voice vote.[7] While I believe a Taxpayer Bill of Rights should have the force of law, and therefore hope the Senate passes this legislation, the IRS has the authority to adopt a Taxpayer Bill of Rights on its own. I have been working with the IRS leadership to try to get agreement to do so. Particularly when resources are dear, it is important to have a set of foundational principles that guide operations and serve as a framework for effective tax administration.

In my testimony today, I will elaborate on the following key issues:

1. *Taxpayer Services and IRS Funding*.—The IRS is failing badly at meeting taxpayer needs because it lacks resources.[8] Last year, the IRS received some 109 million telephone calls on its customer service lines. The IRS could answer only 60.5 percent of calls seeking to reach a customer service representative (CSR)—and those taxpayers who got through had to wait an average of 17.6 minutes on hold. Initial statistics for fiscal year 2014 through April 15 indicate service has remained at low levels, with taxpayers waiting an average of slightly more than 17 minutes and tax practitioners kept on hold for nearly 27 minutes.[9] The tax collector is rarely the Government's most popular agency, but at the end of the day, IRS funding reductions do not "punish" the IRS nearly as much as they punish the nearly 150 million individual taxpayers and more than 10 million business entity taxpayers who are trying to comply with the tax laws and not receiving the help they need. When the IRS receives 109 million telephone calls, there is no substitute for the funding to hire enough CSRs to answer them. If the IRS does not receive more funding, it will be unable to assist millions of taxpayers seeking assistance from their Government to comply with the tax laws.
2. *Erosion of IRS Employee Training and Skills*.—To deal with a complex, constantly changing tax law and provide taxpayers with accurate and complete service, IRS employees must receive prompt and appropriate training and education. Since fiscal year 2009, budget cuts and sequestration have led the IRS to cut its training budget by over 85 percent. The IRS has reduced its training and education programs to a bare minimum without considering the types of training employees need to perform basic job functions, protect taxpayer rights, and prevent harm to and undue burden for taxpayers.[10]
3. *Identity Theft and Refund Fraud*.—The IRS should establish a meaningful single point of contact for taxpayers who become victims of identity theft. Today,

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[5] Forrester Research Inc., *The TAS Omnibus Analysis,* from North American Technographics Omnibus Mail Survey, *Q2/Q3 2012* 19–20 (Sept. 2012).

[6] Congress has passed several pieces of legislation with "Taxpayer Bill of Rights" in the title. *See* Technical and Miscellaneous Revenue Act, Public Law No. 100–647, § 6226, 102 Stat. 3342, 3730 (1988) (containing the "Omnibus Taxpayer Bill of Rights," also known as TBOR 1); Taxpayer Bill of Rights 2, Public Law No. 104–168, 110 Stat. 1452 (1996) (also known as TBOR 2); Internal Revenue Service Restructuring and Reform Act, Public Law No. 105–206, 112 Stat. 685 (1998) (Title III is known as "Taxpayer Bill of Rights III" or TBOR 3). These laws create specific rights in certain instances, but they do not create a thematic, principle-based list of overarching taxpayer rights.

[7] Taxpayer Bill of Rights Act, H.R. 2768, 113th Cong. (2013). In my 2013 report, I suggested some wording modifications, and as discussed below, the Office of the Taxpayer Advocate recently tested our proposed modifications with focus groups of taxpayers and preparers to assess whether the language accurately conveys the gist of the rights we have identified. Based on input from the focus groups, we are currently tweaking the language of a few provisions.

[8] *See* NTA 2013 Annual Report 20–38 (Most Serious Problem: *IRS Budget: The IRS Desperately Needs More Funding to Serve Taxpayers and Increase Voluntary Compliance).*

[9] IRS, Joint Operations Center, Executive Level Summary report (Oct. 1, 2013 through April 15, 2014).

[10] *See* NTA 2013 Annual Report 40–50 (Most Serious Problem: *Employee Training: The Drastic Reduction in IRS Employee Training Impacts the Ability of the IRS to Assist Taxpayers and Fulfill Its Mission).*

21 separate units handle different aspects of identity theft, and although the IRS says it has adopted a single point of contact, no employee has the authority to coordinate the entirety of the taxpayer/victim's case if, as is common, more than one of the 21 units is involved. Thus, taxpayers traumatized by the crime of identity theft are forced to navigate the IRS by themselves, increasing their frustration and despair.[11] The IRS also takes much too long to resolve ID theft cases and issue refunds to legitimate taxpayers. The Taxpayer Advocate Service's experience with identity theft cases demonstrates the soundness of our recommendation that the IRS assign one employee to work with the victim from the beginning, and help coordinate resolution of the case (not merely monitor it) when it requires work by multiple units.

4. *Affordable Care Act*.—As part of the Affordable Care Act (ACA), the IRS is implementing complicated healthcare tax provisions. I believe the IRS has acquitted itself well in meeting its initial responsibilities under the ACA. At the same time, I have concerns about the IRS's approach to addressing taxpayer questions and adequately training employees on the new provisions. In particular, the IRS is not doing enough to educate taxpayers about the importance of updating their information throughout the year with the Exchange if they are receiving a credit. Our office will continue to work with the IRS to ensure that taxpayers are treated properly and fairly in the implementation of the new law. Within the Taxpayer Advocate Service (TAS), we are also training our employees about taxpayer concerns they are likely to see next year, such as the impact of premium tax credit reconciliation and under- and overpayments, so they will be properly prepared to assist taxpayers.[12]
5. *Accelerated Receipt and Use of Third-Party Information Reports*.—Congress should direct the IRS to develop a plan to enable it to match information return data against tax return data before paying out refunds.[13] If the IRS could match Forms 1040 against Forms W–2 in a pre-refund environment, it could dramatically reduce improper payments to identity thieves and other perpetrators of refund fraud, including some improper Earned Income Tax Credit claimants. At the same time, it could make the data available to taxpayers and thereby help them prepare their returns more accurately and easily.
6. *IRS Information Technology Challenges*.—The IRS's Information Technology (IT) function must be adequately funded, not only to deliver on major initiatives like the ACA and Foreign Account Tax Compliance Act (FATCA), but also to deliver on the many small but important improvements and projects that will make a positive difference for taxpayers, employees, and the public fisc. At present, the IRS is focusing its IT resources almost exclusively on the ACA, FATCA, and the 2015 filing season. All other IT requests are subordinate to these three programs. Thus, important taxpayer service and compliance initiatives are at risk because needed improvements cannot be developed or implemented, compounding harm to taxpayers. Furthermore, without dedicated funding to invest in projects that bring us into the 21st century and the digital age, the IRS will increasingly lag behind other tax administrators and the financial services sector.

I. TAXPAYER SERVICES AND IRS FUNDING

The requirement to pay taxes is generally the most significant burden a government imposes on its citizens. For that reason, I believe the Government has a practical and moral obligation to make compliance as simple and painless as possible. Yet the IRS is increasingly unable to meet the service needs of our taxpayers by phone, in person, and by mail. Consider the following:

—Despite the greater availability of information on IRS.gov, the number of telephone calls the IRS receives from taxpayers on its customer service lines has

[11] *See* NTA 2013 Annual Report 75–83 (Most Serious Problem: *Identity Theft: The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers).*

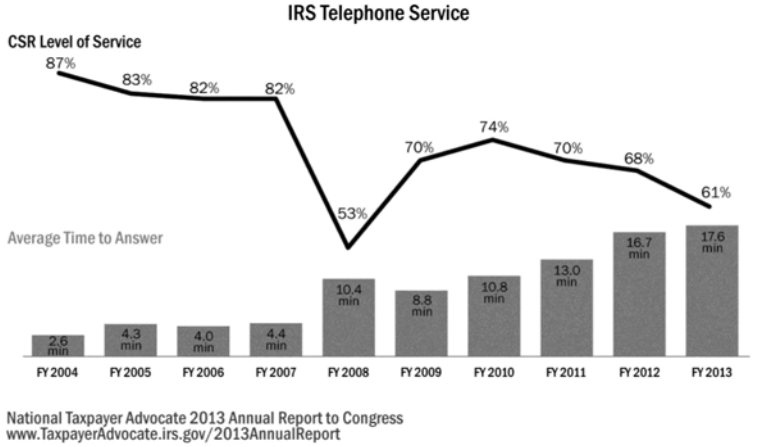
[12] *See generally* National Taxpayer Advocate fiscal year 2014 Objectives Report to Congress 29 (*TAS Prepares for Implementation of Health Care Provisions); IRS: Enforcing Obamacare's New Rules and Taxes: Hearing Before the House Comm. on Oversight & Gov't Reform,* 112th Cong. (2012) (statement of Nina E. Olson, National Taxpayer Advocate).

[13] *See* NTA 2013 Annual Report, vol. 2, 67–96 (Analysis: *Fundamental Changes to Return Filing and Processing Will Assist Taxpayers in Return Preparation and Decrease Improper Payments*). The National Taxpayer Advocate has been recommending this approach since 2009. *See* National Taxpayer Advocate 2009 Annual Report to Congress 338–345 (Legislative Recommendation: *Direct the Treasury Department to Develop a Plan to Reverse the "Pay Refunds First, Verify Eligibility Later" Approach to Tax Return Processing).*

been rising steadily over the past decade—from 71 million calls in fiscal year 2004 to 109 million calls in fiscal year 2013, an increase of 53 percent.[14]

—The IRS lacks the staffing to answer these calls. In fiscal year 2004, the IRS answered 87 percent of calls from taxpayers seeking to speak with a CSR (which, in IRS parlance, is referred to as the "Level of Service" or "LOS"). In fiscal year 2013, the IRS answered only 61 percent of such calls, a reduction of 26 percentage points, or 30 percent, in the LOS. Among those taxpayers lucky enough to get through, hold time increased from 2.6 minutes to 17.6 minutes, a nearly six-fold rise.[15]

Figure 1: IRS Telephone Service Levels, Fiscal Year 2004–2013



—The IRS historically has prepared tax returns for low income, elderly, and disabled taxpayers seeking assistance at its walk-in sites (known as "Taxpayer Assistance Centers," or "TACs"). In fiscal year 2004, the IRS prepared 476,000 returns.[16] Since that time, the IRS has imposed increasing limits on return preparation, and by fiscal year 2013, the number of returns it prepared during the filing season had declined by 59 percent as compared with fiscal year 2004.[17]

—The IRS's ability to timely process taxpayer correspondence has also taken a hit. When the IRS sends a taxpayer a notice proposing to increase his or her tax liability, it gives the taxpayer an opportunity to present an explanation or documentation supporting the position taken on the return. Each year, the IRS typically receives around ten million taxpayer responses, known collectively as the "adjustments inventory."[18] The IRS has established timeframes for processing taxpayer correspondence, generally 45 days. During the final week of fiscal year 2004, the IRS failed to process 12 percent of its adjustments cor-

[14] IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of fiscal year 2013 and fiscal year 2004).

[15] IRS, Joint Operations Center, *Snapshot Reports: Enterprise Snapshot* (final week of each fiscal year for fiscal year 2004 through fiscal year 2013).

[16] This data was provided to TAS by the IRS Wage & Investment Division in connection with the National Taxpayer Advocate's 2007 Annual Report to Congress 162–182 (Most Serious Problem: *Service at Taxpayer Assistance Centers).*

[17] Government Accountability Office, GAO–14–133, *2013 Tax Filing Season: IRS Needs to Do More to Address the Growing Imbalance between the Demand for Services and Resources* 26 (Dec. 2013); GAO, GAO–11–111, *2010 Tax Filing Season: IRS's Performance Improved in Some Key Areas, but Efficiency Gains Are Possible in Others* 45 (Dec. 2010); GAO, GAO–07–27, *Tax Administration: Most Filing Season Services Continue to Improve, but Opportunities Exist for Additional Savings* 29 (Nov. 2006) (supplemented with IRS data provided to TAS for 2004 through 2006).

[18] In fiscal year 2013, receipts in the Adjustments Inventory were about 8.4 million, as compared with 10.4 million in fiscal year 2012. We are not certain why the number declined. The Adjustments Inventory is one component of the Accounts Management function's overall Paper Inventory. In fiscal year 2013, receipts in the Paper Inventory were about 20.8 million, and the percentage classified as overage at year-end was 47 percent. IRS, Joint Operations Center, *Account Management Information Report (AMIR)—National Summary* (week ending Sept. 28, 2013).

respondence within its timeframes. By contrast, during the final week of fiscal year 2013, the IRS was unable to process 53 percent of adjustments correspondence within these timeframes.[19]

As compared with fiscal year 2013, the IRS's ability to assist taxpayers has suffered further declines in fiscal year 2014:

—For fiscal year 2014 through April 15, the LOS on the phones was 66 percent, down from 71 percent during the same period in fiscal year 2013. Among taxpayers who got through, hold time rose from 13.3 minutes to slightly over 17 minutes. For practitioners calling the Practitioner Priority Service line, the decline was even steeper. The LOS dropped from 82 percent to 72 percent, while hold time rose from 12 minutes to 26.7 minutes.[20]

—In an effort to answer more calls, the IRS posted an announcement on IRS.gov in December that said it will answer only "basic" tax-law questions on its phone lines and in its walk-in sites during the filing season (January through mid-April).[21] It will not answer any questions that are "more detailed" than "basic" during the filing season. Moreover, it will not answer any tax-law questions after mid-April, including "basic" questions from the millions of taxpayers who obtain filing extensions and prepare their returns later in the year.

Here are some examples of "complex" tax law questions that the IRS no longer will answer from its taxpayers:

I deliver pizzas for my employer using my car. How can I deduct my car expenses?

I received a 1099–MISC instead of a Form W–2 for my new job, how do I report this on my tax return?

Do I have to report the inheritance I received?

I have started selling some craft items I make as a hobby. Do I have to report that?

These questions are really directional questions—how should I approach this issue? When the IRS is unable and unwilling to answer questions such as these, it increases the compliance burden on its taxpayers and the risk that taxpayers will get incorrect advice from other quarters. Thus, the decision to answer only basic tax law questions through the filing season, and not answer any "complex" question at all, will have a negative effect on tax compliance.

—Also to conserve resources, the IRS announced that it will no longer prepare any tax returns at its walk-in sites, even for low income, elderly, or disabled taxpayers.[22]

At the risk of vast understatement, it is a sad state of affairs when the Government writes tax laws as complex as ours—and then can answer nothing beyond "basic" questions from baffled citizens who are doing their best to comply.

I realize that some may find it difficult to justify increased funding for the IRS. I personally have concerns about IRS performance, and in fact, I am required by statute to be an "IRS critic" by identifying at least 20 of the most serious problems facing taxpayers in my annual reports to Congress.[23] But I must tell you that I do not see any way the agency can begin to meet the service needs of the taxpaying public without substantially more funding. Most notably, almost twenty million phone calls from taxpayers seeking to speak with a customer service representative went unanswered last year. With phone calls up about 17 percent and IRS funding down 8 percent since fiscal year 2010, there is no way the IRS can answer all these calls without more employees.

In part because of mistakes made in the past, the agency has undergone significant leadership changes in recent months. Many policy changes have been made in response to congressional concerns, and the fiscal year 2014 appropriations act contains new directives. If members have continuing concerns, I encourage you to use

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[19] IRS, Joint Operations Center, *Adjustments Inventory Reports: July-September Fiscal Year Comparison (fiscal year 2004 through fiscal year 2013).*

[20] IRS, Joint Operations Center, Executive Level Summary reports (comparing the periods of Oct. 1, 2013 through April 15, 2014 with Oct. 1, 2012 through April 15, 2013).

[21] IRS, e-News for Tax Professionals—Issue Number 2013–49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

[22] IRS, e-News for Tax Professionals—Issue Number 2013–49, Item 4, *Some IRS Assistance and Taxpayer Services Shift to Automated Resources* (Dec. 20, 2013), *at* http://www.irs.gov/uac/Some-IRS-Assistance-and-Taxpayer-Services-Shift-to-Automated-Resources.

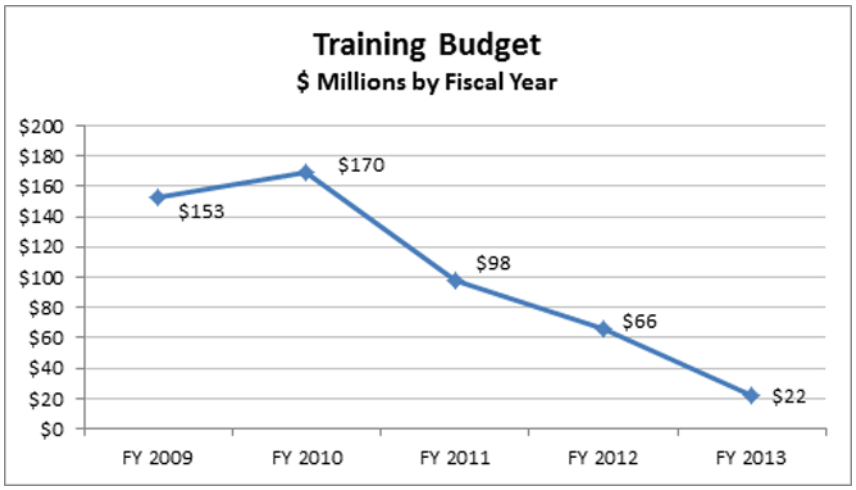
[23] *See* IRC § 7803(c)(2)(B)(ii)(III).

the oversight process to try to address them. But I personally believe it is a mistake to cut the IRS's budget and thereby preclude the agency from providing basic service to millions of taxpayers who seek help each year. When we ask our taxpayers to turn over a significant portion of their incomes to the Government, we owe it to them—the constituents you represent, and the taxpayers for whom I advocate—to ensure we have the infrastructure in place to help them comply with the requirements Congress has imposed by law.

II. EROSION OF IRS EMPLOYEE TRAINING AND SKILLS

The IRS mission is to "provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all."[24] With a complex and constantly changing tax law, it is essential that IRS employees receive prompt and appropriate training and education in order to provide taxpayers with complete and accurate assistance. However, budget cuts and sequestration have led the IRS to reduce its training budget by over 85 percent since fiscal year 2009.[25] Per-employee spending dropped from nearly $1,450 per full-time equivalent employee in 2009 to less than $250 in 2013.[26]

Figure 2: IRS Training Budget, Fiscal Year 2009–2013



Most of the operating divisions that interact directly with taxpayers fared worse than the agency as a whole. The IRS Appeals division reduced its training budget from nearly $6 million in fiscal year 2009 to about $250,000 in fiscal year 2013, or almost 96 percent.[27] During the same period:

—The Tax Exempt and Government Entities (TE/GE) division slashed its training budget by almost 96 percent, or approximately $7 million;
—The Small Business/Self-Employed (SB/SE) division training budget declined by 93 percent;
—The Large Business and International (LB&I) division training budget fell by about 92 percent;
—The Taxpayer Advocate Service (TAS) decreased its training budget by almost 78 percent; and
—The Wage and Investment (W&I) division fared the best, with a decrease of "only" approximately 74 percent.[28]

[24] Internal Revenue Manual (IRM) 1.1.1.1, *The IRS Mission* (Mar. 1, 2006).
[25] IRS response to TAS research request (Nov. 22, 2013). In fiscal year 2009, the IRS spent $153,155,686 on training versus $22,574,539 in fiscal year 2013, a reduction of 85.26 percent. The IRS training budget includes both training and conferences.
[26] IRS, Human Resources Reporting Center, available *at* https://persinfo.web.irs.gov/(last visited Oct. 22, 2013).
[27] IRS response to TAS research request (Nov. 22, 2013).
[28] *Id.*

Not only has the IRS reduced the funding and number of hours of training for employees, it has also cut the number of courses offered and eliminated entire subject areas. In fiscal year 2009, SB/SE offered over 2,000 different in-person and virtual learning courses to its Revenue Officers (ROs, who conduct all field collection), compared to just over 900 in fiscal year 2013, a nearly 60 percent decrease. Other job series saw even more drastic cuts. TE/GE Tax Examiners were offered 166 in-person training courses in fiscal year 2009 but only three in fiscal year 2013, a 98 percent decrease.[29]

We want the IRS to treat taxpayers fairly and to assess the correct amount of tax and to protect taxpayer rights in its interactions with taxpayers. After several years of continuing and drastic cuts to training, U.S. taxpayers cannot have confidence that IRS employees will be able to fulfill these expectations. IRS funding for training (and travel related to in-person training) must be restored to 2009 levels.

III. IDENTITY THEFT AND REFUND FRAUD

As I have written in nearly every Annual Report I have delivered to Congress since 2004, tax-related identity theft is a serious problem—for its victims, for the IRS and, when Treasury funds are improperly paid to the perpetrators, for all taxpayers.[30] In general, tax-related identity theft occurs when an individual intentionally uses the Social Security number of another person to file a false tax return to obtain an unauthorized refund.[31]

Within my organization, the Taxpayer Advocate Service, identity theft receipts increased sharply over the past decade, accounting for approximately one out of four cases in our inventory in recent years.

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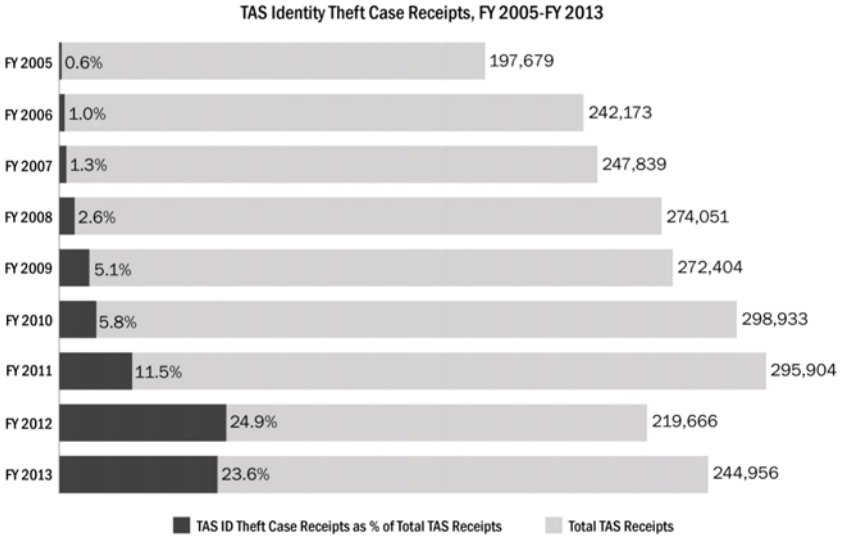
[29] *Id.*

[30] *See* National Taxpayer Advocate 2013 Annual Report to Congress 75–83 (Most Serious Problem: *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden and Anxiety for Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42–67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft*); National Taxpayer Advocate 2011 Annual Report to Congress 48–73 (Most Serious Problem: *Tax-Related Identity Theft Continues to Impose Significant Burdens on Taxpayers and the IRS*); National Taxpayer Advocate 2009 Annual Report to Congress 307–317 (Status Update: *IRS's Identity Theft Procedures Require Fine-Tuning*); National Taxpayer Advocate 2008 Annual Report to Congress 79–94 (Most Serious Problem: *IRS Process Improvements to Assist Victims of Identity Theft*); National Taxpayer Advocate 2007 Annual Report to Congress 96–115 (Most Serious Problem: *Identity Theft Procedures*); National Taxpayer Advocate 2005 Annual Report to Congress 180–191 (Most Serious Problem: *Identity Theft*); National Taxpayer Advocate 2004 Annual Report to Congress 133–136 (Most Serious Problem: *Inconsistence Campus Procedures).*

[31] The IRS refers to this type of tax-related identity theft as "refund-related" identity theft. In "employment-related" identity theft, an individual files a tax return using his or her own taxpayer identifying number (usually an Individual Taxpayer Identification Number or ITIN), but uses someone else's SSN to obtain employment. Consequently, the wages are reported to the IRS under the SSN of the victim, potentially prompting the IRS to pursue the victim for additional tax on the apparent income. *See* IRM 10.5.3.2(4), *Identity Protection Program Servicewide Identity Theft Guidance* (Feb. 27, 2013). Unlike in 1993, when I first represented a client in an identity theft case, the IRS now has procedures in place to minimize the tax administration impact to the victim in these employment-related identity theft situations. Accordingly, I will focus on refund-related identity theft in this testimony.

Figure 3: Taxpayer Advocate Service ID Theft Cases [32]



When we first started writing about tax-related identity theft in 2004, the IRS had no procedures for its employees to follow when a taxpayer claimed to be a victim of ID theft. Since then, the IRS has established a program office to develop victim assistance procedures and has adopted many of the recommendations we have made over the years. The IRS also has done a better job of developing automated filters that flag suspicious returns and delay the payout of refunds while the refund claims are scrutinized, and it has improved some of its victim assistance procedures.

Yet, the IRS still has much room for improvement in how it addresses identity theft. First, it must recognize that the consequences for victims can be significant. Being victimized by an identity thief is a traumatic life event; when someone steals and uses your identity, it is an invasion of your person. On top of that, the victim must spend time and energy having to prove his or her identity to the IRS and must endure months of aggravation and frustration before receiving his or her tax refund, a delay that can create financial hardships for taxpayers—particularly low income taxpayers—who are expecting and depending on their tax refunds to pay basic living expenses. The IRS's current approach in many ways treats the victim as someone experiencing a minor inconvenience, instead of a frightening personal trauma.

In acknowledging that identity theft is a traumatic life event, the IRS should set up a centralized identity theft unit similar to the innocent spouse unit that assists taxpayers who are seeking relief from joint and several liability. It is important to have a centralized unit with specially trained employees who can remain on the case as a single point of contact with the victim from the beginning to full case resolution. Otherwise, the IRS would be guilty of contributing to the problem and perpetuating the trauma to the victim. When I visited the IRS Identity Protection Specialized Unit (IPSU) unit last summer, I met with front-line employees, many of whom expressed frustration about not truly "owning" a case and having to wait for other functions to take actions on these cases that the IPSU could have easily completed.

In my latest report to Congress, I recommended that the IRS designate the IPSU as the centralized function that assigns a single employee to work with ID theft victims until all related issues are resolved. In my meetings with the new IRS leadership, they have expressed willingness to revisit whether the current decentralized approach is the right one. I have offered to collaborate with the Wage and Investment division to test the effectiveness of creating a meaningful single point of contact for victims of identity theft with cases that require the involvement of multiple IRS functions (for example, where the taxpayer is not only trying to get a current

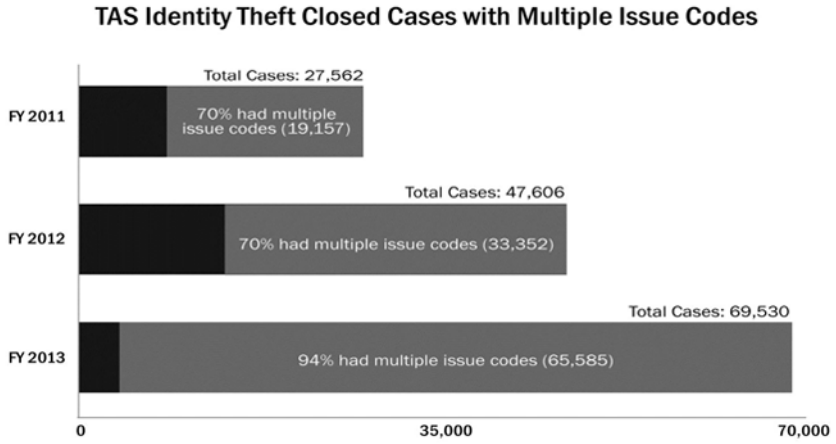
[32] Case receipt data obtained from the Taxpayer Advocate Management Information System (TAMIS) on February 13, 2014.

year's return refund but also seeking abatement of an assessment attributable to a prior year's identity theft return).

The IRS takes much too long to resolve ID theft cases and issue refunds to the legitimate taxpayers, particularly where the case moves back and forth among IRS functions. A 2013 TIGTA report found the IRS took an average of 312 days to work the 100 ID theft cases in the report sample.[33] This included 277 days of inactivity. In other words, though the cases lingered in various IRS units for approximately 10 months, the average case in TIGTA's sample was resolved with just 35 days of direct contact.

The IRS's current approach of using more than 20 specialized units to handle discrete aspects of an identity theft victim's case is simply not working. As far as the victims are concerned, there should be one IRS employee who interacts with the taxpayer. That one employee should maintain control of the taxpayer's case, including all peripheral issues stemming from the identity theft. Because identity theft cases are often very complex, and can involve multiple issues spanning multiple years, too many victims fall between the cracks of the IRS bureaucracy.

Figure 4: Percentage of TAS ID Theft Cases with Multiple Issue Codes, Fiscal Year 2011–2013[34]



The Taxpayer Advocate Service's experience with working identity theft cases demonstrates the soundness of our recommendation that the IRS should assign one employee to work with the victim from the beginning, and oversee the case when it requires coordination among different units. Instead of taking 312 days to work an identity theft case, TAS case advocates resolve them in 87 days.[35] And even though identity theft cases are complex (with over 94 percent of our identity theft cases closed in fiscal year 2013 involving more than one issue code), TAS case advocates have achieved a relief rate of 87 percent.[36] Furthermore, an overwhelming 94 percent of identity theft victims who came to TAS in fiscal year 2013 have expressed satisfaction with our assistance.[37]

The IRS also needs to do a better job of tracking identity theft case data. The IRS cannot even provide a reliable figure for the number of identity theft victims it has assisted, partly because the various specialized units use different systems to track

[33] *See* TIGTA, Ref. No. 2013–40–129, *Case Processing Delays and Tax Account Errors Increased Hardship for Victims of Identity Theft* (Sept. 26, 2013).

[34] The IRS does not track the number of issues in a given identity theft case because, unlike TAS, it treats each module (year/tax/issue) as a different case. Accordingly, we can provide TAS data only. This chart is meant to illustrate that the vast majority of TAS identity theft cases involve multiple issue codes. The increase in the percentage of cases with multiple issue codes from fiscal year 2011 to fiscal year 2013 may be due to better coding by TAS case advocates to record secondary issue codes; it does not necessarily mean that TAS identity theft cases have become more complex in recent years.

[35] Analysis conducted by TAS Technical Analysis and Guidance of data obtained from TAMIS (Oct. 1, 2013).

[36] *Id.*

[37] Analysis conducted by TAS Business Assessment of customer satisfaction scores reported for fiscal year 2013 (through June 2013); data obtained from TAMIS (Oct. 1, 2013).

cases. Moreover, while some IRS functions track the length of time a case is in their inventory, the IRS still cannot provide an overall cycle time from the taxpayer's perspective. For example, specialized units generally measure cycle time from the date that particular unit received the case; their cycle time measures do not reflect the time elapsed since the taxpayer attempted to file the initial return, or all of the prior interactions the victim may have had with the IRS. In my 2013 Annual Report to Congress, I recommended that the IRS develop a method of tracking cycle time from the perspective of the victim.

IV. AFFORDABLE CARE ACT

As part of the Affordable Care Act (ACA), the IRS is implementing complicated healthcare tax provisions that require new technology and significant rule-making.[38] These provisions would present a serious administrative challenge to any agency, but for one such as the IRS, with its annual and continuing tax administration duties, the added work is daunting. To date, I believe the IRS has acquitted itself well in meeting its initial responsibilities under the ACA. Specifically, the IRS has done a good job of updating information technology (IT) systems, issuing guidance, and collaborating with other Federal agencies. The IRS's actions with regard to ACA implementation demonstrate what the IRS can do when it has sufficient lead time to plan and implement a complex social benefit delivered through the tax system.

While the opening of the Health Insurance Marketplaces[39] on October 1, 2013, was riddled with problems, the one aspect that went better than anticipated was the role of the IRS in providing information to the Marketplace on household income and family size. Originally, the IRS agreed that queries from the Marketplace would have an average response time of less than 5 seconds. However the IRS has been providing an average response time of less than one second.[40] The IRS is to be commended on its ability to surpass expectations thus far.

In order to ensure that ACA design and implementation treat taxpayers—both individuals and businesses—appropriately and fairly, the Taxpayer Advocate Service has been actively involved with the IRS roll-out of the Affordable Care Act tax provisions. I personally sit on the ACA Executive Steering Committee and have staff throughout TAS on the ACA Joint Implementation Teams to ensure the provisions are implemented in a fair and equitable manner and that taxpayer rights are protected.[41]

ACA Taxpayer Service and Training Raise Concerns

The true test for the IRS will be in 2015, when taxpayers begin filing their 2014 tax returns. This will be the first year when individual taxpayers will have to report they have minimal essential health insurance coverage when they file their income tax returns, or that they are exempt from the responsibility to have the required health insurance coverage. If the taxpayer does not have health insurance coverage and is not exempt, then he or she will need to make an individual shared responsibility payment (ISRP) when filing a return.[42] Additionally, many taxpayers will have to reconcile the Premium Tax Credit amounts they are currently receiving with the amounts to which they are entitled based on their actual (as opposed to projected) 2014 income.[43]

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[38] *See* Patient Protection & Affordable Care Act of 2009, Public Law No. 111–148, 124 Stat. 119 (Mar. 23, 2010), as amended by the Health Care & Education Reconciliation Act of 2010, Public Law No. 111–152, 124 Stat. 1029 (Mar. 30, 2010).

[39] https://www.healthcare.gov/marketplace/individual.

[40] This is due, in part, to a lower than anticipated volume of inquiries. Data provided verbally at ACA Executive Steering Committee on Nov. 13, 2013.

[41] The Joint Implementation Teams TAS is represented on are: Customer Service Operations, Tax Return Processing, Information Return Receipt and Processing, ACA Notices and Correspondence, Compliance—Individuals, Compliance—Business, and Collection.

[42] IRC § 5000A. The following individuals in the following categories are exempt from the ISRP: a member of a religious sect that is recognized as conscientiously opposed to accepting insurance benefits; a member of a healthcare sharing ministry; a person not lawfully present in the U.S.; a person incarcerated for at least one day of the applicable month in a jail, prison, or similar penal institution or correctional facility after the disposition of charges; a person who has income below the tax filing threshold; a person who lacks coverage for fewer than 3 months; a person who cannot afford coverage where the required contribution exceeds 8 percent of household income for 2014; members of federally recognized Indian tribes; or persons who have suffered hardship as certified by an Exchange with respect to the capability to obtain minimum essential coverage (including, among others, patients of the Federal Indian Health Service not enrolled in a recognized tribe). See IRC § 5000A(d) and (e).

[43] The Premium Tax Credit is a refundable, advanceable tax credit available to help taxpayers with moderate income purchase health insurance through a Marketplace. IRC § 36B.

While other agencies have telephone or Web chat options, the IRS has adopted a Web-first strategy that acts more as a "Web-only" strategy, limiting taxpayers' access to in-person assistance with tax-related healthcare questions.[44] The IRS has specifically advised its assistors "the best service to the customer is to provide the Web URLs. This is known as the 'Web First' strategy."[45] In comparison, Healthcare.gov has telephone assistors trained to answer questions, as well as a live Web chat option.[46]

Web sites alone may not meet the needs of taxpayers dealing with complicated new provisions for the first time.[47] Moreover, those who are eligible for the Premium Tax Credit may not have the necessary language or computer literacy skills to obtain information in this way,[48] and those who lack Internet access still need IRS assistance through other channels. Obtaining healthcare is an inherently complicated and personal decision that can have a major impact on a taxpayer's life and finances. If the IRS cannot answer tax-related questions, taxpayers may unknowingly make healthcare choices that carry significant tax implications.

The IRS Is Not Adequately Training Assistors to Respond to Taxpayer Questions on Health Care Issues

As discussed above, due to resource constraints the IRS already cannot answer millions of telephone calls or respond timely to volumes correspondence from taxpayers.[49] The new work caused by the ACA will compound this backlog. The IRS estimates it needs almost 2,000 new employees to handle the numerous additional calls and letters that may arrive once applicable provisions take effect.[50] Absent additional employees dedicated to the ACA, the IRS must ensure that the employees it does have —particularly in taxpayer-facing roles—are properly trained to respond to taxpayer inquiries.

The IRS has provided some general ACA information to employees but has not yet engaged in substantive training. The IRS says it is developing training for 2014, but TAS has yet to see or review its training plan. In contrast, TAS has been providing training to its employees on the Affordable Care Act since 2010, to give them time to digest and develop a basic understanding of the new provisions. TAS plans to continue this training through 2014, adding more in-depth sessions and specific case studies. It is my understanding that one of the ACA Implementation Teams is reviewing the ACA training TAS offered this year to see if it meets the needs of the ACA overview all IRS employees should receive. I encourage the IRS to use TAS's training and ensure that all IRS employees receive basic training on the new healthcare provisions.

IRS Outreach Does Not Alert Taxpayers to the Issues Surrounding a Change in Circumstances

The IRS has made strides in its ACA outreach efforts. It has issued several user-friendly publications for taxpayers regarding the Premium Tax Credit, and we understand it plans similar publications for the employer provisions and Individual

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[44] *See* Health Insurance Market Place, *Help-Center,* https://www.healthcare.gov/help-center/ (last visited Aug. 12, 2013).

[45] IRS, *Affordable Care Act Web First Strategy: Addressing Health Care Law Inquiries,* http://win.web.irs.gov/field/fadocs/ACA__Web__First__Strat.pdf (last visited Apr. 30, 2013).

[46] *See* Health Insurance Market Place, *Help-Center,* https://www.healthcare.gov/help-center/ (last visited Aug. 12, 2013).

[47] Existing IRS functions, such as Stakeholder Partnership, Education & Communication (SPEC), Stakeholder Liaison, and Taxpayer Assistance Centers may receive questions and even visits from taxpayers who want to know about the ACA. *See* SPEC *Outreach Summary* (Filing Season Jan.-Apr. 2013) (containing 3-pg. ACA Overview); IRS Pub. 5093, *Healthcare Law Online Resources* (1 pg. listing a half-dozen URLs for individuals & employers).

[48] Adults "living in households earning at least $50,000 per year are more likely to have home broadband than those at lower income levels." Pew Res. Ctr., *Home Broadband* 2013, *available at* http://pewInternet.org/Reports/2013/Broadband.aspx (last visited Sept. 17, 2013). As of 2011, only "75.6 percent of households reported having a computer," which means almost a quarter of the Nation's households may be unable to get the information they need from the IRS's Web strategy. U.S. Census Bureau, *Computer and Internet Use in the United States,* P20-569 (May 2013) 1. *See also* National Taxpayer Advocate 2011 Annual Report to Congress 273, 279 (Introduction to Diversity Issues: *The IRS Should Do More to Accommodate Changing Taxpayer Demographics*) ("low income, less educated, minority, elderly, disabled, or rural populations are less likely than others to use the Internet").

[49] *See* NTA 2013 Annual Report 20 (Most Serious Problem: *IRS Budget Cuts Diminish Taxpayer Service*); National Taxpayer Advocate 2012 Annual Report to Congress 34 (Most Serious Problem: *The IRS Is Significantly Underfunded to Serve Taxpayers and Collect Tax*); IRS Joint Operation Center (JOC) Snapshot Report for fiscal year 2013 (Sept. 30, 2013) and JOC Accounts Management Inventory Reports for fiscal year 2013 (Oct. 6, 2012–Sept, 28, 2013).

[50] *See* IRS fiscal year 2014 Congressional Budget Submission, Table 4.9 at 177.

Shared Responsibility Payment.[51] Additionally, the IRS has made efforts to improve the ACA pages on IRS.gov, including by posting new pages on the Premium Tax Credit and the ISRP[52] as well as updated Q&As and legal guidance.[53] The IRS also plans to create a page on the 5000A Individual Shared Responsibility Payment. TAS will continue to work with the IRS on its outreach efforts.

However, we remain concerned that the IRS is not being proactive and educating taxpayers as early as possible on a critical issue: the importance of updating their information throughout the year with the Exchange if they are receiving a credit.[54] To avoid receiving an excess credit, taxpayers must update their information with the marketplace if their incomes or other relevant circumstances change.[55] This is also important for taxpayers who may be eligible for a larger credit due to a reduction in pay or an increase in family size (such as having or adopting a child). Educating taxpayers early and repeatedly about this requirement will help prevent them from owing money to the IRS (or reducing their refunds) or receiving an additional credit amount at the end of the year that they could have received earlier.

Healthcare.gov now has a "Report Life Change" button that allows individuals to modify their health insurance plans (once they are enrolled) if they have experienced a change such as family size, moving, etc.[56] Assuming this option will also allow for a recalculation of the Premium Tax Credit based on these changes, the IRS can easily tie its messages about changing circumstances into this new option.

TAS worked with the IRS to prominently place language in the 2013 Form 1040, *U.S. Individual Income Tax Return,* instructions to alert taxpayers to the importance of updating their information with the marketplaces. However, the IRS still needs to be more proactive. While almost 80 percent of individual returns are refund returns and thus may offset some or all of the reconciliation amount, the IRS should be doing all it can to ensure that as few taxpayers as possible have excessive advanced premium tax credit payments and instead receive the correct amount throughout the year.[57] In addition to preventing taxpayers from owing money, this approach will reduce future costs to the IRS for collection activities.[58]

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[51] Thus far, the IRS has issued several electronic publications, including Pub. 5093, *Health Care Law Online Resources* (July 2013), Pub. 5120, *Facts About the Premium Tax Credit* (flyer) (Sept. 2013), and Pub. 5121, *Facts About the Premium Tax Credit* (brochure) (Dec. 2013). We understand that Spanish versions of the publications are in progress.

[52] The ACA homepage is located *at* http://www.irs.gov/aca. The Premium Tax Credit page is located *at* http://www.irs.gov/uac/The-Premium-Tax-Credit. The ISRP page is located *at* http://www.irs.gov/uac/Individual-Shared-Responsibility-Provision.

[53] http://www.irs.gov/uac/Newsroom/Affordable-Care-Act-Tax-Provisions-Questions-and-Answers.

[54] To apply for a premium assistance credit, an individual goes to an Exchange, which will attempt to verify household income with the IRS. In general, applicable taxpayers seeking health insurance and a premium tax credit through an Exchange will supply names, Social Security numbers, and income data for themselves and their dependents to the Exchange. *See* ACA § 1411(b), 124 Stat. 119, 224 (2010). The Exchange can verify data with HHS, which has authority under the ACA to obtain IRS data, and then disclose any inconsistency to the Exchange. *See* IRC § 6103(l)(21). If IRS information is inaccurate or outdated, the individual may need to present updated documentation or other evidence to HHS to establish eligibility for a premium tax credit. If a taxpayer's household status at year's end is other than anticipated—due either to a change in income or family size—the premium tax credit may be more or less than the amount advanced. Consequently, the IRS may recover the excess as a tax (above a threshold for low income taxpayers), or owe the taxpayer a refund. Section "36B(f)(2)(B) places a graduated set of caps on the additional tax liability for taxpayers with household income under 400 percent of the F[ederal] P[overty] Level]. The repayment limitation amounts range from $600 to $2,500 (one-half that amount for single taxpayers) depending on FPL, and are adjusted to reflect changes in the cost of living beginning in 2015." 76 Fed. Reg. 50931, 50933-934 (Aug. 17, 2011).

[55] Income may change after submission of an application, which reflects the amount on the last tax return, *i.e.,* the one filed in the current year relating to the year that just ended. Thus, a couple of years' worth of life changes may transpire by the time of reconciliation between the advance and ultimate credit amounts. By the same token, certain changed circumstances, such as the birth of a child or a reduction in pay, may increase the credit.

[56] Amy Goldstein, *Administration will allow people to switch health-care plan to a limited degree,* Washington Post (Feb. 7, 2014) *available at* http://www.washingtonpost.com/national/health-science/administration-will-allow-people-to-switch-obamacare-plans-to-a-limited-degree/2014/02/07/56c8bfd2-9015-11e3-b227-12a45d109e03_story.html (last visited Feb. 18, 2014).

[57] IRS Compliance Data Warehouse, Individual Returns Transaction File Tax Year 2012 (Feb. 2014).

[58] TAS looks forward to working with the IRS Office of Research, Analysis and Statistics (RAS) to try to identify the areas and populations of taxpayers most likely to have experienced a change in circumstances. This information can be used by the IRS's SPEC organization, TAS Local Taxpayer Advocates (LTAs), Low Income Taxpayer Clinics (LITCs), and other stakeholders to conduct outreach to these specific populations.

I have additional concerns that other taxpayers will have their returns delayed because they claim a larger Premium Tax Credit than what they received during the year due to a change in circumstances. If the IRS flags these returns as potentially fraudulent, it may hold up legitimate refunds. TAS has seen these issues previously, especially when large dollar amounts are at stake.[59]

While there will always be persons trying to game the tax system, I believe the risk of fraud with respect to the Premium Tax Credit (PTC) is much less than with many other refundable credits. With respect to the Advanced Premium Tax Credit, the credit will be paid to established insurance companies when a policy is actually in place. When a taxpayer claims the PTC on his or her income tax return, it is a reimbursement of amounts already paid; the taxpayer will have to provide proof of a qualified health insurance plan, which the IRS will be able to verify through third-party information reporting. This design minimizes the opportunities for fraud.

TAS is in the final stages of developing an estimator for the Premium Tax Credit that will help taxpayers and practitioners understand how changes in circumstances will impact their credit amounts. TAS hopes to have this tool online and available to the public in the next few months. We have had success with a similar estimator for the Small Business Health Care Tax Credit (SBHCTC), which we launched on the TAS Tax Toolkit in November 2012.[60] The homepage for the estimator received 5,000 page views for October 2013 and over 13,000 page views for October—December 2013.[61]

IRS ACA Audit and Collection Activity May Unduly Burden Low Income Taxpayers

My concerns about the IRS's implementation of the Affordable Care Act (ACA) are similar to concerns I have raised on numerous occasions about the IRS's handling of identity theft claims. Just as the IRS does not resolve identity theft cases through a single point of contact and thereby forces taxpayers to negotiate a maze of various IRS functions to unwind the harm caused by the identity theft, the IRS may not resolve, during routine audits, issues related to the ACA. This case segmentation may prolong the length of time taxpayers must wait to fully and finally resolve their tax liabilities for a given year and burden them with additional IRS contacts. These inefficiencies, some of which appear to be attributable to programming conditions, may disproportionately affect low income taxpayers.[62]

For example, the IRS may audit the return of a taxpayer claiming the Earned Income Tax Credit (EITC).[63] The taxpayer may have also claimed the Premium Tax

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[59] National Taxpayer Advocate 2012 Annual Report to Congress 111–133 (Most Serious Problem: *The IRS's Compliance Strategy for the Expanded Adoption Credit Has Significantly and Unnecessarily Harmed Vulnerable Taxpayers, Has Increased Costs for the IRS, and Does Not Bode Well for Future Credit Administration*); National Taxpayer Advocate fiscal year 2012 Objectives Report to Congress 28–32; National Taxpayer Advocate 2011 Annual Report to Congress 687–689 (Case Advocacy: *Policymakers Can Learn from the Implementation of the FTHBC*); National Taxpayer Advocate fiscal year 2011 Objectives Report to Congress 3, 37–43; National Taxpayer Advocate 2010 Annual Report to Congress 15 (Most Serious Problem: *The IRS Mission Statement Does Not Reflect the Agency's Increasing Responsibilities for Administering Social Benefits Programs*) (Case Advocacy: *TAS Assists the IRS with the Administration of the First-Time Homebuyer Credit*); National Taxpayer Advocate 2009 Annual Report to Congress 506–509; *Hearing on Complexity and the Tax Gap: Making Tax Compliance Easier and Collecting What's Due, Hearing Before the S. Comm. on Finance,* 112th Cong. (statement of Nina E. Olson, National Taxpayer Advocate) (June 28, 2011); *Filing Season Update: Current IRS Issues: Hearing Before the S. Comm. on Finance,* 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate) (Apr. 15, 2010); *The National Taxpayer Advocate's 2009 Report on the Most Serious Problems Encountered by Taxpayers: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means,* 111th Cong. (2010) (statement of Nina E. Olson, National Taxpayer Advocate) (Mar. 16, 2010).

[60] http://www.taxpayeradvocate.irs.gov/Businesses/Small-Business-Health-Care-Tax-Credit-Estimator (last visited Feb. 19, 2014). According to Weber Shandwick, which tracks statistics for the estimator, the SBHCTC estimator has received over 23,500 page views since its launch in 2012.

[61] Taxpayer Advocate Service, fiscal year 2014 1st Quarter Business Performance Review.

[62] Programming deficiencies are evident in other, related areas of IRS operations. See letter from Sen. Grassley to Comm'r Koskinen (Apr. 21, 2014) *available at* http://www.grassley.senate.gov/issues/upload/Grassley-to-IRS-Return-Review-Program-4-21-14.pdf, noting that the IRS is not implementing the needed Return Review Program, a fraud detection system especially critical as the refundable Premium Tax Credit becomes available, due to budgetary constraints.

[63] Taxpayers who claim the Earned Income Tax Credit are more likely to be audited than taxpayers in the general population. EITC audits have historically comprised about a third of all individual taxpayer audits. *See* National Taxpayer Advocate 2012 Annual Report to Congress

Continued

Credit.[64] If the IRS determines the taxpayer's income exceeded the allowable threshold for claiming EITC, the taxpayer may also not be eligible for the PTC. However, under current programming conditions, the IRS would not be able to resolve both issues in the course of the audit because it plans to assess liability under the ACA using different software than it uses to process returns. Return-processing software would not recognize and manage tax liabilities arising under the ACA.[65] Consequently, the IRS would "conclude" the audit and assess additional tax because of disallowed EITC only to contact the taxpayer months later and assess additional tax due to disallowed PTC.

Conversely, if a taxpayer inflated his or her income in order to receive a larger EITC refund and the IRS later adjusts the taxpayer's income downward and reduces the claimed EITC amount, the taxpayer might be entitled to additional PTC because of the decreased income. As a result of the audit, the IRS would assess additional tax due to disallowed EITC, but the taxpayer's final liability, determined months later after the PTC issue is addressed, may be lower. The taxpayer might receive demands for payment related to the disallowed EITC in the meantime.

Similar issues arise with respect to the ISRP. A taxpayer may claim EITC and also report liability for ISRP with respect to the same child.[66] If the IRS determines the child was not a qualifying child, it would disallow the claimed EITC and assess additional tax. If the child was also not the taxpayer's dependent, the taxpayer would not be liable for ISRP with respect to that child, but only later would the IRS contact the taxpayer with respect to the assessed ISRP and ultimately reduce the liability. In the meantime, the taxpayer might be burdened with demands for payment and enforced collection action with respect to the disallowed EITC at a time when the true amount of the taxpayer's liability had not yet been established.

The ACA prohibits the IRS from collecting ISRP liabilities through enforced collection action.[67] However, when the IRS takes enforced collection action, such as a levy, to collect non-ISRP liabilities, it may collect more than the taxpayer actually owes.[68] Once the non-ISRP liabilities have been satisfied, the IRS should refund the overpayment to the taxpayer.[69] However, IRS programming conditions may cause the IRS to automatically apply excess levy proceeds to ISRP liabilities. The IRS tested programming intended to prevent this refund offset, but the proposed solution was successful only if the refund offset occurred in the same cycle the levy payment was received, which occurred only 18 percent of the time.[70] Ensuring that levy proceeds are not applied to ISRP liabilities would require manual processing of these accounts.

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vol. 2, *Study of Tax Court Cases In Which the IRS Conceded the Taxpayer was Entitled to Earned Income Tax Credit (EITC).*

[64] In general, a taxpayer may be eligible for the PTC if the taxpayer's household income for the taxable year is at least 100 percent but not more than 400 percent of the Federal poverty level for the taxpayer's family size. IRC § 36B(c)(1). The 2014 Federal poverty level for a four-person household is $23,850. *See* Federal Poverty Guidelines, *available at* http://aspe.hhs.gov/POVERTY/14poverty.cfm. 400 percent of $23,850 is $95,400. For 2014, joint filers with two qualifying children must have adjusted gross income of less than $49,186 in order to qualify for EITC. *Preview of 2014 EITC Income Limits, Maximum Credit Amounts and Tax Law Updates, available at* http://www.irs.gov/Individuals/2012-EITC-Income-Limits,-Maximum-Credit--Amounts-and-Tax-Law-Updates.

[65] The traditional software used by IRS Exam to conduct audits, Report Generating Software, cannot accommodate the need to assess these tax liabilities resulting from the same audit record.

[66] Under section 5000A(b)(3) of the ACA, the adult or married couple who can claim a child or another individual as a dependent for Federal income tax purposes is responsible for making the payment if the dependent does not have coverage or an exemption.

[67] IRC § 5000A(g)(2)(B).

[68] This may occur, for example, when the IRS imposes a continuous levy on the taxpayer's wages or levies on Social Security benefits and either inadvertently does not release the levy when the tax liability has been satisfied, or releases the levy, but not before the employer or the Social Security Administration has already remitted the payment to the IRS. See IRM 5.11.2.6 (Apr. 15, 2014), noting that "Every reasonable effort will be made to release a notice of levy timely. However, sometimes surplus levy proceeds are received. Surplus proceeds are payments greater than the amount still owed for the liabilities listed on the notice of levy. Example: A refund posts after the levy source has already sent payment for the levy."

[69] *See* IRC § 6342(b).

[70] Wage and Investment Research & Analysis (WIRA) Group 2, Project #2-14-09-A-*206 Refund Offset Adjustment Due to Lien/Levy Overpayment* (April 2014) and attached spreadsheet, showing that out of 11,064 transactions in tax year 2012 in which a levy resulted in an overpayment, in only 2,039 transactions was the overpayment offset to another module in the same cycle and was therefore preventable. 2,039 out of 11,064 is 18 percent. TAS Research has not yet verified the accuracy of these findings.

Delays in Information Matching Show Need for Real-Time Tax System

Last year, the Treasury Department delayed the requirement for certain employers with 100 or more employees to provide coverage to their employees.[71] Due to the delay in implementation, employers will not have to provide information reporting to the IRS regarding the employees they cover.[72] This information reporting will help identify which taxpayers have coverage and which do not (and therefore have to pay a penalty). We do not yet know how the IRS plans to address this lack of information during the 2015 filing season. TAS members on the relevant Joint Implementation Team have been told it will be discussed later.

Without this information, the IRS's job is increasingly difficult. This concern underscores the need for the IRS to develop an accelerated document-matching program, as discussed immediately below.

V. ACCELERATED RECEIPT AND USE OF THIRD-PARTY INFORMATION REPORTS

Accelerated third-party information report processing and upfront document matching would protect revenue, reduce fraud, and improve taxpayer service.

Whether in the context of Premium Tax Credit reconciliation, eligibility for the Earned Income Tax Credit, or returns filed by identity thieves, the IRS faces pressure to satisfy two competing demands: protect the public fisc from erroneous refund claims and meet taxpayer expectations by issuing refunds quickly. Although the IRS has instituted many business rules and filters to identify questionable refunds, it generally matches third-party information reports with tax return data long after it has released any associated income tax refunds.[73]

In 2009, I recommended that Congress establish a timeframe for the IRS to develop a strategy and timeline for accelerating third-party information report processing and providing taxpayers with electronic access to such data.[74] Most recently, a study in my 2013 Annual Report proposed a strategic framework and preliminary recommendations to better structure the filing season to reduce fraud and protect the interests of both the Government and taxpayers.[75] This is a key component of 21st century tax administration.

The Government benefits from the revenue protection aspect of accelerated third-party information report processing and upfront document matching. Third-party information reporting is a crucial element in maximizing tax compliance.[76] By enabling the IRS to match third-party data to tax return information before issuing refunds, the IRS could identify and resolve inaccurate income tax reporting soon after the return is filed and prevent the release of erroneous refunds. This system would deter tax fraud and identity theft by stopping the refund associated with a mismatch.

In addition, accelerated information report processing and upfront matching would substantially improve taxpayer service and reduce taxpayer burden by:

—Providing taxpayers with direct electronic access to the third-party information report data to assist in tax preparation and reduce inadvertent errors;[77]

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[71] Treasury Department Fact Sheet, *Final Regulations Implementing Employer Shared Responsibility Under the Affordable Care Act (ACA) for 2015, available at* http://www.treasury.gov/press-center/press-releases/Documents/Fact%20Sheet%20021014.pdf (last visited April 28, 2014). The requirement was further delayed until 2016 for employers with 50 to 99 employees. Shared Responsibility for Employers Regarding Health Coverage, 79 Fed. Reg. 8544 (Feb. 12, 2014).

[72] Transition Relief for 2014 Under §§ 6055 (§ 6055 Information Reporting), 6056 (§ 6056 Information Reporting) and 4980H (Employer Shared Responsibility Provisions), Notice 2013-45, 2013-31 I.R.B. 116.

[73] For a more detailed discussion of the IRS's processes to review refund returns, see Nina E. Olson, *More Than a 'Mere' Preparer: Loving and Return Preparation,* 2013 TNT 92-131, Tax Notes Tax Analysts Tax Notes Today (May 13, 2013).

[74] National Taxpayer Advocate 2009 Annual Report to Congress 338–345; National Taxpayer Advocate 2011 Annual Report to Congress 284–295; National Taxpayer Advocate 2012 Annual Report to Congress 180–191.

[75] NTA 2013 Annual Report vol. 2, 67–96.

[76] Tax gap data show the importance of information reporting compliance, and how third-party reporting is essential to encourage voluntary compliance; specifically, when taxpayers have a choice about reporting their income, tax compliance rates are remarkably low. For example, workers who are classified as employees have little opportunity to underreport their earned income because it is subject to both information reporting on Forms W–2 and tax withholding. In fact, IRS data show that taxpayers report about 99 percent of their wages and salaries. IRS, *Tax Gap for Tax Year 2006 Overview,* Chart 1 (Jan. 6, 2012).

[77] Taxpayers will not realize the full benefits of accelerated third-party information reporting unless the IRS provides taxpayers and their preparers with the ability to access and download their third party data from an online account. To address inadvertent omissions, the IRS should provide access to real-time transcripts of third-party data to aid in return preparation. Tax-

Continued

—Improving taxpayers' ability to answer questions about an underlying economic transaction if the IRS identifies the mismatch within months rather than a year or more after the fact;
—Avoiding IRS collection actions long after taxpayers have spent the refunds;
—Avoiding the long-term accrual of penalties and interest on unintentionally omitted or under-reported items; and
—Reducing vulnerability to identity-theft related refund fraud.[78]

While the IRS has acknowledged the benefits of accelerated third-party information report processing and upfront matching, it has not made any recent progress in developing a long-term plan for such a system.[79] The IRS's lack of progress only delays the significant benefits we outlined throughout the study. Thus, we reiterated our 2009 Legislative Recommendation that Congress require the IRS and Treasury, in consultation with the Taxpayer Advocate Service, to prepare a plan and timeline to achieve an accelerated third-party report processing system.

In addition, to stimulate serious consideration and discussion of the issue, we offered the following administrative and legislative recommendations to achieve a system that allows the IRS to perform upfront matching to protect Government revenue and improve taxpayer service:

—Provide taxpayers with electronic access to real-time transcripts of third-party information reporting data to aid in return preparation.
—Provide a platform from which taxpayers and preparers could download third-party data directly into commercial tax return preparation software.
—To accelerate the processing of Form W–2 data, develop and implement a 1 year pilot to determine whether the IRS can screen Form W–2 data as effectively as the Social Security Administration.
—Because almost 98 percent of information reports are already e-filed, eliminate the March 31 deadline for e-filed information reports.[80] Thus, all information reports, whether e-filed or filed on paper, would be due at the end of February.
—Create a $50 *de minimis* threshold for corrections, which would eliminate the need to file an amended or corrected third-party information report for any adjustments to income below $50.
—Further increase electronic filing by reducing the 250 report threshold in IRC § 6011(e) to 50 reports and offer 2D bar code technology for those who cannot e-file.
—Issue direct deposit and other electronic refunds by April 30 and paper checks by May 31 for taxpayers who file their returns by April 15.

The proposals included in the 2013 study are meant to serve as a "conversation starter" and are based on research conducted by the Taxpayer Advocate Service, including discussions with impacted stakeholder groups and a review of international tax systems. We attempted to address all identified concerns and risks, but we acknowledge that there will be unexpected challenges and risks before a proposal along these lines is implemented. We recognize that the changes necessary to ac-

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payers and preparers could refer to the transcripts to ensure they do not accidentally omit income. One step above the transcript would be to provide a platform from which taxpayers and preparers could download third-party data submitted to the IRS or the Social Security Administration directly into a commercial tax software package or even an improved version of the IRS's Free File Fillable Forms (FFFF). This second option would eliminate transcription errors and provide a one-stop-service to taxpayers who would not need to download the data separately from each third party. In addition, the Government would enjoy the benefits experienced by other tax administrations through pre-filled returns, but would still encourage competition in the tax software industry. For more information on the benefits of electronic access to third-party data and the experience of international tax administrations, see National Taxpayer Advocate 2013 Annual Report to Congress vol. 2, 67–96.

[78] William Hoffman, *IRS Oversight Board Brainstorms Real-Time Tax System, ID Theft Initiatives,* Tax Notes Today (May 2, 2013); IRS, PowerPoint, *Real Time Tax System Initiative, Public Meeting* 1 (Dec. 8, 2011), *available at* http://www.irs.gov/file_source/pub/irs-utl/rtts_deck.pdf. For more information on identity-theft refund fraud, see National Taxpayer Advocate 2013 Annual Report to Congress 75–83 (Most Serious Problem: *The IRS Should Adopt a New Approach to Identity Theft Victim Assistance that Minimizes Burden to Such Taxpayers*); National Taxpayer Advocate 2012 Annual Report to Congress 42–67 (Most Serious Problem: *The IRS Has Failed to Provide Effective and Timely Assistance to Victims of Identity Theft).*

[79] For written and oral statements of panelists at the two IRS Real Time Tax System Initiative public meetings, *see* http://www.irs.gov/Tax-Professionals/Real-Time-Tax-Initiative (last visited Feb. 13, 2013).

[80] IRS Pub. 6961, *2013 Update: Calendar Year Projections of Information and Withholding Documents for the United States and Campuses,* Tables 2-4 (Of the 2,288,516,144 information reports received in calendar year 2012, 2,240,335,726 were received electronically).

complish an accelerated third-party reporting system require a great deal of forethought, analysis, and stakeholder engagement.

VI. IRS INFORMATION TECHNOLOGY CHALLENGES

An adequately funded, staffed, and skilled IRS Information Technology (IT) function underpins all of the activities described above. IT resources are the common denominator for performing core IRS functions, including taxpayer service, prompt issuance of refunds, selection and assignment of compliance work, and protecting taxpayers and the public from refund fraud and identity theft. If the IT workforce is not appropriately skilled and staffed, the IRS will not be able to bring itself into the 21st century, much less meet its everyday work demands. Cost overruns will occur if the IRS does not have the skilled staff to undertake the necessary strategic planning or provide adequate project and contract oversight.

For fiscal year 2014 and fiscal year 2015, the IRS is focusing its IT resources on three main areas: implementation of the ACA; implementation of FATCA; and implementation of the 2015 filing season, including delivery of various legislative provisions and extenders. All other requests for IT resources are subordinate to these three "heavy lifts." While I understand the importance of each of these areas to tax administration, at current funding and staffing levels the IRS will not be able to deliver on these programs and also improve or correct core processes and systems. The negative impact to taxpayers of not funding everyday improvements to IRS taxpayer service, revenue protection, and compliance activities is significant.

Moreover, because the IT workforce is stretched so thin, the already glacial pace of the IRS's move into a 21st century technology environment is being slowed further. The IRS's inability to digitally communicate with taxpayers places the IRS far behind other international tax administrations and the financial services sector. The slowdown or shutdown of IT support also compounds the impact of taxpayer service funding reductions by driving taxpayers to make numerous telephonic or correspondence contacts with the IRS just to get information about their accounts. It also forces the IRS to continue using archaic compliance methods like correspondence examinations, when a "virtual" face-to-face audit would bring about better and more accurate results in terms of taxpayer response, issue resolution, and taxpayer education.

The Taxpayer Advocate Service has keenly felt the impact of this IT shortfall, when work on a once-in-a generation revision of its case management system (called TASIS) stopped short on March 31, 2014, due to lack of available funds. The work stoppage was based on the IRS's need to prioritize its IT projects and direct all available resources to the three key priorities—ACA, FATCA, and the 2015 filing season. While work will resume on this system shortly because TAS itself has transferred $1.8 million of its operating budget to cover the shortfall, this stop-and-start approach undermines not only TAS's ability to deliver quality service to taxpayers experiencing significant hardship, but also the IRS's efforts in developing an enterprise case management system.

The IRS currently has about 167 case management systems used by different units. This diversity of systems is one reason it is so difficult for IRS employees and taxpayers to find out precisely what the IRS is doing when an issue crosses different IRS functional units. There is no IRS "integrated" or "enterprise-wide" case management system.

The Taxpayer Advocate Service Information System, or TASIS, was designed with this problem in mind. Over a decade ago, TAS began a major redesign effort of its case management and case assignment system, which soon expanded to include all of its activities, including systemic advocacy and research. The result is TASIS—an integrated case, project, and work assignment system that allows for seamless movement and access to cases, projects, research, and archives. TASIS will have the following capabilities:

—TAS Intake Advocates will be able to conduct a real-time initial interview and perform related case-building, including automatically retrieving relevant information from other IRS systems.[81]

—TAS Case Advocates will have the ability to communicate digitally with taxpayers—both receiving and sending information and documents, and sending

[81] As part of our business process review, TAS created an Intake Advocate position to ensure that TAS cases would be as fully developed as possible at the first contact with the taxpayer for assignment to the appropriate case advocate and to eliminate the delays associated with reassigning cases. TAS has also developed procedures for identifying instances where, with a little guidance from the Intake Advocate, the taxpayer could actually resolve the problem him or herself.

automated reminders to taxpayers or IRS employees as needed to keep cases on track toward resolution.

—Taxpayers will be able to submit electronic requests for TAS assistance—whether for help with an individual problem or with solving a systemic problem—and they will be able to check on the status of their cases or systemic issue online without having to call a TAS employee for an update.

—All significant materials—case files, projects, research studies, communications—will be converted to digital files, promoting ease of access and sharing, and eliminating costs of document storage, shipping, archiving, and retrieval.[82]

—Case Advocacy employees will have an easy-to-use method to identify and elevate systemic issues they encounter in the cases.

—TAS will have a sophisticated ability to search our rich repository of information so that projects and data can be easily identified and retrieved via a library of key terms (metadata) that are applied to both cases and projects.

All of these features were designed to minimize the time spent on duplicative keystrokes and data entry, and manual retrieval or requests for information from other functions, so that TAS employees' limited time can be spent on direct communication with and advocating for taxpayers rather than on mere clerical tasks.

In summary, TASIS is a sophisticated case, project, and work assignment management system that has already been identified by the IRS's Chief Technology Officer as a potential foundation for an IRS Enterprise Case Management System, and it is of sufficient significance that the Senate Appropriations Committee has included it on its list of "major information technology project activities" about which the IRS must report quarterly to the Senate and House Appropriations Committees and the Government Accountability Office.[83]

I write about TASIS in detail partly because of its independent significance but also to illustrate the impact of the funding shortfalls in IT more generally. Although TAS is just one small unit within the IRS, it assists taxpayers who are experiencing significant hardship as a result of IRS actions or inaction.[84] The later deployment of TASIS because of the work stoppage will harm those taxpayers, impeding my employees' ability to effectively communicate and advocate on their behalf. The work stoppage also will cost the IRS more in terms of shoring up an obsolete system, unproductive use of employees' direct time, and higher costs once the program is started up again. This pattern is being reproduced several times over in every business unit of the IRS.

As the National Taxpayer Advocate, I believe it is a key taxpayer need that the IRS's IT function be adequately funded, not only to deliver on major initiatives like ACA and FATCA, but also to deliver on the many small but important improvements and projects that will make a positive difference for taxpayers, employees, and the public fisc. Furthermore, the IRS needs dedicated funding to develop projects that bring us into the 21st century and the digital age. The IRS should be in the vanguard of technology, not bringing up the rear.

VII. CONCLUSION

In my 2013 Annual Report, I stated that the short-term crises of the past year masked the major problem facing the IRS today—unstable and chronic underfunding that puts at risk the IRS's ability to meet its current responsibilities, much less articulate and achieve the necessary transformation to an effective, modern tax agency. The issues I have discussed today clearly illustrate this situation. In this and every filing season, the IRS must carry out its core mission of collecting revenue and helping taxpayers comply with their obligations. At the same time, it must deal with threats such as identity theft, prepare for the new challenges presented by the ACA, and bring its technology into the 21st century.

I am hopeful that the new leadership of the IRS, with continued oversight and support from Congress and the involvement of the Office of the Taxpayer Advocate, can meet these goals. In particular, I believe that the IRS can improve tax administration and the fundamental fairness of the system by embracing the Taxpayer Bill of Rights I have outlined here today and using those principles to help guide the

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[82] Reliance on paper files and documents requires storage and handling of 50 to 60 pages for each TAS case, or approximately 12.5 million pages each year. This includes hard copies as well as records kept on employees' local hard drives. TAS incurs repeated copying and shipping costs for transfers, work reviews, and collaboration. The use of virtual documents will almost eliminate costs associated with paper document-handling and storage, allow immediate access for collaboration, and improve TAS's ability to reference the products or conduct research.

[83] S. Rep. No. 113–80, at 34 (2013).

[84] *See* IRC § 7811.

establishment of agency goals and policies. Thank you for the opportunity to submit this testimony.

PREPARED STATEMENT OF THE NATIONAL TREASURY EMPLOYEES UNION

Chairman Udall, Ranking Member Johanns and distinguished members of the subcommittee, I would like to thank you for allowing me to provide comments on the Internal Revenue Service (IRS) budget request for fiscal year 2015. As president of the National Treasury Employees Union (NTEU), I have the honor of representing over 150,000 Federal workers in 31 agencies, including the men and women at the IRS.

Mr. Chairman, despite the critical role that the IRS plays in helping taxpayers meet their tax obligations and generating revenue to fund the Federal Government, the IRS' ability to continue doing so has been severely challenged due to funding reductions in recent years.

Since fiscal year 2011, funding for the IRS has been cut by nearly $1 billion, a reduction of almost 8 percent. The funding cuts have forced the IRS to operate under an exception-only hiring freeze since December 2010, and forced the Service to reduce the total number of full-time, permanent employees by about 10,000, many of whom are responsible for providing critical services that taxpayers require in order to meet their tax obligations.

IRS FISCAL YEAR 2015 BUDGET REQUEST

NTEU was pleased to see that the administration's budget request for the IRS would provide the agency with a total of $12.4 billion in fiscal year 2015, an increase of more than $1.1 billion over the current fiscal year 2014 level which would help restore funding for important taxpayer service and enforcement activities that have been slashed in recent years. These funding reductions have adversely impacted IRS' ability to meet its mission, and without action by Congress, IRS' ability to serve taxpayers and enforce our Nation's tax laws will continue to erode.

TAXPAYER SERVICES

Providing quality taxpayer service is a critical component of the IRS' efforts to help the taxpaying public understand their tax obligations while making it easier to participate in the tax system. Through a variety of in-person, telephone and Web-based methods, the IRS seeks to help taxpayers navigate an increasingly complex tax code and prevent inadvertent noncompliance. Unfortunately, the IRS' ability to provide excellent taxpayer service has been severely challenged due to reduced funding in recent years and the cuts mandated by sequestration. Without additional resources, further degradation in taxpayer services will occur, jeopardizing our voluntary compliance system.

IMPACT OF INADEQUATE FUNDING ON TAXPAYER SERVICES

In the past few years, many experts in the tax community, including the National Taxpayer Advocate, the IRS Oversight Board and the IRS Advisory Council have all warned of the dangers of underfunding the IRS and the adverse impact it has had on taxpayer service.

In her Annual Report to Congress released earlier this year, National Taxpayer Advocate Nina Olson identified insufficient funding of the IRS as one of the most serious problems facing taxpayers. According to Olson, the lack of adequate funding, coupled with a rising workload has had a devastating impact on IRS taxpayer service. Among the report's findings are:

—Last year, only 61 percent of calls from taxpayers seeking assistance reached a customer service representative, leaving 20 million taxpayers unable to get through—that is a decline from 87 percent a decade earlier, with half the decline occurring since 2010.

—Taxpayers who did get through had to wait on hold approximately 17.6 minutes before speaking with a CSR. That's up from 2.6 minutes 10 years earlier, a nearly six-fold increase, with nearly half the increase occurring since fiscal year 2010.

—An 86 percent drop in tax law questions answered from 795,000 10 years ago to only 110,000 in the 2013 tax-filing season.

—A cut of 87 percent, from $172 million in 2010 to just $22 million last year in employee training.

—The IRS historically has prepared tax returns for taxpayers seeking its help, particularly for low income, elderly, and disabled taxpayers. Ten years ago, it

prepared some 476,000 returns. That number declined significantly over the decade, and the IRS recently announced it will no longer prepare returns at all.

—Last year, the IRS received about 8.4 million letters from taxpayers responding to proposed adjustments to their tax liabilities. As of the end of the fiscal year, 53 percent of taxpayer letters in the IRS's "adjustments" inventory were considered "over age" (generally, more than 45 days old). That compares with "over age" percentages of 12 percent 10 years earlier and 28 percent in fiscal year 2010.

—At the same time, the number of individual tax returns grew from 131.4 million in fiscal 2004 to about 146 million in fiscal 2013, an increase of about 11 percent, with about one-third of it having occurred just since fiscal year 2010.

DELAYED START TO FILING SEASON

In late December, the IRS announced it would have to delay the start of the 2014 tax filing season by 10 days to allow the IRS sufficient time to program and test its tax processing system which must be updated annually to reflect tax law updates, business process changes and programming updates in time for the start of the filing season. The annual process for updating IRS systems was significantly delayed by the 16-day Federal Government shutdown which came at the height of IRS' preparations to update its systems. According to the IRS, programming, testing and deployment of more than 50 IRS systems is needed to handle processing of nearly 150 million tax returns. Updating these core systems is a complex, year-round process with the majority of the work beginning in the fall of each year.

However, with roughly 90 percent of IRS operations closed due to the Government shutdown, IRS preparations were delayed nearly three weeks, causing the need to postpone the start of the filing season.

The delayed start to the filing season will have a direct impact on taxpayers who will be forced to wait longer to start the filing process and who are already facing longer wait times to speak to an IRS representative due to the lack of sufficient staffing. According to the IRS, they expect more than 18 million calls to go unanswered this filing season and wait times to rise to around 25 minutes per call, compared with 10 minutes in 2010. Once taxpayers do get through, they may not be able to get the answers they need to resolve their tax issues. The IRS recently announced that due to its budget situation, it would only be able to answer "basic" tax law questions on its telephone lines and in its walk-in sites during the upcoming filing season.

Taxpayers' inability to get the answers they need to understand complex tax issues will almost certainly impact the accuracy of their returns, which could delay refunds to the many taxpayers that depend on their refunds to pay their bills and meet other financial obligations. While returns without any issues may be processed in a timely manner, those returns that are kicked out of the automated process will have to be worked by an understaffed IRS workforce which is down more than 8 percent. A lack of adequate staff to handle these returns will almost inevitably lead to substantial delays in processing refunds for those taxpayers, delaying the financial relief they may require.

With taxpayers unable to receive the assistance they need to resolve their tax questions and accurately prepare their returns, many may be forced to turn to paid preparers for help, resulting in additional expenses for them to simply comply with their tax obligations.

ADVERSE IMPACT OF NEW FILING SEASON INITIATIVE ON TAXPAYERS

Last September, the IRS announced a new fiscal year 2014 filing season initiative that included various procedural changes that the agency plans to implement in fiscal year 2014 at call sites, Taxpayer Assistance Centers (TACs) and campus locations across the country. The changes limit the live assistance that taxpayers receive and direct them to utilize more online services. The changes will primarily impact taxpayers seeking assistance in the following areas: tax law inquiries, tax return preparation, requests for employer identification numbers, requests for transcripts, and updates on the status of their refunds. Below is a summary of changes and the adverse impact they will have on taxpayers this filing season.

—*Tax Law Assistance*—will provide live assistance with basic tax law only, and only through April 15, 2014. All advanced tax law questions, including common complex issues such as estate and trust distributions, the alternative minimum tax (AMT), casualty and theft losses and the qualified State tuition program will be referred to other IRS resources. In addition, all topics related to corporations and partnerships will also be considered "out of scope," thus live assist-

ance will not be available to taxpayers with questions about these difficult topics.

—*Tax Return Preparation*—will direct taxpayers who request return preparation at IRS TACs to other options instead of preparing tax returns for them on site.

—*Employer Identification Number (EIN)*—will refer all new taxpayer EIN requests to the EIN Online Assistant for EIN issuance.

—*Requests for Transcripts*—will redirect all individual taxpayers needing a transcript to the Get Transcript application.

—*Tax Refund Inquiries*—will redirect all taxpayer requests for refund information to *Where's My Refund?* and automated phone channels for the first 21 days after they file.

—*Practitioner Priority Service (PPS)*—will deflect transcript requests made for non-tax account issues to other IRS options.

NTEU believes that limiting the amount of live assistance to taxpayers that are actively seeking help with their tax related issues will be detrimental to efforts to increase compliance with our Nations' tax laws, and only serve to harm those taxpayers that rely on the assistance of qualified and experienced IRS employees to understand and meet their tax obligations.

Mr. Chairman, it is clear funding reductions in recent years have seriously impaired the IRS' ability to provide taxpayers with the services they need. And without the additional funding proposed in the administration's budget request, taxpayers will continue experiencing a degradation of services including difficulty seeking telephone assistance, delays in responses to letters, including those seeking to resolve issues with taxes due, delayed responses to small business owners or individual taxpayers looking to set up payment plans.

That is why we strongly support the President's request of $2.3 billion in funding for taxpayer services in fiscal year 2015, a $195 million increase over the current level. We believe this increase will allow the IRS to further improve customer service to meet rising taxpayer demand and help taxpayers understand their obligations, correctly file their returns, and pay taxes due in a timely manner.

We were also pleased to see the President's request would provide an additional $165 million for IRS taxpayer service as part of the new Opportunity, Growth, and Security Initiative. This funding will support additional IRS customer service improvements, including increasing toll-free telephone level of service by 11 percentage points to over 80 percent, driving responsiveness to taxpayers through correspondence inventory reduction, and bolstering resources to help tackle more labor intensive identity theft and refund fraud cases.

NTEU believes providing quality services to taxpayers is a critical component to our system of tax administration, and that the President's request for additional funding for taxpayer services will help prevent further degradation of services and enable the IRS to provide taxpayers with the services they need to meet their tax obligations.

ENFORCEMENT

Mr. Chairman, the funding reductions to the IRS budget in recent years have also negatively impacted its ability to maximize taxpayer compliance, reduce the tax gap and generate critical revenue for the Federal Government.

IMPACT ON VOLUNTARY COMPLIANCE AND TAX GAP

NTEU believes our system of voluntary tax compliance is most effective when the IRS is able to assist those trying to meet their obligations under the law. In particular, by assisting taxpayers with their tax questions before they file their returns, the IRS can help prevent inadvertent noncompliance and reduce burdensome post-filing actions, such as audits and penalties.

However, funding reductions and the cuts to operating expenses mandated by sequestration have resulted in the inability of millions of taxpayers to get answers from IRS call centers and taxpayer assistance centers (TACs), which lessens their ability to meet their tax obligations.

The National Taxpayer Advocate has previously warned that limited resources were impeding IRS' ability to conduct education and outreach to taxpayers, particularly small business, which is critical to ensuring they are able to understand and comply with their tax obligations. For example, she has repeatedly warned staffing levels at TACs across the country are woefully inadequate, with taxpayers lining up to enter IRS offices well before those offices were even open and with some people being turned away.

Inadequate staffing and the lack of availability of services at TACs has long been a problem at the IRS and disproportionately impacts the most vulnerable popu-

lations who use TACs most often, including non-English speaking taxpayers, the elderly and low income individuals and families, who often need additional assistance in understanding and meeting their tax responsibilities. If these taxpayers are not provided the assistance they need to understand their tax obligations, they may inadvertently file an incorrect return which could necessitate the need for IRS to undertake post-filing actions that are costly and burdensome to both the taxpayer and the IRS.

Incorrect filings could also result in taxpayers paying less than they owe, further hampering efforts to close the tax gap, which is the amount of tax owed by taxpayers that is not paid on time. According to the IRS, the amount of tax not timely paid is $450 billion, translating to a noncompliance rate of almost 17 percent.

The adverse impact of insufficient staffing on IRS' capacity to collect revenue critical to reducing the Federal deficit is clear. According to the IRS, every dollar invested in IRS enforcement programs generates between $4–$7 in return, but reduced funding for enforcement programs in recent years has led to a steady decline in enforcement revenue since fiscal year 2007. In fiscal year 2012, IRS enforcement activities brought in roughly $50.2 billion, down $9 billion from the $59.2 billion high in fiscal year 2007. The IRS has noted that the decline in enforcement revenue has come amid a continuing decline in key enforcement personnel staffing. There were 7,400 fewer permanent enforcement personnel in fiscal year 2013 than in fiscal year 2010, including roughly 3,000 fewer revenue agents and revenue officers who are central to Service enforcement efforts.

The IRS has warned that enforcement staffing will continue to be a significant concern under the fiscal year 2014 funding level and has warned that under this insufficient level of funding, audits will decline by an estimated 100,000 and the number of collection activities will decline by an estimated 190,000.

While we know the tax gap can never be completely eliminated, even an incremental reduction in the amount of unpaid taxes would provide critical resources for the Federal Government. At a time when Congress is debating painful choices of program cuts and tax increases to address the Federal budget deficit, NTEU believes it makes sense to invest in one of the most effective deficit reduction tools: collecting revenue that is owed, but hasn't yet been paid.

That is why NTEU was happy to see the administration's budget request would provide a $349 million increase in funding for IRS tax enforcement above the current level. The increased funding is designed to protect revenue by identifying fraud and preventing issuance of questionable refunds, including tax-related identity theft, addressing offshore noncompliance, and improving examination audit and collection coverage rates.

We also support the administration's program integrity cap adjustment of $474 million to help the IRS continue to target international tax compliance and restore previously reduced enforcement levels. A large portion of this increase will be invested in strengthening current Service compliance programs designed to close the tax gap by combating offshore tax evasion, expanding enforcement efforts on noncompliance among corporate and high-income taxpayers. These investments are expected to generate $2.1 billion in additional annual enforcement revenue, resulting in a return on investment (ROI) of nearly 6 to 1, once new hires reach full potential in fiscal year 2017. This estimate does not account for the deterrent effect of IRS enforcement programs, estimated to be at least three times larger than the direct revenue impact.

CONCLUSION

Mr. Chairman, thank you for the opportunity to provide NTEU's views on the administration's fiscal year 2015 budget request for the IRS. NTEU believes that only by restoring critical funding for effective enforcement and taxpayer service programs can the IRS provide America's taxpayers with quality service while maximizing revenue collection that is critical to reducing the Federal deficit.

Senator UDALL. Now, turning to the Treasury request, Secretary Lew, most of the $13.8 billion of gross funding requests for the Treasury Department is for the IRS. The President's budget requests $1.3 billion to fund the other bureaus and offices of the Department, a decrease of $22 million, or about 2 percent, less than the fiscal year 2014. These bureaus and offices cover a wide variety of activities for the Department, from implementing financial sanctions against our enemies, forecasting economic indicators, and managing the Federal Government's books. And, by the way, we

had a very good hearing with the Financial Sanctions Section with David Cohen, which Senator Johanns and I were involved in, and many other members, and we were very impressed with their work.

I was pleased to see that the President's budget included robust funding for the Community Development Financial Institutions (CDFI) Fund. The budget also proposes to increase the CDFI Bond Guarantee Program to $1 billion to expand access to capital for community development organizations across the country at no cost to taxpayers.

However, the request also includes worrisome cuts for several critical bureaus, including the Alcohol and Tobacco Tax and Trade Bureau, which protects consumers, prevents smuggling, and collects revenue to reduce the deficit. I look forward to hearing from you about why Treasury is requesting cuts for this important bureau.

Now turning to the IRS request, the Internal Revenue Service administers the tax laws and collects the revenues for funding over 95 percent of the Federal Government operations and public services. The IRS has nearly 90,000 employees. Each year, they make hundreds of millions of contacts with the American taxpayer and with businesses. The IRS is the face of the Government for more U.S. citizens than any other agency.

For fiscal year 2015, the President's budget requests $11.997 billion in base appropriated funding for the IRS. This is an increase of $706 million, or a 6 percent boost above the fiscal year 2014 enacted level of $11.291 billion. Another $480 million is sought through a program integrity budget cap adjustment, raising the appropriations request to $12.477 billion.

Now, the fiscal year 2015 funding forecast is not encouraging. Budgetary constraints remain in place. This subcommittee faces challenging funding decisions. This subcommittee is going to have to balance many competing demands for the ensuing fiscal year. It will be helpful to hear Secretary Lew and the Commissioner's frank appraisals of the minimum resource needs to ensure that the Treasury Department can fulfill its stewardship responsibilities for U.S. economic and financial systems. Moreover, we will be carefully assessing what resources are required to deliver top-quality service to taxpayers and enforce the law with integrity and fairness to all.

I look forward to hearing more about the particular challenges the Department and the IRS faces, the consequences of funding shortfalls, and how this subcommittee can be helpful in supporting the Department's vital mission.

With that, I turn to my very distinguished Ranking Member, Senator Johanns, for his opening statement.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Thank you, Mr. Chairman. Thank you for holding this very important hearing today to review the budget requests of the Department of Treasury and the Internal Revenue Service.

As members of this committee, we have a significant responsibility to ensure the hard-earned tax dollars for millions of Americans are spent wisely and, equally as important, appropriately. That is even more critical as decisions are made to again increase

Federal spending, despite persistent annual deficits and nearly $18 trillion in debt hovering over our children and grandchildren.

Our country is in need of serious budgeting. All too often, Washington loses sight of the fact that every dollar the Government spends is a dollar taken from a taxpayer. All too often, Federal agencies lose sight of the fact that their funding belongs to the American people.

Nowhere is the need for oversight more apparent than in the agencies before us today. The IRS should be working on improving services and making tax compliance easier for taxpayers. However, when the IRS takes actions that represent a serious abrogation of the trust of the American people, it alone is responsible for the damage it has done to its credibility. The IRS has undermined taxpayers' faith in the impartiality of the Agency. This imperils the willingness of taxpayers to comply with a system that relies on them to report their income honestly, freely, and voluntarily.

A year ago, these agencies appeared before this subcommittee. Despite being questioned at the hearing, no one alerted this subcommittee to the inappropriate treatment that was taking place by the IRS relative to certain taxpayers. The only response was an agreement, in principle, that there should be no politics in the execution of our tax laws. Once the information about the inappropriate scrutiny of taxpayers became public 3 short days later, I asked that the hearing be reconvened, and that request was not granted. Detailed questions for the record that I subsequently submitted received very generic and, quite honestly, unresponsive answers.

We have all heard comments that, in essence, say investigations in these—into these issues are distracting and that everyone should let the past go and just move on. Unfortunately to taxpayers, these responses appear to reflect a continued lack of accountability and a lack of leadership. My constituents ask, where is the acceptance of responsibility for your Agency's roles in this matter? This is not an instance where you can simply say, well, one bad actor is gone and another has been reprimanded. All too often, that is the Washington way. There are negative press reports and then some employee is singled out for punishment.

That kind of response to this situation demonstrates a lack of awareness or a deliberate disregard for the seriousness of the problems at the IRS. These actions may have been—irreparably damaged the credibility of the IRS, credibility that is essential if it is to function in a system of voluntary compliance. For there to be hope for any effort to repair that damage, there has to be a fundamental change in the culture of the Agency that has given rise to these issues.

Unfortunately, just last week, in the report on the IRS award system, there was again evidence of an Agency culture that, quite frankly, is out of touch. Many no longer trust the IRS to enforce tax laws impartially without regard to an individual's exercise of their constitutional rights.

On top of that, try to explain to my constituents in Nebraska that his hard-earned tax dollars are going to pay bonuses to IRS employees who did not pay their own taxes or committed serious misconduct. There is not an American that would understand that.

And then try to explain that the IRS will need to do a study just to determine whether conduct can be a factor in whether employees receive awards in the future. It just defies common sense.

But awards seem to be an important priority at the IRS. In the fiscal year 2014 bill, which was recently enacted, the IRS received a $92 million increase for the entire Agency. Ninety-two million. So what happened then? One of the IRS' first actions after the enactment of the appropriations bill was to announce they would pay out $63 million in awards to employees, almost 70 percent of the $92 million increase all to awards and bonuses. Once again, IRS management seems to have forgotten that their most important customers are not their employees. It is the American people.

It is disappointing to see that the IRS budget request this year is also equally unrealistic. The President's request for IRS for fiscal year 2015 is about $12.5 billion. This is about $1.1 billion over the 2014 enacted level. Under the changes enacted to the Budget Control Act last fall, overall discretionary spending for the entire Federal Government is due to rise by less than $1.4 billion. So with $1.4 billion available for both defense, domestic spending increases, the IRS tells us that they want 80 percent of it. It just boggles the mind.

Also troubling is the inclusion of a request for a program integrity cap adjustment of $479 million. Treasury and the IRS are fully aware that such cap adjustments were not included in the Budget Control Act of 2011. And no cap adjustment for the IRS was authorized in the budget agreement last fall. Such a completely unrealistic request sets unreasonable expectations, and they are not credible.

Mr. Chairman, again I thank you for calling this hearing. I look forward to working with you as we always have on fiscal requests as we move forward to solving the riddle of the 2015 budget. But I have to tell you, there is so much about what we are going to be hearing about today that I have concerns about, and I appreciate the hearing to ask the appropriate questions. Thank you.

Senator UDALL. Senator Johanns, thank you so much. And now, Secretary Lew, I invite you to present your remarks on behalf of the Department of the Treasury.

SUMMARY STATEMENT OF HON. JACOB LEW

Secretary LEW. Thank you very much, Chairman Udall, Ranking Member Johanns, members of the subcommittee. Thank you for the opportunity to speak about the Treasury budget. I appreciate your cooperation in rescheduling this hearing, and I am going to keep my opening remarks short.

Let me start by saying what an honor it is to work with the dedicated men and women at the Department of the Treasury. They are talented public servants who are focused on strengthening our country. They have performed with excellence under difficult circumstances in recent years, and I want to thank them for their service and commitment.

Our economy has been strengthening over the past 4½ years, but we still have work to do to help increase growth, create jobs, and restore opportunity. And today's advance report on Gross Do-

mestic Product (GDP) just underscores how much we must keep at this.

The President's budget offers proven strategies that invest in the economy to propel growth now and promote longer-run prosperity. To help make sure that prosperity is widely shared, the President will emphasize the importance of raising the minimum wage today. Congress has an opportunity to help make sure no American who works full time has to raise a family in poverty, and we hope Congress will pass legislation to increase the Federal minimum wage to $10.10 an hour as soon as possible.

The request for Treasury is part of the administration's comprehensive blueprint to move our Nation forward. This request will allow the Department to help maintain a strong economy, sensibly manage the Government's finances, foster greater investment in American communities and small businesses, protect our national security, monitor risks to the financial system, and promote conditions that support economic growth and stability at home and abroad.

Over the past 5 years, Treasury has met its responsibilities efficiently and at lower cost. Today's budget request builds on that progress and includes even more ways to reduce costs and achieve savings while offering carefully designed proposals to increase the Department's effectiveness. For instance, we are seeking a second round of funding for the State's Small Business Credit Initiative, which has been enormously successful in strengthening small businesses across the country. We are working to reduce the risks from cybersecurity attacks by helping to improve the financial sector's resilience to such attacks and investing in Treasury's own defenses and infrastructure. And we are requesting sufficient funding for the Internal Revenue Service so it can provide the kind of quality service that American taxpayers deserve.

As we consider what is in the best interests of taxpayers, it is important to note that it has been 5½ years since Fannie Mae and Freddie Mac went into conservatorship. And today's stress tests show taxpayers could still be on the hook in the event of a severe economic downturn. Now is the time to reform our housing finance system, and I want to encourage the Senate Banking Committee to continue making progress on this very complex issue.

Since the financial crisis, Treasury has played a central role in designing and implementing the most comprehensive reforms to the financial system since the Great Depression. A major piece of unfinished business is housing finance reform, and we need legislation that protects taxpayers, ensures continued widespread availability of consumer-friendly mortgage products, like the 30-year fixed-rate loan, provides liquidity during times of economic stress, and facilitates the availability of affordable housing in an explicit and transparent manner.

Before I take questions, I would like to talk briefly about Ukraine. The United States and the international community have made it clear that we will continue to stand with the Ukrainian people during this critical time. That is why we are united in our effort to impose costs on Russia for its unlawful and provocative acts.

PREPARED STATEMENT

On Monday, the United States responded to Russia's latest actions with additional sanctions, which will increase the impact we have already begun to see on Russia's economy from U.S. and international sanctions. We urge Russia to pursue a diplomatic solution to the situation, especially as Ukraine moves forward with the presidential elections next month.

With that, let me thank you for the opportunity to appear before you today, and I look forward to answering your questions.

[The statement follows:]

PREPARED STATEMENT OF HON. JACOB LEW

Chairman Udall, Ranking Member Johanns, members of the subcommittee, thank you for giving me the opportunity to speak about the Treasury budget. The President's fiscal year 2015 budget requests $13.8 billion to fund the Department's operating bureaus. This includes an important increase for the Internal Revenue Service and a decrease for the rest of the Department, which I will cover in more detail below.

Let me start by saying what an honor it is to work with the dedicated men and women at the Department of Treasury. They are talented public servants who are focused on strengthening our country. They have endured much over recent years including a Federal pay freeze, sequestration, and the Government shutdown, and I want to thank them for their service and commitment.

I would now like to turn to an overview of the economy and the substantial progress we have made toward recovering from the worst recession since the Great Depression. We have now experienced nearly 5 years of growth. A stronger private sector is helping grow the economy and drive deficits lower. Our businesses have added 8.9 million jobs over the last 49 months. The housing market has improved. Home prices are rising, and millions of homeowners are no longer under water on their mortgages. Household balance sheets continue to heal, exports are growing, and manufacturing is making solid gains. And healthcare costs are growing at the slowest rate in 50 years.

I want to take a moment and quickly applaud the Senate Banking Committee for beginning their markup of important legislation to reform our housing finance system yesterday. Now is the time to reform our housing finance sector. Housing starts, new home sales, and existing home sales all reached multi-year highs last year, rates of mortgage delinquency and foreclosure have declined to near pre-recession levels, and the appreciation we have seen in home prices has substantially reduced the share of mortgages that are underwater. But we need to build on that progress, and the pent up demand from years of low household formation combined with generally housing affordability can spur a step up in new construction to reverse the downward trend we have seen in home sales since mid-2013. A resurgent housing sector would boost the economy and generate new jobs, and a successful reform to housing finance would reinforce that cycle.

Five and a half years after the Government Sponsored Enterprises (GSEs) were put in conservatorship, we still face a housing finance system that does not adequately meet the needs of the American people. Far too many potential homeowners do not have access to credit, and will not until there is a clear path to a new system that provides certainty to all participants. The system today continues a flawed dynamic where taxpayers must support future losses at Fannie Mae and Freddie Mac should there be another downturn in home prices. We need to start reform now—and we need legislation to achieve the fundamental reforms that protect both consumers and taxpayers. The longer we put it off, the easier it is to forget the damage to the economy, loss of housing wealth, and instability a system with misaligned incentives and inadequate taxpayer and consumer protections.

As the President said in his State of the Union address, we are now better positioned to meet the demands of the 21st century than any other nation.

There is considerably more that needs to be done. While corporate profits have been hitting all-time highs and the stock market has been vibrant, too many in the middle class and those striving to get into the middle class, are struggling to make ends meet.

The President's budget addresses these challenges. It puts forward proven, pro-growth initiatives to expand opportunity for all Americans. And it fulfills the Presi-

dent's pledge to make this a year of action, while offering a framework for long-term prosperity and competitiveness.

As part of this proposal, the President's request for the Treasury will allow the department to carry out its mission to maintain a strong economy and responsibly manage the Government's finances. It will also allow Treasury to foster greater investment in American communities and small businesses, protect our national security, monitor risks to the financial system, and promote conditions that support economic growth and stability at home and abroad.

STRENGTHENING THE ECONOMY AND JOB CREATION, PROTECTING THE FINANCIAL SYSTEM

For nearly 20 years, Treasury's Community Development Financial Institutions (CDFI) Fund has been attracting economic development and job creation to America's underserved communities. This year's request includes $225 million for the CDFI Fund, just over $1 million below last year's request, including a proposed 1 year extension of the CDFI Bond Guarantee program, which provides a source of long-term capital to financial institutions that support lending in underserved communities. Of the total request, $35 million for the Healthy Food Financing Initiative will support the growth of businesses that improve the availability of affordable, healthy food options in low-income communities.

We are also supporting small business growth by requesting a second round of funding for the State Small Business Credit Initiative (SSBCI), which was enacted in 2010 to empower States to help small companies grow. Just last week, I saw the positive difference SSBCI can make in our communities when I visited New Center Stamping in Detroit. New Center Stamping utilized SSBCI funding to grow and hire new employees, and demonstrates how targeted policies and programs can drive growth, strengthen the middle class, and bolster local economies.

The program's original funding of $1.5 billion is expected to result in up to $15 billion in new investments in small businesses by leveraging $10 in private capital for every $1 of Federal support, and during 2013 States more than doubled their use of these funds. To continue our support for State economic development agencies' work with small businesses, the budget proposes a new investment of $1.5 billion for the SSBCI. This additional funding would be awarded in two allocations: $1 billion awarded on a competitive basis to States best able to target underserved groups, leverage Federal funding, and evaluate results; and $500 million awarded according to a need-based formula based on economic factors such as job losses and the pace of economic recovery.

In the coming year, Treasury will continue to rebuild and reform our financial system. Reforms like the Volcker Rule are transforming the way Wall Street operates, while strengthening our financial system and making our economy an engine of economic growth once again. Going forward, we must remain vigilant to potential new threats to the stability of the financial system, constantly monitoring how risks change and evolve. Treasury will continue to wind down the remaining investments in the Troubled Asset Relief Program (TARP), often recovering more than the original support extended, and continue the operation of TARP's housing programs to help struggling homeowners avoid foreclosure.

The budget also proposes to extend the Terrorism Risk Insurance Program and to implement programmatic reforms to limit taxpayer exposure and achieve cost neutrality. The extension will preserve the long-term availability and affordability of property and casualty insurance for terrorism risk.

Finally, we seek to improve the protection and resilience of the critical infrastructure in the financial sectors with a special focus on reducing the risks associated with cybersecurity incidents. Working with industry and government partners, we promote best practices, develop incident management plans, and identify, analyze, and share timely and actionable information. Further, this budget includes $11 million for investments in enhancing Treasury's own cyber-preparedness and the security of Treasury's vast array of unclassified sensitive, classified, and very sensitive intelligence information. We must also ensure that our vital systems and services remain operational even under severe circumstances. As stewards of this information and IT services, it is our responsibility to ensure it is properly secure both from continuously evolving external and insider threats. These improvements to our own systems, and Treasury's continued work with our private sector partners to advance cybersecurity in the financial industry are vital to ensuring continued economic growth.

BOOSTING RESOURCES FOR TAXPAYER SERVICES AND ENFORCEMENT MEASURES, FINDING NEW EFFICIENCIES ACROSS TREASURY PROGRAMS

The President's budget makes substantial investments in improved taxpayer service and enforcement at the Internal Revenue Service (IRS), as well as in technology that will drive IRS efficiencies in the future. The Budget also builds on Treasury's ongoing efforts to improve efficiency, reduce costs, and streamline operations. The IRS continues its commitment to carrying out its responsibilities, providing quality service to taxpayers and preserving the public's faith in our tax system, but the lack of sufficient funding in recent years has made it difficult to provide the kind of services American taxpayers deserve. While the IRS is working hard to provide the highest possible level of taxpayer service within its limited resources, its funding situation is causing taxpayers to face longer wait times on the phone, and it is taking longer to respond to taxpayer correspondence. A sustained deterioration in taxpayer service combined with reduced enforcement activity could create serious long-term risk for the U.S. tax system, which is based on voluntary compliance.

To counter these effects, Treasury's budget request includes substantial investments to help strengthen taxpayer service, enforcement, and technology at the IRS. The fiscal year 2015 Treasury budget includes $2.3 billion for taxpayer service, supporting initiatives designed to improve the IRS' ability to provide timely and accurate responses to taxpayer inquiries, as well as make more information accessible in a secure digital environment.

The request for the IRS includes a $1.2 billion increase, of which $480 million is financed by a proposed program integrity cap adjustment for enforcement initiatives that provide a high return on investment. This proposed cap adjustment funds strategic investments that will help close the tax gap and will return 6 dollars for every 1 dollar invested, once fully implemented. The proposed cap adjustment will yield $2.1 billion in additional enforcement revenue in 2017 and is projected to reduce the deficit by $35 billion over the next 10 years.

Treasury's request also includes $452 million for initiatives that are critical to full and effective IRS implementation of the Affordable Care Act, which the Congressional Budget Office has projected will lower the deficit substantially over the next two decades. Thanks to the Affordable Care Act (ACA), 8 million people have signed up for private insurance through the Health Insurance Marketplace, 3 million young adults have gained coverage by being able to stay on their parents' plan, and millions more have secured coverage through Medicaid and the Children's Health Insurance Program. The law is also providing greater security to Americans who already have coverage, making discrimination based on pre-existing conditions and lifetime limits on coverage a thing of the past.

The fiscal year 2015 Treasury budget builds on our commitment over the past 5 years to deliver core services more efficiently and at a lower cost to the taxpayer. In fact, the department has been able to propose more than $1.1 billion in savings in its budget submissions over the past 4 years. Excluding the IRS, the fiscal year 2015 Treasury budget reflects a decrease of 1.7 percent below the fiscal year 2014 enacted level and identifies $154.2 million in efficiency savings and program reductions.

One area where we have made progress has been our multi-pronged effort to expand the use of electronic transactions in conducting the business of Government, including electronic payroll savings bonds, electronic benefit payments, and electronic tax collection. These efforts have reduced costs, improved customer service, and decreased susceptibility to fraud. The "Paperless Treasury" initiative has saved the Government hundreds of millions of dollars through electronic payment of benefits and increases in the electronic filing rate for tax returns.

It is important to note that the President's budget also includes a separate Opportunity, Growth, and Security Initiative. This Initiative includes pro-growth investments that are fully paid for by cutting spending and closing tax loopholes. Treasury investments under the Initiative will support progress in the areas of taxpayer service, fiscal transparency, and global food security. This includes $165 million to support additional IRS customer service improvements, including increasing annual toll-free telephone service levels to over 80 percent, driving responsiveness to taxpayers through correspondence inventory reduction, and bolstering resources to help tackle more highly burdensome identity theft and refund fraud cases.

PROTECTING NATIONAL SECURITY INTERESTS AND PREVENTING ILLICIT USE OF THE FINANCIAL SYSTEM

I want to end by highlighting the Treasury budget's proposals to protect our national security interests and continue the department's financial intelligence and enforcement activities.

The Treasury budget proposes $105.9 million for the Office of Terrorism and Financial Intelligence (TFI), within the Departmental Offices, to oversee and marshal Treasury's intelligence, enforcement, and economic sanctions functions in support of U.S. national security policies and interests. Our funding request reflects Treasury's continued efforts to safeguard financial systems against illicit use and combat rogue nations, terrorist facilitators, money laundering, and other threats to our national security.

In particular, TFI conducted a sustained sanctions campaign against Iran, its agents, and its front companies in response to Iran's continued defiance of United Nations Security Council resolutions related to its nuclear program. As a result, banks around the world have continued cutting off Iran from the international financial sector; this isolation has played an essential role in bringing Iran to the negotiating table.

Last year, we completed more than 500 actions under our sanctions authorities in an effort to disrupt and dismantle the financial networks that support terrorists, narcotics traffickers, transnational organized crime, and the proliferators of weapons of mass destruction. Our sanctions programs are effective because they stand on a foundation of reliable intelligence analysis, strong systemic safeguards in the financial sector, and robust engagement with our financial sector, foreign governments, and foreign financial institutions.

The Ukrainian people have demonstrated tremendous courage as they have charted an independent course for their country and demanded a government that reflects the will of the people. The United States has been at the forefront of building international support for Ukraine, and of holding Russia accountable for its attempts to destabilize Ukraine. And Treasury has played a key role in these efforts, not just through our carefully designed sanctions program but also in monitoring the impacts to U.S. economic interests, pushing forward the U.S. loan guarantee for Ukraine, offering technical assistance to the Government of Ukraine, and encouraging support from partners and international institutions such as the International Monetary Fund.

The United States very much wants to see Ukraine prosper. It is in our economic interest and it is in our strategic interests to stand with the people of Ukraine in their time of need.

CONCLUSION

The fiscal year 2015 Treasury budget reflects a careful balance of savings proposals and targeted investments in key priorities.

The proposed savings will be achieved through a combination of efficiency improvements and increased streamlining of operational processes, making Treasury even leaner and more effective as it continues to deliver essential services to the American people.

The Treasury budget is balanced, responsible and carefully designed. It adheres to the President's strategy to make our economy stronger while keeping our fiscal house in order. And I am eager to work with you to put it into action.

Thank you and I look forward to answering your questions.

Senator UDALL. Secretary Lew, thank you very much. And I would just remind all of us, we have three panels, and I believe we still have votes at 4:00, so we are going to try to move along. We are going to have 7-minute rounds and try to move through these three panels, and hopefully finish up before 4:00.

STRENGTHENING ECONOMY TO HELP MIDDLE-CLASS AMERICANS

Secretary Lew, in your statement, you highlight the recent growth in the economy. The nonpartisan Congressional Budget Office reported that the annual budget deficit as a percentage of GDP has dropped for the fifth year in a row, the housing market is beginning to rebound, the unemployment rate is dropping but still higher than before the recession. Our economy is recovering, but it still has a long way to go, particularly for middle-class Americans. I hear that all the time from New Mexicans, where I was just home the last couple of weeks, and people talking to me about that. Can you explain how Treasury's fiscal year 2015 budget request will

continue to strengthen our economy and particularly help middle-class Americans?

Secretary LEW. Well, Senator, I think that I can answer that both in terms of the Treasury budget, but also in the larger frame of the President's budget. You know, we are very pleased that the economy is doing much better. You compare the economy today to a few years ago, and it is a world of improvement. But we still have a lot of progress to make. Until every American who wants a job can find a job, and a job that pays a decent wage, we still have more work to do.

In the Treasury budget, we have a number of programs that are, I think, working quite effectively. I mentioned a couple. The State Small Business Credit Initiative (SSBCI) is actually making a real difference in either guaranteeing loans or providing support for collateral for loans for small businesses to create jobs.

Just last week, I visited one borrower, a firm in Detroit, that stamps machine parts. Because of an SSBCI loan, we are making replacement—manufacturer replacement parts for American autos in the United States and not overseas. That is the kind of work SSBCI does and can do if it gets the support to have another round of loans. Our CDFI program, similarly, is supporting communities that are working to develop economic foundations for small business in job creation.

And in the larger picture, I would say that the President's budget has a very clear direction this year, which is that we need to build a foundation for growth, and we all know what it is. We know that it is about building infrastructure because we need to have roads and ports and airports that are ready for the 21st century. That will create short-term jobs in the construction industry, but it will create longer-term foundations for growth. So working together on a bipartisan basis to fund infrastructure will make a difference.

I think that there are other things in the budget, like skills training, that are critically important. We have a lot of jobs open in this country, and we have a lot of people looking for work. There is a gap there that can be closed with skills training, marrying people and jobs.

You know, the third thing I would mention, while it is not in this subcommittee's jurisdiction, immigration reform. We know that immigration reform is a driver of economic growth in this country. It has always been a driver in our history, and we have seen a study from the Congressional Budget Office that shows it will affirmatively help grow our economy and reduce our deficits.

So those are a number of things in this budget. Obviously there is a lot of work to do, but I hope on a bipartisan basis we can do it.

Senator UDALL. Thank you very much, and I could not agree with you more. And it would seem to me an area where we could cooperate a lot would be in infrastructure. I think everybody realizes that it—you get short-term jobs, but you also do lay the foundation for growth. So I am hoping that we will be able to work and find some ways there.

TAX-EXEMPT STATUS FOR SOCIAL WELFARE GROUPS

I wanted to turn my attention here to these tax-exempt organizations. I have long supported the need to make meaningful changes to ensure that the rules to qualify for tax-exempt status are abundantly clear. We need a bright line test to replace the guidance that has led to over a half-century of confusion and inconsistent application. It is 100 percent unacceptable for the IRS to ever unevenly enforce rules based on ideology, politics, or other bases. The same rules should apply equally and equitably to all applicants. But it is also unacceptable for political operatives, regardless of political affiliation, to use 501(c)(4) organizations as de facto political action committees in order to hide their donors' identities and circumvent campaign finance law disclosure requirements.

I understand the IRS is currently evaluating an enormous volume of comments generated in response to proposed rules published last November designed to bring long-needed clarity to the determination of eligibility for tax-exempt status of social welfare groups. What are your current plans for going forward with finalizing the proposed rules? What timetable is the IRS following for further action? And until the rules are changed, what tests or criteria is the IRS using to evaluate applicants for tax-exempt status as social welfare groups?

Secretary LEW. Mr. Chairman, as I said at the time and as I have said since, the actions that were reported on in terms of the 501(c)(4) program were unacceptable. It is unacceptable for there to be any targeting in our tax enforcement based on belief or partisan views. And we went about following the recommendations of our Inspector General, who will be testifying here later. And I am pleased to say we implemented all of the recommendations, and that includes replacing all of the senior officials who were responsible, and issuing guidance to try and create some clarity in an area where ambiguity was at the root of the problem.

The proposed rule that was put out was in many regards an incomplete rule because it was asking for comment to inform what a final rule would look like. There is a lot of work to be done between now and issuing a final rule. There is the need to review 150,000 comments. There is going to be the need ultimately to publish a new final rule. And there are going to be a number of things between now and then where the IRS will be reaching out for comment.

I think that the partisan debate over this has, frankly, obscured what the rule really does. And what the rule does is it restricts discretion in an area where too much discretion caused the problem. Now, that is a hard thing to do, and we do not pretend that it is final. But we look forward to working together and responding to comments to get to the point where we can together say that the problem that underlay the events, that came out, that we all are agreeing were unacceptable, can never happen again.

Senator UDALL. Thank you very much for that answer. Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman. Mr. Secretary, welcome. Good to see you again.

IRS HANDLING OF TAX-EXEMPT APPLICATIONS

As you know, the IRS did single out certain groups, Tea Party groups. They got special scrutiny when they applied for tax exempt status, something they had a lawful right to do. Now, I think to everybody that is extremely troubling that this Agency that has such a huge impact on the lives of millions and millions of Americans would be executing the laws in a manner that targets anybody because of their political views.

But equally troubling is the fact that the IRS acknowledged that this activity, just days after you and Acting Commissioner Miller appeared before this subcommittee to testify about the fiscal year 2014 budget request, there was absolutely no indication of the disclosure that was to come. In fact, Mr. Secretary, as you know, you were asked a question about reports of politically motivated activity, and your statement was, "No politics in the execution of our tax laws," should be there. Would you please explain to us on this subcommittee why you did not make the subcommittee aware of what was to come just 72 hours later?

Secretary LEW. Senator, first, I stand by the statement that it is unacceptable for there to be any political interference in the enforcement of our tax code. And to this day, I have seen no evidence that there were any politically appointed officials who had any say in anything. It was terrible behavior and very bad judgment, but it was not on the part of political—or politically affiliated, you know, political appointees.

Senator JOHANNS. But let me stop you there if I might, Mr. Secretary, because you are drawing an inside-the-beltway distinction that only people like you and I would understand. You are saying political appointees, we have no evidence that they were involved. That does not mean that there is not somebody within the IRS who has a certain political bent, or somebodies——

Secretary LEW. Senator, there was very bad judgment, and I would note that it was applied to groups on the right and groups on the left, in terms of identifying organizations in unacceptable ways. So I am agreeing——

Senator JOHANNS. No, I am not going to let you get away with that because, quite honestly, people on the left, that was so rare as to be almost nonexistent. To Tea Party groups, it was consistent. It was group after group after group. They were held up in trying to get their tax exempt status.

Secretary LEW. Senator, there were an awful lot of applications pending at the time that was not an even distribution of applications, but there was evidence that it was bad judgment applied to both right and left. And that is—it is unacceptable, so I am agreeing that it is unacceptable. In terms of the testimony that I gave last year, I want to point out that I was not aware of the circumstances until our Inspector General briefed me on it.

Senator JOHANNS. Were you briefed before the hearing?

Secretary LEW. And I did not feel at liberty to speak on a subject that was going to be the subject of an Inspector General report until it was issued. And I have spoken to many committees of Congress about it since.

Senator JOHANNS. No, you have not spoken to me. I have sat in your place at one point in my career as a Cabinet member. I have faced this kind of scrutiny. I cannot imagine sitting there having knowledge of something this important, this explosive, and not at least stopping by the ranking member's office or the chairman's office, or both, and saying, look, here is what is going on. I do not want to mislead anybody. This is what is coming. We would have held that in confidence. Why would you not do that?

Secretary LEW. Well, Senator, the fairly well-accepted practice is not to interfere in any way with Inspector General reports, and that, I think, is appropriate as a policy. And I have tried to be very open in discussing this matter with Members of Congress, and following after that.

Senator JOHANNS. I followed that same rule when I was in your position. Inspector General had an investigation, we stayed as clear away from that as we possibly could. But if I was asked a direct question at a hearing, I felt I had the liberty to sit down with them, unless otherwise instructed by the Inspector General, to say, look, I can at least inform you that there is an investigation going on. I would appreciate your confidence. We would have kept that confidence. I can assure you of that. I do not understand why we had to learn from the media that this was going on.

Secretary LEW. Senator, the report obviously was a matter that was taken very seriously by both the administration, by the Department, and by the Congress. We have respected the independence of the Inspector General throughout the process. I think that is the appropriate thing, and I look forward to working with you to make sure that we have the kinds of conversations that give you visibility into what is appropriate as we can.

Senator JOHANNS. Let me ask you another question. The Internal Revenue Service, beyond a shadow of a doubt, has damaged its credibility. I do not think anybody could disagree with that. And it just seems to be one bad story after another. But having said that, they are circling back around now trying to do something with tax exempt organizations. They put this proposed rule out, and I understand it is proposed. And they get an avalanche of comments. I think by anybody's definition, 150,000 comments is a huge number of comments.

Were you—will you assure me, Mr. Secretary, that all comments will be taken seriously, will be reviewed, will be thoughtfully analyzed before any further action is taken on this rule?

Secretary LEW. Senator, that was the intent all along, was to elicit comment, broad comment. I think the number of comments probably exceeds expectation, but I will note that a lot of them are form responses, so the actual number of individual comments is lower. But there are a lot of comments, and I think the IRS and our Office of Tax Policy will be very careful in reviewing comments.

We want to get this right. This—and I would just say, in terms of confidence in the IRS, this was a very small number of people at the IRS who exercised bad judgment. And it—that judgment has been—they have been held accountable, and that judgment is, I think, universally being criticized by this committee, by the administration.

The question of the performance of the IRS, more generally, in fairness to most of the 90,000 people who work at the IRS, is not colored by that experience. We just had a filing season, where under terrible circumstances, late enactment of legislation, Government shutdown, we had a smooth filing system where the American people were able to file electronically, and get quick refunds, under very adverse budget circumstances. We are implementing a new law, Foreign Account Tax Compliance Act (FATCA). People are putting enormous energy into doing it effectively. And around the world, I heard that FATCA should become a global standard now.

So the men and women at the IRS are dedicated public servants, and I just think it would be wrong to look at the 501(c)(4) experience and extend that to all of the men and women of the IRS.

Senator JOHANNS. Not doing that. Not even suggesting that. But I can assure you the American people are dismayed by the activity at the IRS.

Secretary LEW. And I do not disagree, Senator, that there is a lot of work to regain confidence.

Senator UDALL. Thank you, Senator Johanns. Senator Coons.

ACCOUNTABILITY WITHIN THE IRS

Senator COONS. Thank you, Mr. Chairman. And thank you, Mr. Secretary, for your service and for being with us today.

If I might just follow on that general theme, I think we all share a deep concern about the use of inappropriate criteria in determining whether certain political organizations are qualified for 501(c)(4) status. Could you just clarify for us who has been held accountable? What sort of consequences have there been that allow you or that allow me to have any confidence that the IRS and the folks who exercised very poor judgment have seen some real consequences for this——

Secretary LEW. Well, Senator, at—when this report came out, the immediate action was replacing the Acting IRS Commissioner with a new Acting IRS Commissioner, Danny Werfel, who has served with great distinction until Commissioner Koskinen was confirmed. All of the SES—the senior executives in between the Commissioner and the program were relieved of their responsibilities and, in many cases, separated from the Federal service.

I think that we are now in the process of having a conversation about how to make sure this never happens again, and the rule writing is a joint process between the IRS and Treasury's Office of Tax Policy. It is being approached with the greatest seriousness of purpose where we want to fully take into account views, right and left and center, wherever they come from, and get this right because restoring confidence in the IRS is critical. You cannot have, you know, the kind of strong confidence in Government that we need if people do not trust the IRS, which is the point of connection that so many people have with the U.S. Government. So I share the very strong belief that making it clear that this has been fixed is critical.

In the interim, and the Chairman asked me this question, there is a process of self-certification where individuals who apply get to certify their eligibility. So there is not the case-by-case review

going on the way it was. We have got to get to a place with a clear standard that is transparent and simple and that takes away some discretion, because right now I think this is an area where too much discretion is not a good thing.

Senator COONS. Well, thank you, Mr. Secretary, and thank you for your persistent engagement in ensuring some accountability on these actions.

ECONOMIC SANCTIONS AND OFAC

Let me move, if I could, to sanctions. You mentioned in your statement the important role the United States is playing in helping the citizens of Ukraine to stand up to Russian aggression. We previously on this subcommittee held a hearing in which David Cohen, the Under Secretary for Terrorism and Financial Intelligence, testified about the terrific work that the folks under him, and in particular, OFAC, the Office of Foreign Asset Control, perform.

I was struck by the range in scope of actions, more than 500 sanctions enforcement actions they have undertaken, the very difficult and important work that those folks do to ensure that sanctions against Iran, as well as against now Russia, and Syria, and North Korea, and many other countries, are investigated and enforced.

The whole situation in the Ukraine and the sanctions against Russia have emerged since the budget submission. I sent a letter to the full committee chair back on April 10 urging a reconsideration of the budget request. I do think, as we will discuss with the IRS Commissioner, there are customer service reasons to really focus on an increased investment in IRS responsiveness and customer service.

I think there is an equally, if not a greater, compelling reason for us to increase the enforcement funding so that this particularly important grouping within the Department is able to enforce aggressively sanctions against Russia, against Iran, against Syria, against North Korea. The Under Secretary bravely offered answers to my questions, suggesting that there was surge capacity and that folks could be borrowed from other agencies.

My assertion to you is simply this. If there is any time for us to demonstrate that we have pre-funded, that we have ramped up to be able to vigorously enforce sanctions against Iran, it would be this moment.

STATE SMALL BUSINESS CREDIT INITIATIVE

If I could turn our attention to the SSBCI last. In general, I want to commend you for the focus on resilience in cyber preparations, the importance of GSE reform, the importance of extension of the Terrorism Risk Insurance Program. But I wanted to encourage you to speak for a moment to the State Small Business Credit Initiative. You said you had recently visited a small business, I think, in Detroit that had benefitted from it.

I was at the ribbon-cutting for the Frankford Bakery in Delaware that also benefitted from it. My State has taken advantage of it. I think it offers great opportunity to leverage private funds. So

please speak a little bit more, if you would, about what an extension of the SSBCI program might do for job creation.

Secretary LEW. Well, Senator, you know, I can just use an example like the place that I visited or the firm that you visited. There would be a vacant building with broken windows in Detroit if they had not gotten an SSBCI guaranteed loan to essentially buy existing, but unused, equipment to put people in Detroit back to work. And those jobs would have been somewhere else, probably outside of the United States. You know, they did not have collateral that they could go to a bank with, so they needed collateral to be backed by an entity. And the State used the SSBCI money to do that. They are now expanding, putting in conveyor belts to be able to cut from eight hours to one hour how long it takes to switch dyes. Well, that is going to mean more output, more efficiency, and more jobs.

I am using that example because I happened to be there last week. I am sure you could use the example of the bakery that you visited. All over the country, we are seeing businesses that would not be there, but for this support. And I think, redoubling the effort is important.

COMBATTING TERRORIST FINANCING

Can I go back, Senator, to just—and respond very briefly on the Terrorism and Financial Intelligence (TFI) question or comments that you made? We have an extraordinary group of people who work in Terrorist Finance at Treasury. You know, David Cohen, his predecessor, Stuart Levy, has built an institution that did not exist 10 years ago into a powerful tool for the United States to use to carry forward its policies and project its influence in meaningful and important ways.

The team works very hard—OFAC works very hard. I do not think it escaped anyone's attention that in the middle of all the work they are doing on Russia, we cited two more firms yesterday in Iran. They are multitasking. They are working on all fronts. They have the resources they need. I am not saying they have more than the resources they need. But they are doing an extraordinary job, and the American people really should understand what a great asset we have there.

And I did not mean to take you off of your intended question, but I could not let it go by.

Senator COONS. Well, thank you, Mr. Secretary. I do think the SSBCI program is worthy of some extension and support because it leverages private sector dollars 10 to 1 with public dollars.

Secretary LEW. Yes.

Senator COONS. It is locally administered. I have seen its effectiveness in my State. As for your comment on sanctions enforcement, I just would urge you to searchingly reconsider whether we have all the resources we need for this critically important fight at this time. Thank you.

Senator UDALL. Okay, Senator Coons. Thank you so much. And in order to move through all the witnesses, I think we are finished with our questioning here. We are going to excuse you, Secretary Lew, and call the Commissioner forward. Thank you very much for your testimony.

Secretary LEW. Thank you, Mr. Chairman.

Senator UDALL. Really appreciate your service. Mr. Koskinen, I invite you now to present your remarks on behalf of the Internal Revenue Service.

INTERNAL REVENUE SERVICE

STATEMENT OF HON. JOHN KOSKINEN, COMMISSIONER, INTERNAL REVENUE SERVICE

Mr. KOSKINEN. Chairman Udall, Ranking Member Johanns, Senator Coons, thank you for the opportunity to provide you with an overview of our proposed fiscal 2015 budget and what we hope to accomplish with those resources.

In discussing the IRS budget, we remain concerned about the constraints under which the IRS has been operating since 2010. Our funding for fiscal year 2014 was set at $11.29 billion, which is more than $850 million below fiscal year 2010 and $500 million below our pre-sequester level. I think it is important to note the IRS is the only major Federal agency operating at close to our post-sequester level, rather than returning to the higher pre-sequester level, as other agencies were allowed to do.

A solution to the funding problem faced by the IRS begins with the administration's fiscal year 2015 budget request, which totals $12.64 billion, approximately $1.35 billion above the fiscal year 2014 enacted level. In the absence of these additional resources, our ongoing funding shortfall has major negative implications for taxpayers and the tax system.

FILING SEASON

We are particularly concerned about next year's filing season. This year, when all is said and done, we will have processed approximately 148 million individual tax returns. This is a tremendous accomplishment, and does not happen automatically or by accident, but is a result of the work done by our highly experienced, dedicated, and capable workforce.

The 2013 filing season, which just ended, went extremely smoothly. We were able to improve our phone service somewhat, despite our funding limitations. In part, this was a result of our improved ability to provide information on our web site and the lack of major tax legislation in 2013. Because of the modest drop in call volume, we maintained a level of phone service during the filing season of about 71 percent, better than last year's overall average of 60.5 percent, but still an unacceptable level of service since that means that almost 30 percent of calls did not go through.

Furthermore, now that filing season is over and we no longer have extra seasonal employees, we will have fewer people on the phones, and we expect wait times to increase significantly between now and the end of September. For all of fiscal year 2014, we expect our level of phone service to drop below 70 percent and end up closer to last year's 60.5 percent.

We are already beginning to prepare for next year's filing season, and we are concerned that delivering a smooth filing season in 2015 may be significantly more difficult. In a normal year, pre-

paring for filing season takes several months. The advanced work to get our systems ready for 2015 will be more challenging than last year because of the need to accommodate major system changes for important statutory provisions going into effect under the Affordable Care Act and FATCA. We would use a portion of the administration's 2015 budget request, about $394 million, for implementing the Affordable Care Act and FATCA.

IT UPGRADES

A large portion of this is for Information Technology (IT) upgrades. For example, we need to build new technology systems to process and analyze the reports coming to us from financial institutions under FATCA. Investments in IT are also needed to continue implementing Affordable Care Act (ACA) provisions. I want to stress that we are mandated to implement the Affordable Care Act and FATCA, so if we do not receive this funding, we must take it from taxpayer service and enforcement. We have no other choice.

On top of the planning needed for ACA and FATCA, we also need to adjust our systems for numerous additional tax law changes if Congress passes a package of tax extender provisions. Therefore, if there is going to be a tax extender package this year, it would be very helpful if Congress could pass it as soon as possible, to give the IRS maximum lead time to get our systems ready for these changes.

About $400 million of the administration's request for additional funding would go to taxpayer service programs. We estimate this would allow us to answer an additional 12 million taxpayer calls with an approximately 2,400 additional full-time equivalents hired, and cause our level of phone service to exceed 80 percent. The additional calls answered would include calls from those seeking help with the tax-related provisions of the Affordable Care Act. In the absence of additional funding, we estimate that our level of service will plunge to about 53 percent.

About another $334 million of the additional request would go to enforcement programs. With this funding, we estimate closing more than 500,000 additional cases, including individual audits, employment tax exams, and collection activities. Through these activities, we estimate we would collect an additional $2.1 billion a year in enforcement revenues, to a large extent as a result of hiring about 1,200 additional revenue officers and agents. These increased collections would more than pay for the entire additional funding being sought for 2015.

An important subject of enforcement is the fight against refund fraud caused by identity theft. About $65 million of the additional request would go to this area. We estimate that, through improved identity theft fraud detection, we would protect an additional $360 million a year in revenue from going out the door. We would also close an additional 13,000 cases where taxpayers have been victimized by identity thieves.

I want to emphasize that we take very seriously the need to be careful stewards of the funding received. As Senator Johanns said, we are well aware of the fact that these are taxpayer dollars we are spending, and they deserve to be confident that we are spend-

ing them wisely. It is my responsibility to ensure that that funding is used wisely.

PREPARED STATEMENT

I would be delighted to report back to the subcommittee, as fiscal year 2015 unfolds to discuss with you what the American taxpayer, in fact, received from additional investments in our Agency.

This concludes my statement. I would be happy to take your questions.

[The statement follows:]

PREPARED STATEMENT OF HON. JOHN KOSKINEN

Chairman Udall, Ranking Member Johanns and members of the subcommittee, thank you for the opportunity to appear before you today to update you on the Internal Revenue Service's (IRS') performance under our current funding levels for fiscal year 2014 and to provide you with an overview of our fiscal year 2015 budget and what we hope to accomplish with those resources.

The IRS is vital to the functioning of Government and to keeping our Nation and economy strong. We support the Nation's tax system by providing taxpayer service to help people understand and meet their tax responsibilities while ensuring enforcement of the tax laws. The agency plays a unique role in Government, and resources invested in the agency lead to significant revenue increases for the Nation.

In fiscal year 2013, the IRS collected $2.9 trillion in gross revenue to fund the Federal Government, approximately 91 percent of all Federal receipts. Moreover, for fiscal year 2013, we processed more than 147.6 million individual income tax returns and issued more than 118 million refunds to individual taxpayers totaling nearly $314 billion. This is a tremendous accomplishment, especially given that processing such a high volume of returns is an annual occurrence for this agency. It is important to remember that this does not happen automatically or by accident, but occurs as a result of the efforts of our highly experienced and capable workforce.

The IRS has made major progress since fiscal year 2010 in finding hundreds of millions of dollars in cost savings and efficiencies. However, even with these savings, the fiscal year 2014 IRS budget approved by Congress continued a funding shortfall for the agency that has major implications for taxpayers and the tax system, both for this year's tax season and beyond. It is important to note that the IRS continues to operate at near sequestration levels, with the agency's fiscal year 2014 funding less than 1 percentage point above fiscal year 2013 levels. Our current level of funding is clearly less than what the agency needs, especially to provide the level of taxpayer services the public has a right to expect.

This year, millions of taxpayers continue to see longer wait times on the phone to get basic questions answered and resolve tax issues, though IRS employees are working diligently to reduce those wait times as much as possible. Further, as a result of fewer staff and reduced enforcement activities, the IRS estimates it will not be able to collect billions of dollars in enforcement revenues. The IRS is committed to carrying out its core responsibilities and working to preserve the public's faith in the essential fairness and integrity of our tax system, yet continued funding reductions will pose serious challenges to these efforts.

The IRS remains committed to being as efficient as possible and spending taxpayer dollars wisely, and we will continue to find savings wherever we can. At the same time, the fiscal year 2015 President's budget will allow us to invest in strategic priorities so that we can continue to fulfill our dual mission of strong enforcement of the tax laws and excellent customer service.

To summarize, the budget funds the following activities and programs: improving service to taxpayers; increasing our efforts against refund fraud, especially fraud caused by identity theft; making our compliance efforts more strategic, using new tools, data and capabilities to conduct a balanced enforcement program; and investing in advanced technology to enhance both service and enforcement activities. The IRS will also continue to implement and administer tax-related provisions of major legislation, including the Foreign Account Tax Compliance Act (FATCA) and the Affordable Care Act (ACA).

In discussing our budget situation, we recognize that there has been a loss of confidence among taxpayers and particularly within Congress in regard to the way we manage operations, particularly the management problems that came to light last year in the section 501(c)(4) area. One of my responsibilities is to ensure that we

are minimizing risks and quickly solving management and operational problems that may arise, so that Congress can be confident that when we request additional funding the money will be used wisely. Taxpayers provide the funds we receive and they deserve to be confident that we are careful stewards of those resources.

Despite the limits on our resources, I remain impressed with the professionalism and commitment of our workforce. Our employees have continued, throughout these challenging times, to perform critical work for the IRS and the Nation—helping people understand and meet their tax responsibilities while ensuring enforcement of the tax laws. They are making every effort to ensure a smooth experience for taxpayers despite the funding shortfall.

IRS PERFORMANCE: FISCAL YEAR 2013 AND CURRENT FILING SEASON

Through both taxpayer service and enforcement programs, the IRS remains committed to making the tax laws easier to access and understand and to improving voluntary compliance and reducing the tax gap—the difference between taxes owed and taxes paid on time. Taxpayer service supports and protects the trillions of dollars in revenue that come into the Treasury each year voluntarily from taxpayers by helping them understand their obligations under the tax law. Enforcement pursues those who evade or misrepresent their tax responsibility.

Filing Season

One of the most important activities the IRS undertakes each year is delivering a smooth and successful filing season. The IRS delivered another successful tax filing season in 2013, rising to the challenges posed by tax legislation enacted on January 2 of that year. The filing season began on January 30, 2013, less than 1 month after the passage of legislation that affected more than 600 tax products needed for the filing season. The IRS took the necessary steps to minimize disruptions for taxpayers, including working around the clock to update our forms and computer systems.

As noted, during 2013 the IRS processed more than 147.6 million individual income tax returns and issued 118.7 million refunds totaling almost $314 billion. In addition, IRS employees responded accurately to 95.7 percent of tax law questions and 96 percent of taxpayer account questions. Largely as a result of the ongoing decline in agency funding and the late tax law changes, for fiscal year 2013, the telephone level of service for taxpayers trying to reach the IRS' toll-free lines dropped to 60.5 percent, the lowest level since fiscal year 2008. That means that approximately 40 percent of taxpayers who called were unable to reach an IRS employee.

The 2014 filing season, which began on January 31, started strongly and ran very smoothly. Through April 11, 2014, the IRS received more than 112 million individual income tax returns and issued more than 85 million refunds for approximately $234.5 billion.

Our level of phone service has appeared to improve this filing season as compared to the average for fiscal year 2013. We have been able to maintain a level of phone service of around 70 percent so far, meaning that about 70 percent of taxpayers who called this filing season got through to the IRS. One reason may be that the volume of calls to our toll-free lines is actually down somewhat. We believe that is largely because there were no significant tax law changes enacted in 2013 and because tax return processing has gone relatively smoothly. In addition, we continue to provide more resources to taxpayers on our Web site, which we believe offers an alternative to the phone. However, increases in volume will negatively impact these results, and we expect that for the year we will drop below 70 percent and end up closer to last year's 60.5 percent. We will continue to monitor telephone service levels and work to maintain as high a level of phone service as possible within our resource limitations.

An area of concern this year is the amount of time people have had to wait to get in-person help at our Taxpayer Assistance Centers (TACs). We have had reports from field staff of taxpayers lining up outside TACs well before the centers open in the morning to make sure they receive service the same day. We also have had reports of people waiting 90 minutes or more to be helped once they arrived inside the TAC and taken a number for service. Unfortunately, given our resource limitations we have few options to drive down these wait times.

Taxpayer Service

Providing taxpayers with top quality service and helping them understand and meet their tax obligations remained top priorities for the IRS in fiscal year 2013. During fiscal year 2013, the IRS updated forms to help taxpayers comply with filing requirements, converted forms for visually impaired taxpayers, and translated more tax products into multiple languages. In addition, the IRS continued its effort to re-

design taxpayer correspondence in plain language and in a consistent format to make it easier for taxpayers to understand their obligations.

The IRS continued to provide alternative service options in fiscal year 2013 by increasing the amount of tax information and services available on IRS.gov. In fiscal year 2013, taxpayers viewed IRS.gov Web pages more than 1.87 billion times as they used the Web site and mobile applications to obtain forms and publications, get answers to tax law questions, and check the status of their refunds.

Taxpayers used the "Where's My Refund?" online tool in 2013 nearly 201 million times to check refund status, an increase of 51.6 percent from 2012. Last year, the IRS enhanced the "Where's My Refund?" tool to allow taxpayers to find out when their tax return was received, when the refund was approved, and when the refund was sent.

The IRS also deployed a new telephone and Web tool called "Where's My Amended Return?" in both English and Spanish that allows taxpayers to check the status of their Form 1040X amended tax returns for the current year and up to 3 prior years. The tool also provides taxpayers with other information, such as when their amended return was received, adjusted, and completed, as well as specific information regarding offset conditions, such as a previous IRS tax liability or a past due obligation.

The IRS continues to improve and expand on its outreach and educational services through partnerships with State taxing authorities, volunteer groups, and other organizations. Volunteer Income Tax Assistance (VITA) and Tax Counseling for the Elderly (TCE) sites provide free tax assistance for low-income individuals, the elderly and disabled, and individuals with limited proficiency in English. In fiscal year 2013, more than 91,800 volunteers prepared 3.4 million Federal returns, 95.3 percent of which were filed electronically, and more than 2.5 million State returns. The IRS also teamed up with its national partners to offer a remote filing method—Facilitated Self-Assistance (FSA)—at VITA sites. More than 82,000 FSA returns were filed at the 330 VITA sites offering the FSA remote filing model.

I am pleased to report that the IRS' technology efforts in relation to improving taxpayer service recently received public recognition. In March, the Excellence.gov Awards Program sponsored by the American Council for Technology and the Industry Advisory Council recognized the IRS' Virtual Service Delivery (VSD) program for Excellence in Customer Experience. VSD technology units allow face-to-face contact between IRS employees and taxpayers at remote sites through two-way video conferencing. These units help the IRS resolve taxpayer issues remotely at understaffed and unstaffed Taxpayer Assistance Centers, Taxpayer Advocate Service sites, and Low Income Taxpayer Clinic locations.

With the IRS budget now in its fourth year of relative decline, significant effects on taxpayer services will become more apparent in fiscal year 2014. The IRS has had 11,000 fewer people working during the 2014 filing season than it had in 2010 while processing the largest number of tax returns in the agency's history.

In addition to our concerns about the overall level of phone service noted above, we estimate that taxpayers may see average wait times of 25 minutes per call, compared with 10 minutes in 2010. Given current resources, we also expect that it will take longer for us to respond to taxpayer correspondence. Historically, 70 percent of letters we receive have been answered within 30 days, but we expect that more than half of all correspondence this year will take more than 45 days to answer.

As Forbes magazine recently noted, a reduction in IRS funding that erodes service levels "punishes" taxpayers.

Tax Compliance

In fiscal year 2013, as a result of the impacts of sequestration and furloughs, the IRS delivered key enforcement programs well below historical levels. Total individual audits fell 5 percent from 1.48 million in 2012 to 1.40 million, while audits of high-income individuals declined from 179,000 to 172,000. This translated to an individual coverage rate below 0.9 percent, a historical low. Likewise, business return audits dropped 13 percent from 70,000 to 61,000.

Collections related to all enforcement activities totaled $53.3 billion in fiscal year 2013, an increase of $3.1 billion over fiscal year 2012. This was the fourth consecutive year the IRS exceeded $50 billion, for a total IRS-wide return on investment (ROI) of $4.8 to $1. Most of the increase came from a $2.6 billion rise in revenue from our appeals function which, due to the timing of the appeals process, generally relates to examinations occurring in previous years. Revenue from the collection function, the levels of which also frequently rise and fall in tandem with the overall health of the economy, increased by nearly $1 billion in fiscal year 2013.

While the overall receipts from enforcement increased in 2013 compared to the prior year, the total is still down by more than $4.3 billion from 4 years ago. The

reason for this decline is primarily due to a decline in revenue from audits, which dropped nearly $400 million in fiscal year 2013 to $9.83 billion, the lowest level in a decade. This decline in audit revenue is attributable to a decline in the number of returns audited.

We are concerned the decline in core enforcement activities during fiscal year 2013 that was noted above is expected to continue in fiscal year 2014, given the ongoing challenging budget environment. For example, we expect audits to decline by an estimated 100,000 from fiscal year 2013 and the number of collection activities to decline by an estimated 190,000.

Despite the circumstances, the IRS has made significant progress in a number of major enforcement areas. One of these is international compliance. Strategic enforcement efforts and the parallel Offshore Voluntary Disclosure Program (OVDP) give U.S. taxpayers with undisclosed offshore assets or income an opportunity to become compliant with the U.S. tax system and avoid potential criminal charges. The OVDP has resulted in more than 43,000 disclosures and the collection of about $6.5 billion in back taxes, interest, and penalties since the program was first established in 2009.

The IRS also continued to focus on service and compliance activities in regard to tax return preparers. Return preparers play a key role in increasing taxpayer compliance and strengthening the integrity of the U.S. tax system. The IRS requires anyone who prepares or assists in preparing Federal tax returns for compensation to have a valid Preparer Tax Identification Number (PTIN). PTINs allow the IRS to collect more accurate data on who is preparing returns, the volume and types of returns being prepared and the qualifications of those doing return preparation. Additionally, PTIN data is essential in determining where to direct compliance and educational outreach efforts for erroneously prepared tax returns. The IRS recently held a successful PTIN renewal season, offering enhanced PTIN system usability, troubleshooting tips, and other tools. As of March 2014, the number of valid PTINs totaled approximately 677,000.

In fiscal year 2013, the IRS continued to educate and inform return preparers on tax law compliance in a number of ways, including: making visits to more than 3,000 return preparers around the country, including 300 compliance visits to preparers who handled large numbers of returns claiming the Earned Income Tax Credit (EITC); and addressing preparers who were found to have made egregious errors through education and outreach and through a variety of methods to ensure appropriate penalties and/or sanctions were imposed.

A critical area of focus involves stopping erroneous claims for refundable tax credits, particularly the EITC. We are concerned that the improper payment rate has remained unacceptably high throughout the program's history. Therefore, we initiated a major review of our activities in this area earlier this year. If Congress enacts the proposal in the administration's fiscal year 2015 budget to provide the IRS with greater flexibility to address "correctable errors," we will have additional tools to stop erroneous claims and, as a result, we believe we will be able to make a real reduction in the improper payment rate.

The IRS criminal investigation program examines potential criminal violations of the Internal Revenue Code and related financial crimes such as money laundering and tax-related identity theft fraud. In fiscal year 2013, the IRS completed 5,557 investigations; achieved a conviction rate of 93.1 percent; maintained a Department of Justice case acceptance rate of 95.5 percent, which compares favorably with other Federal law enforcement agencies; and obtained 3,311 convictions.

Refund fraud related to identity theft continues to be a major focus for us and touches nearly every part of the IRS. In fiscal year 2013, the IRS continued to focus on a comprehensive and aggressive strategy to identify and combat tax-related identity theft. Last year, the IRS conducted a number of activities in this area. These included: issuing Identity Protection Personal Identification Numbers (IP PINs) to more than 770,000 taxpayers for the 2013 filing season; conducting 191 identity theft outreach events with tax and accounting practitioners, the general public, and the media; and working with victims to resolve and close more than 963,000 identity theft cases.

Business Systems Modernization

IRS modernization efforts during fiscal year 2013 continued to focus on building and deploying advanced information technology (IT) systems, processes, and tools to improve efficiency and productivity. Fiscal year 2013 modernization successes included the following:

—The IRS' Customer Account Data Engine 2 (CADE 2) posted more than 139 million returns and issued more than 111 million refunds totaling $281 billion during the filing season. Daily processing and posting of individual taxpayer ac-

counts—which improved on the prior system of weekly processing and posting—enabled faster refunds for millions of taxpayers.

—Modernized e-File (MeF) Release 8 deployed for the filing season and was the sole e-file platform used as the IRS processed 224.7 million individual returns, and 16.8 million Business Master File returns.

—The IRS launched the Information Return Document Matching program and began selecting casework in January 2013. This program matches new information returns, such as Form 1099–K, Payment Card and Third Party Network Transactions, with both individual and business tax returns to identify potential income underreporting or non-reporting.

—The IRS launched a new Web portal that improved taxpayer access to IRS.gov. The Integrated Enterprise Portal accommodated a 22 percent increase in visits and a 6 percent increase in page views in fiscal year 2013 compared to fiscal year 2012.

Looking ahead, we believe that IRS IT operations in fiscal year 2014 will suffer a significant negative impact from the continuing tight budget environment. We anticipate that fiscal year 2014 funding will not be sufficient to address critical technology infrastructure needs such as: additional improvements to IRS.gov; new identity theft prevention tools; and upgrades to the basic computer software used by our employees that are needed to reduce system vulnerabilities.

Implementing Enacted Legislation

Within its budget constraints, the IRS nonetheless has an obligation to carry out the legislative responsibilities Congress has approved over the last several years, particularly ACA and FATCA. Implementation activities involving both statutes carried out in fiscal year 2013 will evolve and continue through fiscal year 2014 and into fiscal year 2015.

With regard to ACA implementation, I am pleased to be able to tell you that the systems and processes that the IRS developed to support enrollment in the new Health Insurance Marketplace were launched on schedule and are working as planned. We continue to focus on two significant provisions that go into effect in 2014: the premium tax credit and the individual shared responsibility provision. These two provisions will have a profound impact on IRS forms and procedures beginning with the 2015 filing season, and will require additional taxpayer services and education activities.

Preparation is already well underway to modify forms and instructions, enhance education and outreach to taxpayers and their advisors, and update our systems and processes in time for the 2015 filing season. The IRS is also focusing on ensuring that returns that erroneously or fraudulently claim refundable premium tax credits (or fail to reconcile advance payments of the credit) are efficiently identified and addressed using Marketplace information available during the filing season as well as the ever-improving IRS tools used for all returns to address errors and fraud.

Another major initiative is implementation of FATCA, which is an important new tool in our offshore compliance efforts. FATCA requires foreign financial institutions (FFIs) to report information to the IRS about financial accounts held by U.S. taxpayers, or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. Withholding requirements under FATCA go into effect on July 1, 2014. It is important to note that legal restrictions in some countries prevent FFIs from fulfilling the reporting, withholding and account disclosure requirements. For that reason, the Department of the Treasury (Treasury), with assistance from the IRS, is advancing an intergovernmental approach to FATCA implementation that is focused on bilateral agreements that address these legal impediments, simplify practical implementation and reduce the costs to FFIs. As of last week, there were 28 signed intergovernmental agreements. In addition another 27 jurisdictions had been publicly identified as having reached agreements in substance, bringing the total number of countries considered to have agreements in effect to 55.

The IRS FATCA registration Web site opened in August 2013 to allow financial institutions to begin to enter data. In January 2014, financial institutions were able to begin submitting their electronically signed FATCA agreements. Going forward, one of the IRS' biggest challenges involves having the resources to build and maintain systems that can effectively process all the incoming data. Beyond building these systems, we also will need additional staff to analyze the information and develop compliance programs around the new data.

Exempt Organizations

The IRS is continuing the efforts it began in fiscal year 2013 to implement broad managerial and operational improvements in the determination process for tax-ex-

empt status. In this work we are focusing on applications for recognition of tax-exempt status under both sections 501(c)(3) and 501(c)(4).

We continue to address the issues and concerns surrounding the determinations process for section 501(c)(4) applications. In fiscal year 2013 and continuing into this fiscal year, the IRS has made important progress in responding to the recommendations made by the Treasury Inspector General for Tax Administration (TIGTA) in a May 2013 report describing problems with the processing of these applications. As of the end of January 2014, the IRS completed action on all nine TIGTA recommendations contained in that report.

Our responses to the TIGTA recommendations include the actions we have taken to reduce the inventory of section 501(c)(4) applications, including the group of 145 cases in the "priority backlog"—those that were pending for 120 days or more as of May 2013. As of March 13, 2014, 126 of those cases, or 87 percent, have been closed. Of the closed cases, 98 of them were approved, including 43 organizations that took advantage of a temporary self-certification procedure we offered in summer 2013. Of the remaining 28 closed cases, most were closed either because the organization withdrew the application or it failed to respond to our questions. To date, three applications have been formally denied. The 19 cases still open generally fall into one of two categories: either the taxpayer has asked for and received additional time to respond to our questions, or the case is being litigated. None of these 19 organizations opted to accept the self-certification procedure used by 43 organizations to obtain prompt approval of their applications.

Also consistent with the response to the TIGTA recommendations, draft proposed regulations were released in November 2013 that are intended to provide clarity in determining the extent to which an organization's political activity is consistent with tax-exempt status as a social welfare organization. I believe it is extremely important to make this area of regulation as clear as possible, not only because it will help guide the IRS in proper enforcement, but because it will also give a better roadmap to applicants and help those that already have section 501(c)(4) status understand the applicable standards and properly administer their organizations.

As Treasury has noted in the past, the central purpose of any Notice of Proposed Rulemaking is to solicit public comments on proposed regulations, and we intend to consider all public comments we have received on these proposed regulations before moving forward in the regulatory process. Indeed, we received more than 150,000 comments on these proposed regulations, which is a record for an IRS rulemaking comment period. In addition, while I do not control the regulatory process, I am committed that any final regulation should be fair to everyone, understandable and easy to administer. It is also important that every taxpayer be confident that, whenever they interact with the IRS, they will be treated the same as any other taxpayer, no matter what their beliefs, what organizations they belong to or whom they voted for in the last election. Taxpayer trust in the integrity of the IRS is our most important asset, and my primary goal is to do whatever is necessary to restore whatever trust has been lost as a result of the inappropriate criteria used to scrutinize some 501(c)(4) applications.

Improving the section 501(c)(3) application process has been another significant area of focus for our agency, and we have been working diligently to make the process less burdensome for applicants in a number of ways. We presently have a backlog of 60,000 section 501(c)(3) applications, many of them well over a year old.

Our Exempt Organization (EO) group consistently receives more than 60,000 applications per year, consisting primarily of applications for section 501(c)(3) status. The agency has experienced a substantial rise in applications since 2010, due in large part to automatic revocations of tax-exempt status that occurred under the 2006 Pension Protection Act beginning in 2011, and the subsequent requests for reinstatement, which have added more than 50,000 cases to EO's workload since fiscal year 2010.

We have taken a number of actions to deal with the backlog in 501(c)(3) applications. On January 2, 2014, the IRS issued Revenue Procedure 2014–11, which makes the reinstatement process more efficient for organizations whose status was automatically revoked and allows a majority of revoked organizations to use a streamlined process to apply for retroactive reinstatement of their exempt status.

Looking beyond the issue of automatic revocations, the IRS has recently developed another way of making the determination process more efficient for section 501(c)(3) organizations. The Interactive Form 1023, Application for Recognition of Exemption under section 501(c)(3), which was made available online in September 2013, should result in more complete applications. This will thus reduce processing time by minimizing the IRS' need to request additional information to make a determination.

We have also taken all applications that were more than a year old as of last fall and devoted the necessary resources to resolving virtually all of them in the next

months. We also are working to have no applications still pending at the end of this year that have been filed more than 9 months earlier. Ultimately, we want to process all applications within a 6-month timeframe, with a backlog of less than 30,000 cases at any time.

To make this possible we are also examining the feasibility of creating a streamlined application process for certain organizations seeking tax-exempt status, in particular small organizations that pose a low risk of noncompliance. The goal is to come up with a new procedure this summer that is more efficient without introducing major risks into the system for approving applications. These streamlined applications could be processed in a matter of weeks rather than months.

THE ADMINISTRATION'S FISCAL YEAR 2015 BUDGET REQUEST

The budgetary constraints under which the IRS has been operating since 2010 continue to pose very serious challenges to our efforts to enforce the tax laws and provide excellent customer service. Our fiscal year 2014 enacted appropriation was $11.29 billion, which is more than $850 million below the fiscal year 2010 funding level in nominal dollars, or over $1 billion in real dollars. This represents a 7 percent cut in our annual budget since 2010 while the total population of individual and business filers grew by more than 4 percent over the same time period.

Essentially, the Federal Government is losing billions of dollars in revenue collection to achieve budget savings of a few hundred million dollars. In general, the IRS estimates that for every $1 invested in the IRS budget, it produces $4 in enforcement revenue, which is a $4-to-$1 return on investment to the American taxpayer. This year, for example, the IRS estimates it would have returned to the Federal Government over $2 billion more in collections had we received the remaining $500 million that our budget was cut as a result of the sequester.

The solution to the funding problems faced by the IRS begins with the President's fiscal year 2015 budget request, which, with the inclusion of the program integrity cap adjustment and the Opportunity, Growth and Security Initiative, totals $12.64 billion. This is approximately $1.35 billion above the fiscal year 2014 enacted level of $11.29 billion. This amount includes a $480 million program integrity cap adjustment to vitalize tax compliance and a $165 million additional investment through the Opportunity, Growth and Security Initiative to deliver performance enhancements that taxpayers deserve.

The aim of the President's proposal is twofold. First, it is designed to reverse the erosion in the IRS budget over the last several years. In so doing, it will help taxpayers get the service they expect. It will also strengthen compliance in key areas, such as international tax compliance, high-wealth individuals and flowthrough entities, in large part by halting the recent declines in the number of key enforcement personnel. Longer term, the proposal also positions the IRS well for the future by allowing the agency to invest in necessary basic infrastructure, as well as advanced technology.

The budget request also provides funding to: implement enacted legislation; enforce return preparer compliance; expand criminal investigation capabilities; address compliance issues in the tax-exempt sector, including employee retirement plans, exempt organizations, and direct-pay bonds; and provide appropriate and balanced coverage by improving examination audit and collection coverage rates.

In regard to compliance, increased resources for IRS enforcement programs yield direct, measurable results through activities that provide a high return on investment. It is important to point out that this request includes a $480 million program integrity cap adjustment that will reduce the deficit through above-base funding for high-return tax enforcement and compliance programs, of which $5 million will be transferred to the Alcohol and Tobacco Tax and Trade Bureau. The $475 million requested for the IRS fiscal year 2015 enforcement initiatives funded through this program integrity cap adjustment is expected to generate nearly $2.1 billion in additional annual enforcement revenue once the new personnel hired reach full potential in fiscal year 2017. At full performance, these resources requested for enforcement initiatives are expected to generate a return on investment of nearly $6 to $1, not including indirect deterrence effects estimated to be at least three times the direct revenue impact. Over the 10-year budget window, the proposal is expected to generate $52 billion in additional revenue while costing $17 billion, thereby reducing the deficit by $35 billion.

It is fair to ask what value the American taxpayer would receive for the increase in funding requested by the President of approximately $1.2 billion over the fiscal year 2014 enacted level. Let me detail for you how the IRS intends to spend these additional funds in various categories:

Improve taxpayer service: $211 million—This additional funding will allow the IRS to meet the expected increase in demand for taxpayer services in fiscal year 2015. Combined with Opportunity, Growth and Security Initiative resources, the additional funding will allow us to answer about 12 million additional calls from taxpayers seeking our help, including taxpayers seeking assistance in regard to the ACA, and will cause our level of phone service to exceed 80 percent. It also includes $19 million that will be invested in advanced technology to further expand and improve the services taxpayers receive when they call the IRS. For example, this additional funding will allow the IRS to enhance its automated phone system to let taxpayers elect to be called back instead of waiting on hold, and will allow customer service representatives to call up immediate displays of taxpayer information on their computers, improving response time.

Prevent refund fraud and identity theft: $65 million.—This additional funding will allow the IRS to help more taxpayers who have been victims of identity theft resolve their cases. We will also invest in advanced technology to further our efforts in identifying potentially fraudulent returns, allowing us to reduce improper payments. We project that investments in these activities will protect nearly $1.5 billion in revenue by fiscal year 2017, an ROI of more than $22 to $1.

Address offshore tax evasion: $57 million.—This additional funding will allow us to expand our efforts to identify and pursue U.S. taxpayers with undisclosed offshore accounts. It will also help the IRS expand criminal investigations of international tax and financial crimes, and expand information gathering to identify those who promote or facilitate abusive offshore schemes. We estimate that this investment will enable the IRS to close an additional 6,600 cases and produce additional, direct annual enforcement revenue of approximately $293 million once the new hires carrying out these activities reach full potential in fiscal year 2017. That is an ROI of $4.8 to $1.

Expand audit coverage of individuals: $98 million.—This additional funding will allow the IRS to hire additional personnel to improve our examination efforts in regard to individuals. With these new resources, the IRS will be able to do more exams, match more documents to detect misreported or unreported income, and invest in advanced technology to make our work more efficient by, for example, using barcoding so that some paper documents we receive can be electronically processed. As a result, we estimate that we will be able to close an additional 243,000 individual examination cases. Through these activities, we expect to collect $674 million more in direct enforcement revenue once the new hires reach full potential in fiscal year 2017, an ROI of $7.1 to $1.

Expand audit coverage of high-wealth taxpayers: $21 million.—This additional funding will allow the IRS to hire more enforcement personnel to continue our focus on high-wealth taxpayers. This is a challenging area, as these taxpayers frequently operate complex enterprises containing many interrelated businesses that often have international components. We estimate that, with this investment, we will be able to close an additional 325 cases and produce additional annual enforcement revenue of $243.9 million once the new hires reach full potential in fiscal year 2017—an ROI of $11.3 to $1.

Improve audit coverage of partnerships and flow-through entities: $36 million.—This additional funding will allow the IRS to hire additional staff to keep pace with this segment of taxpayers, the most rapidly growing portion of all tax returns filed. In particular, this will allow us to increase the number of tax examiners with specialized knowledge about partnerships. We estimate that we will be able to close an additional 2,800 cases involving partnerships and produce $268 million more enforcement revenue annually once the new hires reach full potential in fiscal year 2017, an ROI of $6.8 to $1.

Enhance collection coverage: $67 million.—This additional funding will allow the IRS to hire new staff to improve our efforts to work with taxpayers to collect back taxes owed. With the additional funding, we will be able to take a more proactive role in reaching out to taxpayers earlier in the collection process. We estimate that this will allow us to close an additional 244,000 collection cases. The funding also will provide additional staff to handle an increasing number of cases involving unpaid employment taxes, which we estimate will allow us to close an additional 45,000 employment tax cases. As a result, we project additional annual, direct enforcement revenue of $617 million once new hires reach full potential in fiscal year 2017, an ROI of $8.5 to $1.

Improve efforts in the tax-exempt sector: $16 million.—With this additional funding, the IRS will be able to continue its focused oversight of the tax-exempt sector and improve service to make voluntary compliance easier. We estimate these additional resources will allow us to reach our goal of cutting our backlog of 501(c)(3) applications in half and reducing the processing time for all applications to a period

of 2 weeks or less for smaller organizations and no more than 6 months for all applications.

Pursue fraud referrals and tax schemes: $18 million.—This additional funding will be dedicated to improving our efforts in the core enforcement areas of corporate fraud, employment tax, and abusive tax schemes by increasing the number of convictions and assessments of unpaid tax. A portion of the funding will be for the use of computer software that will allow the IRS to apply so-called network analysis to detect corporate fraud and abuse. With this software tool, the IRS will be able to identify schemes by linking together multiple potentially fraudulent returns or information items. These efforts are expected to help us achieve a conviction rate in this area for fiscal year 2015 of 92 percent.

Enhance return preparer compliance: $17 million.—This additional funding will allow the IRS to increase service and compliance activities in regard to tax return preparers. The IRS will be able to increase audits of preparers and increase monitoring and pursuit of preparers engaged in fraudulent activities, including those who prepare large numbers of returns involving EITC claims. We estimate we will be able to conduct 200 additional preparer visits and more than two dozen additional investigations into fraudulent activity.

Use technology to enhance criminal investigation: $4 million.—This additional funding will allow the IRS to automate the processing of evidence gathered by our criminal investigators by implementing a virtual digital evidence processing environment. This new system will allow for more secure and efficient evidence processing nationwide, and reduce travel by IRS agents and investigative specialists.

Use technology to improve audit case selection: $37 million—This additional funding will enable the IRS to improve the way we gather and use electronic data, which will in turn allow us to do a better job of selecting cases for audit and focusing on issues that need to be examined. This is important because the IRS needs to continually adapt to changing taxpayer behavior to prevent tax fraud and abuse. Under the initiative we envision, we will significantly increase the digital availability of tax return information and then employ technology to analyze this information in order to better detect noncompliant taxpayer behavior.

Expand Virtual Service Delivery (VSD): $8 million.—This additional funding will create a secure, Web-based digital communications channel through the Internet using online messaging that ultimately will allow the IRS to communicate directly with taxpayers while they are at work or at home, or using their mobile device. This will improve the taxpayer experience in resolving difficult issues with their accounts.

Enhance online services: $16 million.—With this additional funding, the IRS will develop additional digital applications that will further improve taxpayers' online interactions with the IRS. This technology investment will help provide secure digital communications, and add more interactive capabilities to existing Web self-service and mobile products.

Implement ACA: $452 million.—This additional funding, the majority of which is for required information technology upgrades, will allow the IRS to increase efforts to ensure compliance with a number of tax-related provisions of the ACA, and also perform outreach and educational activities so that taxpayers will understand what these provisions require, as well as covering additional phone calls made by taxpayers inquiring about the ACA. The funding will also assist the IRS in continuing to implement a major ACA provision going into effect in 2014—the premium tax credit, which will help millions of Americans purchase affordable coverage.

Implement FATCA: $32 million.—With this additional funding, the IRS will invest in advanced technology to allow the agency to continue implementing FATCA, which in turn will provide more information to us on offshore accounts of U.S. citizens. As mentioned above, FATCA includes new reporting and withholding requirements for foreign financial institutions. To properly process and analyze the data we receive as a result of these new requirements, the IRS will need to build new technology systems and modify existing systems.

Enhance information technology services: $10 million.—This additional funding will enable the IRS to continue upgrading its computer systems, and in particular convert the agency's operating system to a less complex standard, which will decrease our need for computer hardware. These investments will result in a more stable computing environment and reduce delays in providing service to taxpayers.

Consolidate and revitalize IRS office space: $10 million.—With this additional funding, the IRS will be able to consolidate office space in Atlanta, Georgia, and design a new, modernized facility for processing tax returns at the IRS campus in Covington, Kentucky. These activities, in turn, will allow the agency to improve efficiencies and achieve long-term savings.

Enhance IRS procurement and security systems: $31 million.—This additional funding will allow the IRS to improve the efficiency of our procurement processes and also improve security for our employees and our resources.

Improve IRS financial accounting systems: $12 million.—This additional funding will help the IRS ensure more timely and accurate reporting of data on the revenue we collect. The funding will also allow the IRS to make necessary system and programming changes to comply with various Federal mandates, and to stay current with internal changes made to IRS' tax processing systems for tax administration that also affect financial reporting.

CONCLUSION

Chairman Udall, Ranking Member Johanns and members of the subcommittee, thank you again for the opportunity to update you on IRS operations and discuss the fiscal year 2015 President's budget request for the IRS. It is vital that we find a solution to our budget problem, so that the IRS can be on a path to a more stable and predictable level of funding. I look forward to working with Congress and this subcommittee to do just that. In order to ensure that the IRS can continue to deliver on its dual mission of providing quality taxpayer service and ensuring compliance with the Nation's tax laws, I hope that one of the legacies of my term as IRS commissioner will be that we put the agency's funding on a more solid footing. This concludes my statement, and I would be happy to take your questions.

IDENTITY THEFT

Senator UDALL. Commissioner, thank you very much for your testimony. You know, one of the things that—and for your service today—the big issues that you face are refund fraud and identity theft. And these are serious, pervasive problems in the United States, and I think they are probably daunting task for the IRS.

Taxpayers are harmed when identity thieves file fraudulent tax documents using stolen names and Social Security numbers and wrongfully receive refunds. Identity theft can be devastating for victims whose legitimate refunds are blocked, forcing them to spend months untangling their account problems with the IRS. The rapid growth of tax related identity theft has resulted in a backlog. My understanding, it is about 140,000 cases.

What is the IRS' strategy for dealing with identity theft and refund fraud? Is it comprehensive and aggressive enough to keep pace with fraudsters? And what is your plan for tackling the backlog? What measures make it easier for the IRS to better detect fraud and halt refund fraud schemes in their tracks? And what additional resources, both technology and human capital, does the IRS need to expedite case resolution for innocent victims, who often wait months for their rightful refunds?

Mr. KOSKINEN. It is a critical problem that exploded, really, in 2010 to 2012, and overwhelmed both the IRS and law enforcement. We have made great progress since then, particularly in protecting and working with taxpayers whose identities have been stolen. It used to take, when this first started, over 360 days to resolve a case. We now have those cases being resolved in less than 120 days. The backlog at this time last year was 260,000 cases. The end of this filing season, the backlog was under 100,000 cases, reduced by over 60 percent.

Our problem is that these are not individuals filing false returns. This is organized crime around the world that is filing hundreds, if not thousands, of returns at the same time, stealing Social Security numbers in various ways. We have developed fraud detectors that have allowed us to detect trends. Last year in the filing sys-

tem overall, we stopped $17 billion of fraudulent refunds from going out the door. We continue to adjust those filters.

One of the technology changes which we hope to fund would allow us to change those filters on the run, rather than only once a year. Our system is somewhat archaic, and it is like running a Model-T. And so, we can only adjust the filters once a year. With more technology expenditures, which we hope to devote to this activity, we will be able to adjust those filters on the run and try to keep ahead of them.

Even though we have made great progress, I have asked our senior executive team—we have had two meetings on this—to step back and ask what else can we do? One of the things we can do, and we have asked for legislative support, is move the receipt for W–2s to the IRS from mid-March to the end of January. All employees get their W–2s by the end of the January. We would like to have the IRS have access to those W–2s at that time because what has happened is we are a victim of our own success. In the old days, which I remember, you used to get your refund in a check from the IRS sometime in August through October.

And by that time, all the third-party information was into the IRS. You now have improved the technology enough that we tell you if you file in January or February, within 21 days we will give you a refund, and we have met that standard. Ninety million people got refunds by April 15. So we leapfrogged the third party information. We need to have the W–2 information earlier so we can have some of the third-party information earlier. 1099s are too complicated to try to get that information much earlier.

We need to reconsider how we handle refund requests. We need to actually adjust those so we can get them in a reasonable time. We are working very well. We have partnerships with law enforcement at the State and local level. We have partnerships with financial institutions, with the prisons where a lot of this originally started, which is one of the reasons we are getting our arms around the problem.

We also have significant enforcement activity going on. In fiscal year 2011, we had 300 criminal investigations. Last year, we had almost 1,500. We have over 500 already in this filing season. We have moved to—we had 1,000 indictments last year with 438 sentences. Those are for multi-year sentences. This year already, just in the filing season, we have had 412 indictments and 342 convictions. And as I say, people are going to jail for 5, 10, 15 years.

So to some extent, one of the reasons we think we are getting our arms around this is we have sent a lot of criminals to jail. And these are not, as I say, people filing one return at a time. These are people filing 50, 100, 5,000 of them at a time. But we need to be continually vigilant. We need to continually devote resources to it.

PROPOSED 501(C)(4) REGULATIONS

Senator UDALL. Thank you. Obviously, a very serious issue. The—we had a lively exchange up here on the tax exempt. And I do not want to rehash a lot of that, but the one thing that I am wondering about with the proposed rule out there, until the rules

change, what tests or criteria is the IRS using to evaluate applicants or tax exempt status as a social welfare group?

Mr. KOSKINEN. Last summer, to try to resolve the backlog of applications that had been pending far too long—some of them, 2 years—an interim measure was adopted that said if you will simply state and affirm that you are not going to spend more than 40 percent of your resources and revenues on political activities, you could, in fact, pass through. That has continued. So people applying today, if they simply say they are not going to spend more than 40 percent of their funding on political activities, can be reviewed and processed immediately.

We have, as the Secretary noted, implemented and adopted all of the recommendations of the Inspector General. There is training and re-training for people around every election cycle, which will not happen until later this year. But at this point, there are provisions making sure that any applicant that does not want to sign the 40 percent attestation and wants to be reviewed on the facts and circumstances, goes through review process, to make sure that no individual has the ability to stop one of those applications.

Senator UDALL. Thank you. Senator Johanns.

POLITICAL ACTIVITY BY TAX-EXEMPT ENTITIES

Senator JOHANNS. Mr. Commissioner, welcome. Who defines political activity?

Mr. KOSKINEN. Part of the problem is the facts and circumstances of political activity have been vague. There are, if you look in the regulations and the advice from the IRS over the years, there are 12 or 14 examples of what is in and what is out.

One of my concerns—and I share everybody's interest in this regulation which was drafted before I was confirmed—is that we need to have a clear standard, and not just for people applying. We need to have a clear standard for people running these organizations. They ought not to have to look over their shoulder, worrying that somebody is going to say the facts and circumstances have changed, you are now doing something that puts your tax exemption in——

Senator JOHANNS. Mr. Commissioner, I do not have much quarrel with what you just said. But you just informed us that if I file under 501(c)(4) and I attest to you that no more than 40 percent of our resources will go to political activity, then I go right on through.

Mr. KOSKINEN. Right.

Senator JOHANNS. But if I am 42 percent, I will not go right on through. Now, political activity, who defines it? Do you define it? Who in your office is responsible for saying, Mike——

Mr. KOSKINEN. As I said, there is public information about a range of examples of what is political activity. Advocacy, for instance, historically has not been viewed as political activity. One of the goals of the new regulation, and my commitment to it is, as the chairman noted earlier, that any final regulation ought to be fair to everybody. It ought to be clear on just this question and any other question, and it ought to be easy to administer. We ought not to be in the business of making subjective determinations of when you are over the line of political activity.

Senator JOHANNS. But I think today you are. It sounds extremely arbitrary and capricious to me that you have set a 40 percent limit, and you have told everybody out there that if they are at 41 percent or 40.5 percent, then they are going to get some kind of special scrutiny from the IRS. On the other hand, if you are at 40 percent or 39 percent, zip right on through. But I cannot figure out what is political activity. You are not expressing that, and that to me sounds arbitrary.

Mr. KOSKINEN. No. As I said, there is public information giving a wide range of examples of what is and is not political activity. As I said, advocacy has been held not to be political activity. The standard is are you primarily a social welfare organization, and "primarily" has never been defined in terms of what percentage it is. The 40 percent was just taken as an idea that that was a lot of resources to put into political activity, and in this interim period it would be a way of streamlining the process.

But you are exactly right. The problem is what the definition of political activity is, and how much of it should you be allowed to engage in before you are no longer a social welfare organization. And that is exactly what the regulation process is meant to decide and provide.

Senator JOHANNS. Well, if I was at 41 percent and I were a private citizen out there, I would be hollering like crazy because I think you are treating that person different for their activity versus the person who is at 39 percent. And we should not be doing that.

Mr. KOSKINEN. The issue is, unless you want to say that everybody can spend as much as they like on political activity and still be a social welfare organization, the statute says you should primarily be a social welfare organization. So whatever the line is, historically, that has been drawn, if you are over the line, you are not viewed as a social welfare organization. You are discriminated against because of your political activity, and you are not qualified. That is the way it has been for 50 years.

The problem is it has been extremely unclear for 50 years, and what, hopefully, we will get out of the regulatory process when we reissue, and I think we will reissue a new draft for public comment, is a regulation that is, in fact, more understandable, more transparent, easier for people applying and easier for people who are running organizations to know what is allowed and what is not allowed.

There is a definition right now in the present regulation of what political activity is, and we have got over 150,000 comments, a lot of them addressing whether that is the right definition. But it is a pretty clear definition. It is not a definition that people—a lot of people have felt it is broad, and that is a position that has been held on both ends of the political spectrum.

But it is clear. I think what we have in a redraft of this should be equally clear, but it should take into consideration the 150,000 comments, and we will do that.

FISCAL YEAR 2015 BUDGET REQUEST

Senator JOHANNS. Let me—quite honestly, you are talking in circles, but let me go on to the budget. According to the changes in the Budget Control Act that resulted from the Ryan-Murray agree-

ment last fall, total discretionary spending will rise from $1 trillion and $12 billion to $1 trillion and $14 billion. The actual increase is smaller than a $2 billion difference. It is closer to about $1.4 billion.

In your budget alone, you are asking for an almost $1.2 billion increase. Even without the requested cap adjustment of $480 million, you are still asking for a $700 million increase, which would be more than half of the total increase in discretionary spending for everything, from fiscal year 2014 to fiscal year 2015.

It just strikes me that that is not consistent with reality. I cannot imagine as the Secretary of Agriculture walking into OMB and saying to them, I want half of every increase in discretionary dollars in agriculture. I think I would have been thrown out of the office.

Mr. KOSKINEN. The difference is, and it is an important difference for this subcommittee and an important difference for the country, is the Secretary of Agriculture with his $700 million, is not going to give you money back. The IRS returns four to six times back to the Government for every dollar it gets.

As I have said, if we had our pre-sequester $500 million, I have testified we would have provided $2 billion to $3 billion more into the Treasury than we are now able to provide. Our enforcement revenues are going to go down. We have 4,500 fewer revenue agents and revenue officers, whose only job is to collect revenue. If we do not have those people, they will not collect the revenue.

So it is not as if we are spending this money on a social welfare program. This money in the IRS budget is designed to assist taxpayers to make it as easy as possible to pay and to assist the Government in collecting the money that is owed to it. We collect on average over the years $50 billion to $60 billion just in our collection efforts, which is four to five times the budget of the IRS. As our budget is constrained, the amount of revenue to the Government is going down by a multiple of four to five.

Senator JOHANNS. Your argument seems to be going along the lines of you should just give us an unlimited amount of money, and we will just keep collecting and collecting and collecting. But Congress decides that, and we have decided with the Ryan-Murray agreement, and you are not even showing even a close attempt to live within that agreement, in my judgment.

Mr. KOSKINEN. The President's budget decisions are made by the administration and by OMB. Our position is simply that we have told you what you will get when you give us the resources. We have told you what you will not get if you do not give us the resources. It is a judgment you will have to make. All we want to do is make sure you understand the negative impacts on taxpayer services, the negative impacts on collection that are going to result if we end up with the—anything like the same budget we have now.

Senator JOHANNS. Thank you, Mr. Chairman.

Senator UDALL. Senator Moran, if you are prepared to proceed, we are actually right at—I do not want to put you on the spot. We can start——

Senator MORAN. I think you have already done that.

Senator UDALL. No, no, no. We can do another round. I am just saying if you——

Senator MORAN. That is fine. If you would go ahead, Mr. Chairman, I would wait.

Senator UDALL. Okay. Okay. Great. I just—I did not know whether your staff scheduled you so well that you just walk in and start your questioning. So but anyway, thank you.

Senator MORAN. Did you do that? Apparently not.

Senator UDALL. Okay. Okay.

Mr. KOSKINEN. If they do that, I would like to borrow your staff once in a while.

OVERSEAS TAX EVASION INITIATIVES

Senator UDALL. You know, they end up, Commissioner, they can watch the TV and see everything that is moving along, and then move you right in, and set it down in front of you. But it takes a lot of juggling, and our staffs are always good at that. Our staff is very good at that.

Let me—I think—this is—this whole issue of these organizations troubles me, and I want to kind of tell you what I see from the practical side happening. Congress passed a law—we are talking this tax exempt social welfare organization—passes a law. And it says that these organizations are established, and this is the quote from the law, "exclusively for the promotion of social welfare." So that is what the law said.

Mr. KOSKINEN. Right.

Senator UDALL. Well, the way you guys got yourselves, and it was not you, but the way the IRS got themselves in a mess is they interpreted the word "exclusively" to means "primarily." So to me, that is a big jump from "exclusively" to "primarily." And so, then you have had to come up with this political test and all those kinds of things and the 40 percent.

What is happening out there, and I think people should understand this, is that these 501(c)(4)s, money is contributed, and the donors are not publicly available. And so, what can happen, and this is, in a sense, in my opinion, money laundering, is that a 501(c)(4) can start with this intention of doing political activity. And the money flows in, and nobody knows how that money is connected to the political system in any way.

The 501(c)(4) can close its doors and then put that money into a super Pac, and you will end up having no evidence of who were the donors, and that is what the big problem is. And it is growing to a huge proportion. I think in the last elections it was $400 million, which is really what people are calling out there, and I agree with this—secret money, dirty money, that kind of thing.

So anyway, that is—I just want to tell you that is the issue that you are tackling is that we have always had a political system where we knew who was supporting whom. And we are getting a long ways from that when we have these organizations. And I think when you look at all these comments and get your congressional input, you really need to look at how this is impacting the core of our democracy really.

So with that, let me shift, and I am not asking for a comment on that. I want to talk a little bit about offshore tax invasion. U.S. taxpayers can hold offshore accounts for legitimate reasons, but they must comply with their tax obligations. Catching overseas tax

dodgers is a top priority of the IRS, and you know that very well, and it is to make sure honest taxpayers are not footing the bill for those hiding assets offshore.

The IRS has operated some successful offshore compliance programs, such as the offshore voluntary disclosure program that has recouped $6 billion in back taxes, penalties, and interests, and provided an opportunity for 43,000 tax dodgers to come clean. These programs have also provided the IRS with a wealth of information on various banks and advisors assisting people with offshore tax evasion.

The IRS' 2015 funding request of $56.8 million to support overseas tax evasion initiatives is conditioned on securing funds that would exceed the available budget cap. Without 2015 funding, the IRS will lack critical resources to meet overseas tax collection priorities.

So my questions are these. What have been the benefits for the IRS in conducting the various overseas voluntary disclosure programs? What is the IRS doing now in 2014 to implement strategies to address international tax compliance issues? Can you confirm that as presented in your 2015 budget justification the $56.8 million in requested funds for overseas compliance initiatives depend on securing resources above the statutory budget cap, and how will the IRS devote resources to the overseas initiatives in 2015 if the requested funds are not appropriated?

Mr. KOSKINEN. Well, I would begin by agreeing with you that the benefits of the Foreign Account Tax Compliance Act are broader than just the amount of money we have collected. It is important for the average taxpayer to know when they are writing their check that everybody is paying their fair share, and they do not have to think, well, if I had a really fancy lawyer or a good accountant, I could hide my money somewhere and not pay taxes on it. They need to know that we take tax evasion seriously; that if you, in fact, willfully are not paying your taxes, we will track you down, and we are going to find you. And that includes in overseas tax havens.

We are working with the Department of Justice very closely, our Criminal Investigation Division, on the criminal side of this issue. We have been working on the civil side. We need funding to implement FATCA. We are about to start to get reams, volumes of data on individual taxpayer accounts from banks around the world.

But I would say, and money is in this request, and as I said earlier, the implementation of the Foreign Account Tax Compliance Act and the implementation of the Affordable Care Act are statutory mandates. So if we do not get the funding that we need in the budget, we will have to take the funding from our discretionary areas, which are taxpayer services and enforcement, because we are mandated to implement FATCA and the Affordable Care Act.

But what we need to have everybody understand is, this year, in 2014, we got zero dollars to implement the Affordable Care Act. So we have had to find $400 million in the budget to continue with that implementation, which is met primarily from IT resources. Three hundred million dollars of important IT projects, including some related to identity theft and fraud, are not being done. If we go forward into 2015 without sufficient resources, we will imple-

ment FATCA. We will implement the Affordable Care Act. And it will come at the cost of taxpayer service and other enforcement.

Senator UDALL. Thank you. Senator Johanns.

PERFORMANCE AWARDS

Senator JOHANNS. Mr. Commissioner, in February you made the decision to spend $62.5 million in fiscal year 2014 funds to pay out performance awards to employees for fiscal year 2013. $43.4 million went to bargaining unit employees, and about $19.1 million went to other employees, including managers at the IRS.

Now, your—the previous commissioner had made the decision to suspend those awards because of funding pressures and the need to fund other crucial priorities. Could you explain to us why you reached a different decision, and why you decided to spend this money in that direction versus some of the priorities that you have testified to at this hearing?

Mr. KOSKINEN. I would be delighted to. The previous decision had been made when the IRS was challenged to meet the sequester levels. It had to find almost $600 million to take out of the budget. It ended up with furlough days. It ended up with almost no training to employees anywhere during the year. And it ended up making a decision under the contract which provided for 1.75 percent as a performance award pool to change it to zero.

The union, under the contract, then filed an unfair labor practice and grievance and a lawsuit. When I came, all of that was pending. We were spending money on that. We were able to settle the claim that under the contract we needed to provide 1.75 percent as the award. The performance award pool was changed to make it 1 percent to be consistent with what the Government-wide number is, so that, in fact, the $40 million, give or take a little, that we paid to the bargaining unit employees, was probably $25 million to $30 million less than we would have paid if we had lost that lawsuit.

So it was a settlement of a disagreement that was in the courts that saved us money in litigation and the risk that we would end up paying more. It also seemed to me an important investment in our workforce. These are people who had not gotten a pay raise in 4 years. They had just had the shutdown, furlough days, were doing critical work for us across the board. But it was a settlement of litigation that it seemed to me at the time was appropriate, and if I had to do it again, I would do it again.

Senator JOHANNS. We have received information, which I would like you to verify or not verify, that in paying out the awards, awards were given to employees within the Tax Exempt and Government Entities Business Unit. These awards were paid out despite an ongoing investigation relative to the disparate treatment of taxpayers that we have talked about.

Why did you decide it was important to pay out the awards to a group under investigation, even though that had not been concluded at the moment? It is hard to tell when it will be concluded. And I would just offer a comment. I think to the average person in America, that just seems extremely tone deaf.

Mr. KOSKINEN. Well, I think it is important to understand there are over 800 people in that unit. Seventy to 80 percent of that unit's work is on 501(c)(3)s, not on (c)(4)s. So to say that we would

not provide any of them a performance award—these are not bonuses, they are performance awards. Only two-thirds to 70 percent of the employees get those awards, and the average award for bargaining units employees is about $950. So nobody is making a fortune off of this. And to deny everybody in the organization, whether they were near the (c)(4)s or not, their performance award possibility, it would not have made any sense.

Also the significant people involved in this are no longer in the IRS. They did not get awards. The fact that people have been involved in the process under investigation, but have not been found that they themselves engaged in erroneous work, it seems to me it would be unfair to them to then say, while it is all pending, and we do not know whether there is anything further coming out, nobody gets an award.

If it turns out people performed badly—and that is why I am hoping that we will get reports out of the six investigations going on—we will look at those facts, and we will respond appropriately. If there are people who are found to have performed badly, they will not be eligible for performance awards. But we need to know what the findings are. We cannot simply say everybody involved in any investigation by anybody for anything is, therefore, not going to get an award.

Senator JOHANNS. Mr. Commissioner, it gets worse, though. Recently, there was a review of IRS performance awards, which I am guessing you are familiar with, between 2010 and 2012. During that time, more than 2,800 employees with recent substantiated conduct issues resulting in disciplinary action received more than $2.8 million in monetary awards, more than 27,000 hours in time off awards, and 175 quality step increases.

EMPLOYEE TAX COMPLIANCE

Among these, more than 1,100 IRS employees with substantiated Federal tax compliance problems—in other words, they are not paying their taxes—received more than a million dollars in cash awards, more than 10,000 hours in time off awards, and 69 quality step increases within a year after the IRS substantiated their tax compliance problems.

Now again, to the average American, the thought that you would—not you, but the IRS—would award an employee who is not paying their taxes is just incomprehensible.

Mr. KOSKINEN. We take tax compliance very seriously, obviously. The compliance rate of IRS employees is over 99 percent. That is significantly better than anybody else in the Federal Government, significantly better than people on the Hill, and it is, clearly, substantially better than the public.

Notwithstanding that, when an employee comes to work for the IRS, they commit that they will pay their taxes. We monitor all 90,000 employees regularly. As the IG reported, there is no policy across the Government that says you should or should not take conduct into consideration, or tax payment into consideration. We have a separate disciplinary process, and anybody who willfully does not file their taxes is subject to dismissal, and we have dismissed people for that.

But I agree—we agreed with the IG's recommendation, notwithstanding the absence of a general policy. We should have a policy in the IRS, and we will develop that and we are about to start. We are in the middle of a negotiation with the union about our next 5-year contract because a big bulk of this deals with union employees. And we have advised the union, and they said they are prepared to discuss with us the proposal we are developing, which we will discuss with them in the next few weeks because I do think it is exactly right. The reason we take it so seriously is if we are chasing you for your taxes, we should be paying our taxes.

And as I would stress again, over 99 percent of the IRS employees are compliant with their taxes. Those that are not compliant oftentimes have the same issues everybody has. They have got an issue about whether they declared head of household correctly. They may not have put a 1099–R in about a pension payment or outside income that they got. There may be issues about deductibility of dependents. So a lot of those, and a number of those thousand, were in the group of those who had differences of views as to what were appropriate taxes. They had not paid, and they were appealing it. They were then singled out as they had not paid.

Ultimately, I think that it is appropriate for people to say if you are in the IRS, you should pay your taxes. Some people might say if you are in the Government you should pay your taxes.

Senator JOHANNS. Thank you, Mr. Chairman.

Senator UDALL. Thank you, Senator Johanns. And, Commissioner, I really appreciate you taking this matter seriously. Based on the recent TIGTA filing, certain past bonus decisions were troubling and questionable, and I am glad you are making it a priority to revise the policies and practices. Senator Moran.

Senator MORAN. Chairman, thank you very much. Thank you for giving me the moment to collect my thoughts and listen to what the Commissioner had to say.

Commissioner, thank you very much for joining us. Let me follow up just a moment on the line of questioning that Senator Johanns had with you. My understanding is that you believe that the policy was absent and needed to be put in place to prevent the bonuses from being paid to employees at the IRS who have not or did not pay their taxes. That is what your testimony is?

Mr. KOSKINEN. Yes, sir. We have had a policy for senior level employees and executives that if they are not compliant, they are not eligible for awards. But we are developing a broader policy, and I think we should develop, although we have to negotiate it with the union. We have advised them that we should have a policy that basically says if you willfully are not compliant with your taxes, you should not be eligible for a performance award.

Senator MORAN. When were these performance awards granted in relationship to your arrival as Commissioner at the IRS?

Mr. KOSKINEN. The performance was for the fiscal year 2013, which was before I arrived. The decision, as Senator Johanns and I were talking about, to actually make the awards or create the pool that would allow somewhere between 65 and 70 percent of people to receive these awards was made in February by me.

Senator MORAN. So the determination about who would receive the award was made before you arrived. The ultimate decision to

have the pool that was necessary to make the awards actually occur occurred after your arrival.

Mr. KOSKINEN. That is right. These were for determinations already made. The way the process for bargaining unit employees works is it begins as a recommendation, and it has two levels of review to make sure that, in fact, there was performance that merited an award. A third to sometimes 40 percent of employees get no award.

Senator MORAN. In your review of this circumstance, did you determine that there was a realization on the part of the individuals—the management at the IRS that made the decision to include these employees in receiving a bonus, that there was an awareness that these employees had not paid their taxes?

Mr. KOSKINEN. No, I do not——

Senator MORAN. They did not know that?

Mr. KOSKINEN. My understanding is that, historically, as in the rest of the Government, that performance issues are separate from any disciplinary issues, on the theory, I guess, that if you get disciplined you get disciplined, but in the meantime your performance is whatever it was. So in determining those performance awards, as a general matter, there was not a process that said, okay, what are the disciplinary issues.

Some managers may have been aware of whether the employees were tax compliant or not, although again, as a general matter, we protect taxpayer information very carefully. So if you are an IRS employee and you have a problem with your taxes, that information, as a general matter, will not be available to anybody else, even in the IRS.

Senator MORAN. I do not know that I will phrase this correctly, but the people involved in disciplinary actions at the IRS would have known this——

Mr. KOSKINEN. Yes.

Senator MORAN [continuing]. But not the management of these individuals—not the managers of these individual employees.

Mr. KOSKINEN. As I said, some of them, obviously, would be, depending on the nature of the disciplinary action. If you were a manager and your employee had been disciplined, you might have been the disciplining agent. You may have known about it otherwise as you went forward. But the process at the time did not require them, and, in fact, did not allow them to say, well, as a result I am changing my view of your performance because of this other issue.

Senator MORAN. Is this change in policy that you have determined as necessary, is it subject to negotiations with the union?

Mr. KOSKINEN. Yes, it is. The bargaining unit agreement has a provision right now that says the only time you can take any of these things into consideration is when it affects the integrity of the Agency. And historically that has not been interpreted to be a standard disagreement about taxes. So we are developing a proposal. We have told the union that we want to include that in the negotiations, and the union has said that they are prepared to consider it.

Senator MORAN. So when you indicated to the committee that you support a change in policy, that does not at this point nec-

essarily mean it will occur. Negotiations still have to occur between the bargaining units.

Mr. KOSKINEN. No. The policies apply to the executives and senior level employees already. We are developing them to make sure it goes down through managers. Bargaining unit employees are subject to the contract, and I think that, you know, our——

Senator MORAN. So that is to be determined.

Mr. KOSKINEN. That is to be determined. But you know, my view is employees understand they work for the IRS. They are held to a higher standard than if they worked anywhere else in the Government or in the private sector. And I think it is appropriate—I agree with the Senator and others—that people ought to be comfortable if I work for the IRS and I am chasing you for your taxes, I should have paid mine.

AFFORDABLE CARE ACT

Senator MORAN. Let me change topics. A letter was written to you, Commissioner, on February 10. I do not expect you to know this off the top of your head, but you have not responded, and I would encourage you to do that. It is a letter from six United States senators generally led by Senator Coburn of Oklahoma.

But we are in what I think is a very straightforward, pretty apolitical kind of way asking questions of you as to the enforcement of the individual mandate based upon the circumstances that you now find yourself in with the delays and extensions that have been announced and provided for the enforcement of the Affordable Care Act.

And there are seven specific questions that are outlined in this letter that I think would helpful for us as Members of Congress to know how you intend to enforce the individual mandate. And so, I wanted to use this opportunity to bring to your attention this letter.

Mr. KOSKINEN. I am sorry we have not responded. My view is that we ought to respond to every letter promptly. I know of that letter. There is a clearance process for complicated issues. Tax policy is an issue controlled by the Treasury Department, not by us.

I will make sure that we get you that answer promptly because I do believe, and my commitment in my confirmation hearing was, if you write me a letter, I am going to read it. I have looked at that letter. And secondly, if you write to me, not only will I read it, I will try to get back with you as quickly as we can, and this is too long in delay.

Senator MORAN. Commissioner, thank you very much. I appreciate that attitude and very much would like to see that policy implemented. I became a member of the Appropriations Committee when I became a United States Senator, shortly thereafter. And one of the reasons was that the committee that makes spending decisions, maybe we are spending too much money, we can spend less. We certainly have the opportunity to prioritize.

But also an important feature of the role that I think my colleagues and I have is the ability to question the agencies that we are responsible for funding. And it seems to me that, and I have not been an appropriator prior to this Administration. This is not—I do not have anything to compare it to. But it is troublesome to

me the number of instances in which agency heads and Department secretaries are asked for language—asked to respond in language to questions that we have asked that go unanswered. And I very much appreciate the suggestion that that is not your practice, and that you will respond to this letter. I would encourage your colleagues to do the same.

Mr. KOSKINEN. I cannot control anybody else, but I will tell you as well, if you get a letter from me and you do not think it is responsive, you should let me know. My goal is to not only respond promptly, but to be responsive.

Senator MORAN. Well, I am really interested in making certain that we do our jobs appropriately. Information is key to the ability to do that. And in my view, this is a letter that is not intended to create any political climate, score any political points. It is just how are you going to do this so that we know how to respond. And this committee has a responsibility to make certain we do it right. I thank you, Commissioner.

Mr. KOSKINEN. Thank you.

Senator UDALL. Thank you, Commissioner. Senator Moran, we are trying to get in one more panel before the 4:00 vote, so if you have any additional questions——

Senator MORAN. Mr. Chairman, I have questioned the Commissioner sufficiently.

Senator UDALL. Great. Thank you very much. Commissioner, thank you for your testimony.

Mr. KOSKINEN. You are welcome.

Senator UDALL. I understand that you are going to stay here during the testimony of the Inspector General. We very much appreciate that. And I would call forward Inspector General George, and as soon as you get up here and get situated, I would invite you to present your remarks. Please proceed.

TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

STATEMENT OF HON. J. RUSSELL GEORGE, INSPECTOR GENERAL

Mr. GEORGE. Thank you, Mr. Chairman. Chairman Udall, Ranking Member Johanns, and Senator Moran, thank you for the opportunity to appear today. During my testimony I will address three key issues: first, the Internal Revenue Service's fiscal year 2015 budget request; second, TIGTA's recent work related to the most significant challenges currently confronting the IRS; and third, the fiscal year 2015 budget request for TIGTA.

The proposed IRS budget requests approximately appropriated resources of $12.5 billion. This is an increase of over $1.2 billion from the fiscal year 2014 enacted level. The IRS is faced with several challenges as it administers our Nation's tax laws and a reduced budgetary environment.

Let me start with the topic of providing quality customer service, which is the first step to achieving taxpayer compliance. We have seen a decline in the IRS' ability to provide a sufficient level of customer service in each of the ways that taxpayers interact with the IRS, namely by telephone, walk in, and correspondence. Many taxpayers use the telephone to contact the IRS. Addressing their questions with reduced staffing continues to be a struggle, resulting in long wait times, abandoned calls, and taxpayers' redialing the IRS' toll free telephone lines multiple times.

At its walk-in offices, known as taxpayer assistance centers, the IRS has decided to eliminate certain services, such as tax return preparation, that can be obtained through other channels. The IRS assisted over six and a half million taxpayers at these centers in fiscal year 2013, but plans to assist 14 percent fewer—that is 840,000—taxpayers this year.

The IRS' ability to process taxpayer correspondence in a timely manner has also declined while the backlog of paper correspondence inventory has substantially increased. The over-age inventory rose from 181,000 at the end of 2010 to almost 1.2 million at the end of 2013.

Tax fraud related identity theft continues to be a growing problem that results in billions of dollars of improper payments. For tax year 2011, we identified 1.1 million undetected returns that have potentially refunds totaling $3.6 billion. Now, while this is a decrease of $1.6 billion from the prior year, indicating that the IRS is making some progress, significant improvements are still needed.

Implementation of tax law changes associated with the Affordable Care Act will also present many challenges to the IRS in the coming years. For example, the ACA provides for a refundable

credit, known as a premium tax credit, to offset an individual's health insurance expenses. In September 2013, we reported that a fraud mitigation strategy is not in place to guide Affordable Care Act's systems development.

The IRS informed us that two new systems are under development that will address fraud risk. However, until these new systems are successfully developed and tested, we remain concerned that the IRS' existing fraud detection system may not be capable of identifying and preventing refund fraud.

We are also concerned about the protection of confidential taxpayer data that will be provided to the exchanges. The IRS' role in providing customer service in this area will become more significant in 2015. We continue to monitor IRS implementation of the ACA and help identify and correct any problems early in the process.

The tax gap is also a continuing challenge. The most recent IRS assessment is that the gross tax gap is about $450 billion annually. Most of this amount—$376 billion—is attributable to taxpayers under reporting their tax liabilities.

Finally TIGTA's fiscal year 2015 proposed budget request requests approximately—resources in the amount of $157 million, an increase of less than 1 percent compared to the fiscal year 2014 enacted budget. TIGTA's budget priorities include mitigating risks associated with tax refund fraud and identity theft, monitoring the IRS' implementation of the ACA and other tax law changes, and assessing the IRS's ability to provide quality taxpayer service and address the tax gap.

PREPARED STATEMENT

In addition, we will continue to give priority to investigating allegations of serious misconduct and criminal activity by IRS employees, ensuring IRS employees are safe and IRS facilities, data, and infrastructure are secure and not impeded by threats of violence and protecting the IRS against attempts to interfere with tax administration.

Chairman Udall, Ranking Member Johanns, Senator Moran, thank you for the opportunity to share my views.

[The statement follows:]

PREPARED STATEMENT OF HON. J. RUSSELL GEORGE

REVIEW OF THE PRESIDENT'S FISCAL YEAR 2015 FUNDING REQUEST FOR THE DEPARTMENT OF THE TREASURY AND THE INTERNAL REVENUE SERVICE

Chairman Udall, Ranking Member Johanns, and members of the subcommittee, thank you for the opportunity to testify on the Internal Revenue Service's (IRS) fiscal year[1] 2015 budget request, our recent work related to the most significant challenges currently facing the IRS, and the Treasury Inspector General for Tax Administration's (TIGTA) fiscal year 2015 budget request.

The Treasury Inspector General for Tax Administration, also known as "TIGTA," is a nationwide organization. We are statutorily mandated to provide independent audit and investigative services necessary to improve the economy, efficiency, and effectiveness of IRS operations, including the oversight of the IRS Chief Counsel and the IRS Oversight Board. TIGTA's oversight activities are designed to identify high-risk systemic inefficiencies in IRS operations and to investigate exploited weaknesses in tax administration. TIGTA's role is critical in that we provide the Amer-

[1] The Federal Government's fiscal year begins on October 1 and ends on September 30.

ican taxpayer with assurance that the approximately 95,000[2] IRS employees who collected over $2.9 trillion in tax revenue, processed over 241 million tax returns, and issued $364 billion in tax refunds during fiscal year 2013,[3] do so in an effective and efficient manner while minimizing the risks of waste, fraud, or abuse.

TIGTA's Office of Audit (OA) reviews all aspects of the Federal tax administration system and provides recommendations to: improve IRS systems and operations; ensure the fair and equitable treatment of taxpayers; and prevent and detect waste, fraud, and abuse. The Office of Audit places emphasis on statutory coverage required by the IRS Restructuring and Reform Act of 1998 (RRA 98),[4] the American Recovery and Reinvestment Act of 2009,[5] and other laws, as well as areas of concern raised by Congress, the Secretary of the Treasury, the Commissioner of Internal Revenue, and other key stakeholders. The OA has examined specific high-risk issues such as identity theft, refund fraud, improper payments, information technology, security vulnerabilities, complex modernized computer systems, tax collections and revenue, and waste and abuse in IRS operations.

TIGTA's Office of Investigations (OI) protects the integrity of the IRS by investigating allegations of IRS employee misconduct, external threats to employees and facilities, and attempts to impede or otherwise interfere with the IRS's ability to collect taxes. Misconduct by IRS employees manifests itself in many ways, including extortion, theft, taxpayer abuses, false statements, financial fraud, and identity theft. The OI places a high priority on its statutory responsibility to protect all IRS employees located in over 670 facilities nationwide. In the last 4 years, threats directed at the IRS have become the second largest component of OI's work. Physical violence, harassment, and intimidation of IRS employees continue to pose significant challenges to the implementation of a fair and effective system of tax administration. The OI is committed to ensuring the safety of IRS employees and the security of IRS facilities.

TIGTA's Office of Inspections and Evaluations (I&E) provides responsive, timely, and cost-effective inspections and evaluations of challenging areas within the IRS, providing TIGTA with additional flexibility and capability to produce value-added products and services to improve tax administration. Inspections and Evaluations' work is not a substitute for audits and investigations. In fact, its findings may result in subsequent audits and/or investigations. Inspections are intended to monitor compliance, assess the effectiveness and efficiency of programs and operations, and inquire into allegations of waste, fraud, abuse, and mismanagement; evaluations are intended to provide in-depth reviews of specific management issues, policies, or programs. In the last year, I&E has reviewed the IRS's implementation of the Telework Enhancement Act of 2010, assessed the costs and frequency of IRS executives' temporary duty travel and the associated travel taxability, and determined that the IRS needs to improve the comprehensiveness, accuracy, reliability, and timeliness of the Tax Gap estimate.

OVERVIEW OF THE IRS'S FISCAL YEAR 2015 BUDGET REQUEST

The IRS is the largest component of the Department of the Treasury and has primary responsibility for administering the Federal tax system. The IRS's budget request supports the Department of the Treasury's Strategic Plan and agency priority goal of focusing on expanding the availability and improving the quality of customer service options. The IRS's Strategic Plan goals are to: (1) Deliver high quality and timely service to reduce taxpayer burden and encourage voluntary compliance and (2) Effectively enforce the law to ensure compliance with tax responsibilities and combat fraud. The IRS's role is unique within the Federal Government in that it collects the revenue that funds the Government and administers the Nation's tax laws. It also works to protect Federal revenue by detecting and preventing the growing risk of fraudulent tax refunds and other improper payments.

To achieve these goals, the proposed fiscal year 2015 IRS budget requests appropriated resources of approximately $12.5 billion.[6] The total appropriations amount

[2] Total IRS staffing as of April 5, 2014. Included in the total are approximately 19,000 seasonal employees.

[3] IRS, *Management's Discussion & Analysis, Fiscal Year 2013.*

[4] Public Law No. 105–206, 112 Stat. 685 (1998) (codified as amended in scattered sections of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).

[5] Public Law No. 111–5, 123 Stat. 115 (2009).

[6] The fiscal year 2015 budget request also includes approximately $101 million from reimbursable programs, $27 million from non-reimbursable programs, $396 million from user fees, $265

Continued

is an increase of $1.2 billion, or approximately 11 percent more than the fiscal year 2014 enacted level of approximately $11.3 billion. This increase is illustrated in Table 1. The budget request includes a net staffing increase of 6,998 full-time equivalents (FTE)[7] for a total of approximately 91,187 appropriated FTEs.

TABLE 1—IRS FISCAL YEAR 2015 BUDGET REQUEST INCREASE OVER FISCAL YEAR 2014 ENACTED BUDGET

[In thousands]

Appropriations account	Fiscal year 2014 enacted[8]	Fiscal year 2015 request	$ change	Percent change
Taxpayer Services	$2,156,554	$2,317,633	$161,079	7.5
Enforcement	5,022,178	5,371,826	349,648	7.0
Operations Support	3,798,942	4,456,858	657,916	17.3
Business Systems Modernization	312,938	330,210	17,272	5.5
Total Appropriated Resources	11,290,612	12,476,527	1,185,915	10.5

Source: TIGTA analysis of the IRS's fiscal year 2015 Budget Request, Operating Level Tables.

The three largest appropriation accounts are Taxpayer Services, Enforcement, and Operations Support. The Taxpayer Services account provides funding for programs that focus on helping taxpayers understand and meet their tax obligations, while the Enforcement account supports the IRS's examination and collection efforts. The Operations Support account provides funding for functions that are essential to the overall operation of the IRS, such as infrastructure and information services. Finally, the Business Systems Modernization account provides funding for the development of new tax administration systems and investments in electronic filing.

As a result of the Balanced Budget and Emergency Deficit Control Act, as amended,[9] the IRS was required to reduce planned spending from its appropriations by $594 million for fiscal year 2013 as a result of sequestration.[10] The IRS was also required in fiscal year 2013 to reduce planned spending from its appropriations by $24 million as the result of an across-the-board rescission.[11] These funding reductions represented a total decrease of $618 million to the IRS's budget of $11.8 billion, resulting in a revised annual budget for fiscal year 2013 of $11.2 billion.

The IRS achieved these budgetary savings by cuts in key spending areas such as personnel compensation ($276 million), including not issuing bargaining unit employee awards during fiscal year 2013 and furloughing employees for three days, travel ($92 million), and equipment ($50 million). We are currently assessing the IRS's steps to plan for and implement the reductions in its fiscal year 2013 budget due to sequestration.[12]

Implementation of the sequestration mandated cuts, coupled with a trend of lower budgets, reduced staffing, and the loss of supplementary funding for the implementation of the Patient Protection and Affordable Care Act of 2010 (hereinafter referred to as the ACA or Affordable Care Act),[13] impacted the IRS's ability to effectively deliver its priority program areas, including enforcement activities. For example, examinations of individual tax returns declined from 1,481,966 in fiscal year 2012 to 1,404,931 in fiscal year 2013, an approximate 5 percent decrease. Further, collection activities initiated by the IRS, such as taxpayer liens, levies, and property

million in available unobligated funds from prior years, and a transfer of $5 million to the Alcohol and Tobacco Tax and Trade Bureau for a total amount of $13.3 billion in available resources.

[7] A measure of labor hours in which one FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year.

[8] Fiscal Year 2014 enacted includes $92 million in funding ($34 million in Taxpayer Services and $58 million in Operations Support). The $92 million was a nonrecurring appropriation increase in the Consolidated Appropriations Act 2014. The additional funds were granted to improve the delivery of services to taxpayers, improve the identification and prevention of refund fraud and identity theft, and address international and offshore compliance issues.

[9] Public Law No. 112–25, 125 Stat. 240 (2011).

[10] Sequestration involves automatic spending cuts of approximately $1 trillion across the Federal Government that took effect on March 1, 2013.

[11] A rescission cancels part of an agency's discretionary budget authority and is usually established as a percentage reduction to the budget authority.

[12] TIGTA, Audit No. 201310030, *Implementation of fiscal year 2013 Sequestration Budget Reductions,* report planned for May 2014.

[13] Public Law No. 111–148, 124 Stat. 119 (2010) (codified as amended in scattered titles of the U.S.C.).

seizures declined from 3,669,663 in fiscal year 2012 to 2,457,647 in fiscal year 2013, an approximately 33 percent decrease.

KEY CHALLENGES FACING THE IRS

In this section of my testimony, I will discuss several of the most significant challenges now facing the IRS as it administers our Nation's tax laws.

TAXPAYER SERVICE

Providing quality customer service is the IRS's first step to achieving taxpayer compliance. One of Congress' principal objectives in enacting RRA 98 was to mandate that the IRS do a better job of meeting the needs of the taxpayers. In the past, TIGTA has evaluated the IRS's efforts in providing quality customer service and made recommendations for areas of improvement. Although the IRS has implemented certain procedures to better assist the American taxpayer, funding reductions pose a significant challenge.

Overall, the IRS's fiscal year 2013 enacted budget was over $1 billion less than its fiscal year 2010 enacted budget as a result of the fiscal year 2013 sequestration and rescission and declines in its fiscal year 2011 and fiscal year 2012 budgets. These budget constraints continue to result in the IRS cutting service to taxpayers which make it difficult for the IRS to effectively assist taxpayers. As demand for taxpayer services continues to increase, resources devoted to customer service have decreased, thereby affecting the quality of customer service that the IRS is able to provide. I would like to provide you with some specific examples.

First, the IRS continues to struggle in providing high-quality customer service over the phone. These struggles result in long customer wait times, customers abandoning calls, and customers redialing the IRS toll-free telephone lines[14] for service. Despite other available options, most taxpayers continue to use the telephone as the primary method to make contact with the IRS. For the 2014 Filing Season as of March 8, 2014, approximately 46.3 million taxpayers contacted the IRS by calling the various customer service toll-free telephone assistance lines seeking help to understand the tax laws and meet their tax obligations. IRS assistors have answered 6 million calls and have achieved a 74.7 percent Level of Service[15] with an 11.7 minute Average Speed of Answer.[16] The Level of Service for the 2013 Filing Season was 67.9 percent. The IRS forecasted a 70.2 percent Level of Service for the 2014 Filing Season.

Although the IRS is reporting an increase in the Level of Service, IRS numbers continue to show a decline in the total number of taxpayers who contact the IRS who are actually assisted. As of March 8, 2014, the number of taxpayers actually assisted has dropped from 56.1 percent to 51.6 percent as of the same time last year.[17] We previously reported that the Level of Service measure does not accurately reflect total call demand (i.e., total number of taxpayers attempting to call the IRS).[18] The Level of Service only measures the percentage of calls in the queue waiting to be answered by an assistor that are actually answered. The Level of Service does not measure the success of taxpayers attempting to call the IRS to use the IRS's automated services. The IRS can manage the Level of Service by increasing or decreasing the number of calls it allows into the assistor queue.[19]

Second, the IRS's ability to process taxpayer correspondence in a timely manner has also declined. The over-age correspondence inventory rose from approximately 181,000 at the end of Processing Year 2010 to almost 1.2 million at the end of Processing Year 2013, representing an increase of 556 percent.[20] IRS management indicated that the continued increase in the over-age correspondence inventory is the result of reduced resources. The allocation of limited resources requires difficult decisions with the focus on maximizing taxpayer assistance on the toll-free telephone

[14] The IRS refers to the suite of 29 telephone lines to which taxpayers can make calls as "Customer Account Services Toll-Free."

[15] The primary measure of service to taxpayers. It is the relative success rate of taxpayers who call for live assistance on the IRS's toll-free telephone lines.

[16] The average amount of time for an assistor to answer the call after the call is routed to a call center staff.

[17] Using automation or live assistance, the IRS answered 31.6 million of the 56.3 million calls received as of March 8, 2013 (56.1 percent) and 23.9 million of the 46.3 million calls received as of March 8, 2014 (51.6 percent).

[18] TIGTA, Ref. No. 2009–40–127, *Higher Than Planned Call Demand Reduced Toll-Free Telephone Access for the 2009 Filing Season* (Sept. 2009).

[19] TIGTA, Ref. No. 2014–40–029, *Interim Results of the 2014 Filing Season* (Mar. 2014).

[20] Numbers have been rounded. The percentage of change is based on the actual inventory volumes as of the end of Processing Years 2010 and 2013.

lines during filing season while concentrating any remaining resources toward various priority programs such as identity theft and aged work.[21]

Third, the number of taxpayers assisted by Taxpayer Assistance Centers (TACs) will decrease this fiscal year. The IRS assisted more than 6.5 million taxpayers in fiscal year 2013 and plans to assist 5.6 million taxpayers in fiscal year 2014, which is 14 percent fewer than in fiscal year 2013. The IRS indicated that budget cuts and its strategy of not offering services at TACs that can be obtained through other service channels, such as the IRS's Web site, result in the reduction of the number of taxpayers the IRS plans to assist at the TACs.

In fiscal year 2014, the IRS eliminated or reduced services at TACs. Currently, TACs are not preparing tax returns. Instead, taxpayers seeking this assistance will be referred to Volunteer Income Tax Assistance sites or other free preparation options. TAC assistors will only answer basic tax law questions during the filing season and will not answer any tax law questions after April 15, 2014. After April 15, 2014, the IRS will direct all tax law inquiries to alternative services such as IRS.gov, TeleTax, commercial software packages, or a tax professional. In addition, TACs will no longer answer taxpayers' tax refund inquiries unless the taxpayer has waited more than 21 days for the refund. Taxpayers with refund inquiries will be referred to the "Where's My Refund?" application on IRS.gov. Finally, the TACs are transitioning to no longer provide transcripts upon request without extenuating circumstances. For the 2014 Filing Season, TACs will still provide transcripts but are encouraging taxpayers to obtain them through other sources.[22]

The reduction in services was implemented without completing the required taxpayer burden risk evaluation for the taxpayers most likely to visit a Taxpayer Assistance Center, such as low-income, elderly, and limited-English-proficient taxpayers. The purpose of such an evaluation is to assess the burden that service changes can have on taxpayers.

IMPROPER PAYMENTS

The Improper Payments Information Act of 2002[23] requires Federal agencies, including the IRS, to estimate the amount of improper payments made each year and to describe the steps taken to ensure that managers are held accountable for reducing these payments. Agencies must also report to Congress on the causes of and the steps taken to reduce improper payments and address whether they have the information systems and other infrastructure needed to reduce improper payments. The Improper Payments Elimination and Recovery Act of 2010[24] (IPERA) amended the Improper Payments Information Act of 2002 by redefining the definition of improper payments and strengthening agency reporting requirements. TIGTA is required to review annually the IRS's compliance with the Act's reporting requirements.

The Office of Management and Budget has declared the Earned Income Tax Credit (EITC) Program a high-risk program that is subject to reporting in the Department of the Treasury's Agency Financial Report. The IRS estimates that 22 to 26 percent of EITC payments were issued improperly in fiscal year 2013. The dollar value of these improper payments was estimated to be between $13.3 billion and $15.6 billion.

In March 2014,[25] we reported that the IRS continued to not provide all required IPERA information to the Department of the Treasury for inclusion in the Department of the Treasury's Agency Financial Report for fiscal year 2013. For the third consecutive year, the IRS did not publish annual reduction targets or report an improper payment rate of less than 10 percent for the EITC. IRS management indicated that on March 20, 2014, the Office of Management and Budget approved the establishment of supplemental measures for use in evaluating the incremental reduction in EITC improper payments. The IRS is in the process of developing these supplemental measures.

Finally, although risk assessments were performed for each of the programs that the Department of the Treasury required the IRS to assess, the risk assessment process still may not provide a valid assessment of improper payments in tax administration. As such, the EITC remains the only area considered at high risk for improper payments. There continues to be no effective process to address the continued risks associated with improper tax refund payments resulting from other re-

[21] TIGTA, Ref. No. 2014–40–029, *Interim Results of the 2014 Filing Season* (Mar. 2014).
[22] TIGTA, Ref. No. 2014–40–029, *Interim Results of the 2014 Filing Season* (Mar. 2014).
[23] Public Law No. 107–300, 116 Stat. 2350.
[24] Public Law No. 111–204, 124 Stat. 2224.
[25] TIGTA, Ref, No. 2014–40–027, *The Internal Revenue Service fiscal year 2013 Improper Payment Reporting Continues to Not Comply With the Improper Payments Elimination and Recovery Act* (Mar. 2014).

fundable tax credits[26] and tax refund fraud. Improper payments due to identity theft are the most significant example of a category that is not estimated by the IRS. As such, we believe the IRS's identification of EITC as the only program of high risk of improper payments may significantly underestimate the risk of improper payments to tax administration. IRS management indicated that on March 20, 2014, the Office of Management and Budget provided guidance exempting improper refunds made without relation to any refundable tax credit program from improper payment requirements. We plan to evaluate the impact of the Office of Management and Budget guidance in an upcoming review.

IDENTITY THEFT AND TAX REFUND FRAUD

While refundable tax credits increase the risk of potentially fraudulent tax refunds, other issues concerning tax administration can also pose a significant risk for improper payments. The IRS continues to be challenged with the rapidly growing problem of identity-theft tax refund fraud, including tax fraud related to the use of stolen Employer Identification Numbers (EIN).[27] Efforts to identify and detect tax returns with these characteristics are hampered by the IRS's lack of third-party information to effectively verify income and withholding when tax returns are processed.

Identity Theft

The IRS has described identity theft as the number one tax scam for 2014.[28] The IRS has made this issue one of its top priorities and has made some progress; however, significant improvements are still needed.

As of December 28, 2013, the IRS had identified more than 2.9 million incidents of identity theft in calendar year 2013. As of December 31, 2013, the IRS reported that during the 2013 Filing Season it stopped the issuance of more than $10.7 billion in potentially fraudulent tax refunds associated with over 1.8 million tax returns classified as involving identity theft.

In September 2013, TIGTA reported that the impact of identity theft on tax administration continues to be significantly greater than the amount the IRS detects and prevents.[29] Using the characteristics of tax returns that the IRS has confirmed as involving identity theft and income and withholding information the IRS received in 2012 late in the filing season and in early 2013, we analyzed tax year 2011 tax returns processed during the 2012 Filing Season and identified approximately 1.1 million undetected tax returns where the primary Taxpayer Identification Number on the tax return was a Social Security Number. The undetected tax returns have potentially fraudulent tax refunds totaling approximately $3.6 billion, which is a decrease of $1.6 billion compared to the $5.2 billion we reported for tax year 2010.[30]

In addition, we expanded our tax year 2011 analysis to include tax returns where the primary Taxpayer Identification Number on the tax return is an Individual Taxpayer Identification Number (ITIN).[31] We identified more than 141,000 tax year 2011 tax returns filed with an ITIN that have the same characteristics as IRS-confirmed identity-theft tax returns. Potentially fraudulent tax refunds issued for these undetected tax returns totaled approximately $385 million, which is in addition to the approximately $3.6 billion referred to earlier. In total, the IRS could issue potentially fraudulent refunds of approximately $4 billion annually as a result of identity-theft tax refund fraud.

A common characteristic of tax returns filed by identity thieves is the reporting of false income and withholding to generate a fraudulent tax refund. Another aspect to this problem is that many individuals who are victims of identity theft may be

[26] A refundable credit is not limited to the amount of an individual's tax liability and can result in a Federal tax refund that is larger than the amount of a person's Federal income tax withholding for that year.

[27] An EIN is a Federal Tax Identification Number used to identify a taxpayer's business account. The EIN is used by employers, sole proprietors, corporations, partnerships, nonprofit associations, trusts and estates, government agencies, certain individuals, and other types of businesses.

[28] IRS Press Release, IR–2014–16 (Feb, 19, 2014), *available at* http://www.irs.gov/uac/Newsroom/IRS-Releases-the-"Dirty-Dozen"-Tax-Scams-for-2014;-Identity-Theft,-Phone-Scams-Lead-List.

[29] TIGTA, Ref. No. 2013–40–122, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Sept. 2013).

[30] TIGTA, Ref. No. 2012–42–080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

[31] An ITIN is available to individuals who are required to have a taxpayer identification number for tax purposes, but do not have and are not eligible to obtain a Social Security Number because they are not authorized to work in the United States.

unaware that their identity has been stolen and used to file fraudulent tax returns. These individuals are typically those who are not required to file a tax return.[32]

The IRS continues to expand the number of identity-theft filters it uses to identify potentially fraudulent tax returns and prevent the issuance of fraudulent tax refunds from 80 filters during Processing Year 2013 to 114 filters during Processing Year 2014. The identity-theft filters incorporate criteria based on characteristics of confirmed identity-theft tax returns. These characteristics include amounts claimed for income and withholding, filing requirements, prisoner status, taxpayer age, and filing history.

Tax returns identified by these filters are held during processing until the IRS can verify the taxpayer's identity. The IRS attempts to contact the individual who filed the tax return and, if this individual's identity cannot be confirmed, the IRS removes the tax return from processing. This prevents the issuance of many fraudulent tax refunds. For Processing Year 2014 as of February 28, 2014, the IRS reported that it identified and confirmed 28,076 fraudulent tax returns and prevented the issuance of nearly $143 million in fraudulent tax refunds as a result of the identity-theft filters.[33]

In January 2012, IRS Criminal Investigation created the Identity Theft Clearinghouse (the Clearinghouse). The Clearinghouse was created to accept tax fraud-related identity-theft leads from the IRS's Criminal Investigation field offices. The Clearinghouse performs research, develops each lead for the field offices, and provides support for ongoing criminal investigations involving identity theft. Since its inception, the Clearinghouse has received 5,287 identity-theft leads that have resulted in the development of 568 investigations.

Finally, the IRS has significantly expanded the number of tax accounts that it locks by placing an indicator on the individual's tax account.[34] In Processing Year 2011, the IRS began locking taxpayers' accounts where the IRS Master File[35] and Social Security Administration data showed a date of death. The IRS places a unique identity-theft indicator to lock the individual's tax account if he or she is deceased. Electronically filed tax returns using the Social Security Number of a locked account will be rejected (the IRS will not accept the tax return for processing). Paper tax returns will be processed; however, the tax returns will not post to the taxpayer's account due to the account lock, and a refund will not be issued.

Between January 2011 and September 2013, the IRS had locked approximately 11 million deceased taxpayer accounts, which will assist the IRS in preventing future identity-theft fraudulent tax refunds from being issued. For Processing Year 2014 as of February 28, 2014, the IRS had rejected 67,079 e-filed tax returns. As of September 30, 2013, the IRS had prevented the issuance of approximately $10 million in fraudulent tax refunds since the inception of the lock on paper tax returns. In November 2013, the Chairman of the Senate Finance Committee proposed restricting access to the Social Security Administration's public death data—the Death Master File, which would help the IRS's efforts to reduce tax fraud via the use of a deceased individual's Social Security Number.

Despite these improvements, the IRS could continue to expand the use of characteristics of confirmed identity-theft cases to improve its ability to detect and prevent the issuance of fraudulent tax refunds. As we reported in July 2008,[36] July 2012, and again in September 2013, the IRS is not in compliance with direct-deposit regulations that require tax refunds to be deposited into an account only in the name of the individual listed on the tax return. Direct deposit, which now includes debit cards, provides the ability to receive fraudulent tax refunds quickly, without the difficulty of having to negotiate a tax refund paper check. The majority of the tax year 2011 tax returns we identified with indicators of identity theft (84 percent) involved the use of direct deposit to obtain tax refunds totaling approximately $3.5 billion. There are indications that abusive practices are ongoing. For example, one bank account received 446 direct deposits totaling over $591,000.[37]

To improve the IRS's conformance with direct-deposit regulations and to help minimize fraud, TIGTA recommended that the IRS limit the number of tax refunds

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[32] Individuals who generally are not required to file a tax return include children, deceased individuals, the elderly, and individuals who earn less than their standard deduction or earn non-taxable income such as some Social Security benefits.

[33] TIGTA, Ref. No. 2014–40–029, *Interim Results of the 2014 Filing Season* (Mar. 2014).

[34] When an account is locked, tax refunds are not processed.

[35] The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

[36] TIGTA, Ref. No. 2008–40–182, *Processes Are Not Sufficient to Minimize Fraud and Ensure the Accuracy of Tax Refund Direct Deposits* (Sep. 2008).

[37] TIGTA, Ref. No. 2013–40–122, *Detection Has Improved; However, Identity Theft Continues to Result in Billions of Dollars in Potentially Fraudulent Tax Refunds* (Sep. 2013).

being sent to the same direct-deposit account. As of December 2013, the IRS is still considering this recommendation, but the IRS did develop new filters for the 2013 Filing Season to identify and stop tax returns with similar direct-deposit and address characteristics. As of March 3, 2014, the IRS indicated that it had identified 395,468 tax returns using these filters and prevented approximately $1.3 billion in tax refunds from being issued.[38] Recently, the IRS indicated it is developing a systemic restriction to limit to three the number of deposits to a single bank account. After three deposits to a single account, including situations where refunds are split, the entire refund amount will be sent by paper check to the taxpayer at the address of record.

In addition, the IRS implemented a pilot program in January 2013 with the Department of the Treasury's Bureau of Fiscal Service[39] designed to allow financial institutions to reject direct-deposit tax refunds based on mismatches between the account name and the name on the tax return. Once the refund is identified by the institution, it is sent back to the Bureau of Fiscal Service to be routed back to the IRS. As of the end of calendar year 2013, there have been 20,898 refunds returned from financial institutions totaling more than $67 million. This is a promising first step in recovering fraudulent tax refunds issued via direct deposit.

Identifying potential identity-theft tax fraud is the first step. Once the IRS identifies a potential identity-theft tax return, it must verify the identity of the individual filing the return. However, verifying whether the returns are fraudulent will require additional resources. Using IRS estimates, it would cost approximately $22 million to screen and verify the more than 1.2 million tax returns that we identified as not having third-party information on income and withholding. Without the necessary resources, it is unlikely that the IRS will be able to work the entire inventory of potentially fraudulent tax returns it identifies. The net cost of failing to provide the necessary resources is substantial, given that the potential revenue loss to the Federal Government of these tax fraud-related identity theft cases is in the billions of dollars annually.

TIGTA Criminal Investigations of Identity Theft and Impersonation Scams

Identity theft has a negative impact on the economy, and the damage it causes to its victims can be personally, professionally, and financially devastating. When individuals steal identities and file fraudulent tax returns to obtain fraudulent refunds before the legitimate taxpayers file, the crime is tax fraud, which falls within the programmatic responsibility of IRS Criminal Investigation. TIGTA's Office of Investigations focuses its limited resources on investigating identity theft characterized by any type of IRS employee involvement, the misuse of client information by tax preparers, or the impersonation of the IRS through phishing[40] schemes and other means. Where there is overlapping jurisdiction, TIGTA OI and IRS Criminal Investigation will work together to bring identity thieves to justice.

Currently, TIGTA is investigating several cases that involve identity theft. A recent example of this activity involved two hospital employees who conspired with each other to defraud the United States by filing false Federal income tax returns using the personal identifiers of patients at the hospital where they were employed and directing more than $400,000 in tax refunds to be deposited into bank accounts they controlled, or accounts linked to prepaid debit or gift cards.[41] One individual was sentenced to a total of 81 months of imprisonment for his role in the conspiracy and aggravated identity theft.[42] The other individual was sentenced to 57 months of imprisonment for his role in the conspiracy.[43] Both were ordered to pay restitution to the IRS in the amount of $116,404.[44]

IRS employees are entrusted with the sensitive personal and financial information of taxpayers. Using this information to perpetrate a criminal scheme for personal gain negatively impacts our Nation's voluntary tax system and it can generate widespread distrust of the IRS. TIGTA aggressively investigates IRS employees involved in identity-theft-related tax refund fraud and refers these investigations to the De-

[38] Statistical information provided by the IRS Wage and Investment Division Return Integrity and Correspondence Services.

[39] Formerly the Department of the Treasury Financial Management Service.

[40] Phishing is an attempt by an individual or group to solicit personal and financial information from unsuspecting users in an electronic communication by masquerading as trustworthy entities such as government agencies, popular social Web sites, auction sites, online payment processors, or information technology administrators.

[41] E.D. Va. Indictment dated Aug. 7, 2013.

[42] E.D. Va. Judgment dated Jan. 13, 2014.

[43] E.D. Va. Judgment dated Jan. 24, 2014.

[44] E.D. Va. Restitution Orders dated Jan. 10, 2014, and Jan.24, 2014.

partment of Justice for prosecution. Many of these employees face significant prison sentences as well as the loss of their jobs if convicted.

For example, in November 2013, TIGTA special agents arrested an IRS Tax Examining Technician for aggravated identity theft and conspiracy.[45] The IRS employee conspired with another individual to divert a tax refund belonging to another taxpayer by changing the taxpayer's mailing address without the taxpayer's permission, causing a refund of $595,901 to be mailed to her co-conspirator.[46] Further criminal action is pending.

TIGTA also investigates tax preparers who misuse their clients' information to commit identity theft-related refund fraud. For example, TIGTA investigated a tax preparer who stole the personal identifiers of her clients and filed numerous fraudulent tax returns without their permission or knowledge. The tax preparer, who was indicted in April 2013 on charges of aggravated identity theft, wire fraud, mail fraud and false claims, prepared and filed more than 200 fraudulent tax returns and defrauded the U.S. Government of more than $1 million in tax refunds. She used the proceeds from the fraudulently obtained tax returns to purchase 20 real properties in Arizona.[47]

In addition to these TIGTA investigations, the IRS announced in February 2013 the results of a nationwide effort with the Department of Justice and local U.S. Attorneys' offices focusing on identity theft suspects in 32 States and Puerto Rico, which involved 215 cities and surrounding areas. This joint effort involved 734 enforcement actions related to identity theft and refund fraud, including indictments, informations, complaints, and arrests.

Criminals have been impersonating the IRS for years. While the fraud schemes may change, the motive remains the same: to bilk honest taxpayers out of their hard-earned money. Scammers and thieves often prey on immigrants and the elderly and sometimes even resort to threats. For example, in the late summer of 2013, TIGTA began noticing numerous complaints from around the country about suspicious callers claiming to be IRS employees collecting taxes from recent IRS audits. The callers demanded that the tax payments be made to pre-paid debit cards and threatened arrest, suspension of business or driver's licenses, and even deportation if the callers' demands were not met. In many cases, the callers became hostile and insulting. As of April 2014, the TIGTA Hotline has received tens of thousands of reports related to this scam, and it is estimated that the scheme has resulted in over $2 million in payments made by the victims. TIGTA special agents are actively reviewing these complaints.

Tax Refund Fraud

Verification of Income and Withholding

Access to third-party income and withholding information at the time tax returns are processed is the most important tool the IRS could use to detect and prevent tax fraud resulting from the reporting of false income and withholding. While the IRS has increased its detection of fraudulent tax returns at the time tax returns are processed and has prevented the issuance of billions of dollars in fraudulent tax refunds, it still does not have timely access to third-party income and withholding information needed to make any substantial improvements in its detection efforts.

Expanded access to the National Directory of New Hires could immediately provide the IRS with this type of information that could help prevent tax fraud. Currently, the IRS's use of this information is limited by law to just those tax returns that include a claim for the EITC. The IRS has included a legislative proposal for expanded access to this information in its annual budget submissions for fiscal years 2010 through 2014 and has once again included this proposal in its fiscal year 2015 budget submission. In an effort to combat identity theft, the Chairman of the Senate Finance Committee proposed in November 2013 granting the IRS authority to use the Department of Health and Human Services (HHS) National Directory of New Hires to verify employment data.

Improvements can also be made to the income and verification processes when tax returns are identified by the IRS as potentially fraudulent. In August 2013, we reported[48] that ineffective income and withholding verification processes are resulting in the issuance of potentially fraudulent tax refunds. Our review of a random sample of 272 tax returns sent for verification found that ineffective verification proc-

[45] N.D. Ga. Executed Arrest Warrant dated Nov. 26, 2013.
[46] N.D. Ga. Crim. Compl. dated Nov. 25, 2013.
[47] S.D. Cal. Indict. filed Apr. 13, 2013.
[48] TIGTA, Ref. No. 2013–40–083, *Income and Withholding Verification Processes are Resulting in the Issuance of Potentially Fraudulent Tax Refunds* (Aug. 2013).

esses resulted in the issuance of the potentially fraudulent tax refunds associated with these tax returns.

Stolen or Falsely Obtained Employer Identification Numbers

Individuals attempting to commit tax refund fraud commonly steal or falsely obtain an EIN to file tax returns reporting false income and withholding. A valid EIN for the employer must be provided in support of wages and withholding reported on individual tax returns. Individuals who report wages and withholding on a tax return must attach a Form W–2, Wage and Tax Statement,[49] to a paper-filed tax return to support the income and withholding reported. For an e-filed tax return, the filer must input the information from the Form W–2 into the e-filed tax return.

TIGTA identified 767,071 tax year 2011 e-filed individual tax returns with refunds based on falsely reported income and withholding using a stolen or falsely obtained EIN.[50] TIGTA estimates that the IRS could issue almost $2.3 billion annually in potentially fraudulent tax refunds based on these EINs. There were 285,670 EINs used on these tax returns. Of these:

—277,624 were stolen EINs used to report false income and withholding on 752,656 tax returns with potentially fraudulent refunds issued totaling more than $2.2 billion.

—8,046 were falsely obtained EINs used to report false income and withholding on 14,415 tax returns with potentially fraudulent refunds issued totaling more than $50 million.

These 767,071 returns with potentially fraudulent refunds issued are in addition to the approximately 1.2 million undetected tax year 2011 tax returns we identified as having characteristics of an identity-theft tax return discussed earlier in our testimony.

The IRS has developed a number of processes to prevent fraudulent refunds claimed using stolen and falsely obtained EINs. As previously noted, third-party information is not available to effectively detect the reporting of false income and withholding at the time tax returns are processed. Nonetheless, the IRS has both tax information and other data that can be used to proactively identify tax returns with income reported using a stolen or falsely obtained EIN. Using these data, the IRS could have identified 53,169 tax returns with refunds issued totaling almost $154 million that had income reported with a stolen or falsely obtained EIN. IRS management agreed with our recommendation to update fraud filters using the tax information and other data we identified such as the Suspicious EIN Listing.[51]

IMPLEMENTATION OF THE AFFORDABLE CARE ACT

The Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010[52] contain an extensive array of tax law changes that will present many challenges for the IRS in the coming years. The ACA provisions provide incentives and tax breaks to individuals and small businesses to offset healthcare expenses. They also impose penalties, administered through the tax code, for individuals and businesses that do not obtain healthcare coverage for themselves or their employees. The ACA represents the largest set of tax law changes in more than 20 years and represents a significant challenge to the IRS.

ACA-related Customer Service

In December 2013, we issued a report on the IRS's ACA customer service strategy,[53] which is a collaborative and coordinated effort between the IRS and multiple Federal and State agencies. The Department of Health and Human Services (HHS) will serve as the "public face" for customer service at the Exchanges[54] until calendar year 2015. Individuals who contact the IRS for ACA assistance will be referred to the HHS's public website (Healthcare.gov) and toll-free telephone assist-

[49] The IRS requires employers to report wage and salary information for employees on a Form W–2. The Form W–2 also reports the amount of Federal, State, and other taxes withheld from an employee's paycheck.

[50] TIGTA, Ref. No. 2013–40–120, *Stolen and Falsely Obtained Employer Identification Numbers Are Used to Report False Income and Withholding* (Sep. 2013).

[51] The Suspicious EIN Listing is a cumulative listing of EINs that the IRS has confirmed as suspicious. The IRS has confirmed 6,333 EINs as suspicious since January 2003.

[52] Public Law No. 111–152, 124 Stat. 1029 (codified in scattered titles of the U.S.C.).

[53] TIGTA, Ref. No. 2014–43–006, *Affordable Care Act: The Customer Service Strategy Sufficiently Addresses Tax Provisions; However, Changes in Implementation Will Create Challenges* (Dec. 2013).

[54] Exchanges are intended to allow eligible individuals to obtain health insurance, and all Exchanges, whether State-based or established and operated by the Federal Government, will be required to perform certain functions.

ance lines. The IRS will also refer individuals to its own recorded telephone messages and self-assistance tools. In calendar year 2015, the IRS will take the lead in providing customer service when individuals begin filing their tax year 2014 tax returns. The IRS's customer service strategy includes sufficient plans to: (1) perform outreach and education; (2) update or develop tax forms, instructions, and publications; and (3) provide employee training to assist individuals in understanding the requirement to maintain minimum essential coverage and the tax implications of obtaining the Premium Tax Credit.

However, changes in the implementation of ACA tax provisions may result in increased demand for customer service assistance resulting in more contacts with the IRS. Depending on the nature of any changes made to ACA tax provisions, the IRS's strategy and plans to provide adequate customer service could be affected. Attempting to mitigate the effect that implementation changes may have on its ability to provide adequate customer service, the IRS has developed oversight and monitoring processes and procedures to alert management at the earliest possible time of actions that may affect its operations.

Security of Federal Tax Data

The information technology and security challenges for the ACA are considerable and include implementation of interdependent projects in a short span of time, evolving requirements, coordination with internal and external stakeholders, cross-agency system integration, and testing. ACA implementation will have a significant impact on existing systems, so there must be bandwidth to support all provisions. Finally, projects must be staffed with personnel who have the required knowledge and skills to efficiently deploy new technologies. To manage these challenges, the IRS created a Project Management Office for the ACA within the Information Technology program area.

The Exchanges are forwarding requests for income and family size information for each applicant and their family members who are qualified to apply for health insurance to the IRS. The Department of Health and Human Services' Data Services Hub provides the connections for the Exchanges and all other Federal agencies, including the IRS.

The IRS, using Federal tax data, will determine the applicant's historical household income, family size, filing status, adjusted gross income, taxable Social Security benefits, and other requested information. The IRS will then transmit the Federal tax data to the HHS Data Services Hub for delivery to the appropriate Exchange. The Exchanges use the IRS information along with other available data to verify the information provided by the applicant.

TIGTA issued a report on the IRS Income and Family Size Verification Project and found that the project was on schedule and the IRS was managing known information technology risks at the time the audit was conducted.[55] TIGTA recommended that the IRS: (1) improve the management of ACA changes to requirements; and (2) use an integrated suite of automated tools to manage ACA requirements and application test cases.

TIGTA remains concerned about the protection of confidential taxpayer data that will be provided to the Exchanges. The Federal tax data provided to HHS and the Exchanges will be protected through the IRS's Safeguard Review Program. TIGTA is currently conducting an audit of the IRS's Safeguard Review Program and will issue a report on its operations in fiscal year 2014.[56] TIGTA has concerns that the Safeguard Review Program may lack sufficient staffing or funding to adequately expand its operations to include the addition of the Federal and State Exchanges.

Protection Against Fraudulent ACA Claims on Tax Returns

The Affordable Care Act provides for a refundable tax credit to offset an individual's health insurance expenses. Beginning in tax year 2014, some low to moderate income individuals eligible to obtain health insurance through one of the State Exchanges or the Federal Exchange may be eligible for a refundable credit to assist them in paying monthly insurance premiums. The amount of the credit is determined by an individual's income in relation to the Federal poverty level, among other factors. In October 2013, the IRS began working with the Exchanges to provide a computation of individuals' estimated maximum monthly Premium Tax Cred-

[55] TIGTA, Ref. No. 2013–23–034, *Affordable Care Act: The Income and Family Size Verification Project: Improvements Could Strengthen the Internal Revenue Service's New Systems Development Process* (Mar. 2013).

[56] TIGTA, Audit No. 201320029, *Review of the Internal Revenue Service's Office of Safeguards,* report planned for July 2014.

it.[57] Individuals can elect the amount of credit they want advanced up to the maximum credit for which the Exchange has approved them to receive. Qualified individuals can elect to either: (1) have the monthly credit sent directly to their insurance provider as an advance payment (Advance Premium Tax Credit)[58] to lower the amount of monthly premiums they would pay out-of-pocket; or (2) wait to receive the credit when they file their tax year 2014 tax return. As of March 31, 2014, the Department of Health and Human Services reported that more than $1.4 billion in Advance Premium Tax Credits have been paid to insurers.

Like other refundable credits, there is a risk for improper payments with the Premium Tax Credit. For example, Advance Premium Tax Credits are computed using a number of factors, including an individual's projected 2014 income, family size, etc. The Exchanges will use income and family size information received from the IRS, as well as information provided by the applicant and other data sources, to project the income and family size amounts used to determine eligibility for the credit. The Exchanges also rely on the IRS's computation of the maximum available credit based on the projected income and family size when assisting applicants in choosing a health insurance plan. TIGTA is currently evaluating the accuracy of the data that the IRS provides to the HHS for use in enrolling individuals and calculating the Advance Premium Tax Credit, and plans to issue a report this year.[59] We plan to assess the protection of Federal tax data provided by the IRS in the future.[60]

It is not until the individual files his or her tax year 2014 tax return during calendar year 2015 that the IRS will know the individual's actual income for 2014 and the amount of the tax credit the individual is entitled to receive. Individuals who receive an Advance Premium Tax Credit will reconcile the amount received to the amount of Premium Tax Credit they are eligible to receive based on their actual 2014 income and family size when they file their tax year 2014 tax return.

Individuals who are eligible to receive the Premium Tax Credit but did not receive a credit in advance can claim the credit on their tax year 2014 tax return. Individuals who received more than they were entitled in the form of an Advance Premium Tax Credit will be responsible for repaying all or part of the advanced credit received. The IRS will assess the additional credit on the taxpayer's account and attempt to collect it.

TIGTA is concerned that the potential for refund fraud and related schemes could increase as a result of processing ACA Premium Tax Credits unless the IRS builds, implements, updates, and embeds ACA predictive analytical fraud models into its tax filing process. The IRS has developed a plan to prevent, detect, and resolve fraud and abuse during ACA tax return processing. The plan, when fully developed and implemented, is designed to leverage third-party reporting from the Exchanges and new computer analytical capability built into the Return Review Program.[61] The plan calls for the development of the ACA Validation Service, which will be used to identify improper ACA-related refunds. The ACA Validation Service will be designed to perform screening for improper refunds and will also identify fraudulent schemes that include multiple returns. The IRS plans to rely on the Electronic Fraud Detection System and/or the new Return Review Program to provide the systems to identify and prevent ACA-related refund fraud.

The applications for processing electronic and paper tax returns will need to be modified before January 2015 in order for the IRS to be able to use the new ACA Validation Service to determine if a taxpayer claiming the Premium Tax Credit also purchased insurance through the Exchanges or received an Advance Premium Tax Credit in 2014, and if any math errors exist.

We have developed a multi-audit strategy to evaluate the IRS's implementation of the Premium Tax Credit. To date, we have completed evaluations of the IRS's development of needed information systems and the adequacy of the IRS's plans to provide customer service to individuals seeking assistance with the Premium Tax Credit. In September 2013, we reported that a fraud mitigation strategy is not in

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[57] A Premium Tax Credit is a refundable tax credit to assist individuals and families in purchasing health insurance coverage through an Exchange.

[58] An Advance Premium Tax Credit is paid in advance to a taxpayer's insurance company to help cover the cost of premiums.

[59] TIGTA, Audit No. 201340335, *Affordable Care Act: Accuracy of the Income and Family Size Verification and Advanced Premium Tax Credit Calculation,* report planned for May 2014.

[60] TIGTA, Audit No. 201420302, Security Over Federal Tax Data at Health Insurance Exchanges, report planned for September 2014.

[61] The Return Review Program is the key automated component of the IRS's pre-refund initiative and will implement the IRS's new business model for a coordinated criminal and civil tax noncompliance approach to prevent, detect, and resolve tax refund fraud, including refundable ACA premium tax credits.

place to guide ACA systems development, testing, initial deployment, and long-term operations.[62] The IRS informed us that two new systems are under development that will address Affordable Care Act tax refund fraud risk. However, until these new systems are successfully developed and tested, TIGTA remains concerned that the IRS's existing fraud detection system may not be capable of identifying Affordable Care Act refund fraud or schemes prior to the issuance of tax refunds.

ACA Provisions Impacting the Current 2014 Filing Season

Several ACA tax-related provisions became effective for calendar year 2013 that affect individuals with high incomes including the creation of a new net investment income tax,[63] and an increase in the employee-share of the Medicare tax (i.e., Hospital tax).[64] The ACA also increased the income limit for qualifying medical and dental expenses taken as an itemized deduction. In prior years, individuals could take an itemized deduction for qualified medical and dental expenses that exceeded 7.5 percent of their Adjusted Gross Income. Beginning in calendar year 2013, the qualifying expenses must exceed 10 percent of Adjusted Gross Income.

Taxpayers began filing tax returns with these tax changes on January 31, 2014. In addition to reprogramming its computer systems to properly reflect these changes, the IRS had to issue guidance to taxpayers and tax return preparers explaining each of these provisions and revise or develop new tax forms, instructions and publications to reflect the tax law changes. In an ongoing review, we will determine whether the IRS has correctly implemented these provisions, which includes analyzing tax returns to ensure that they are accurately processed.[65]

IRS TAX GAP

A serious challenge confronting the IRS is the Tax Gap, which is defined as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely pay for a tax year. The most recent gross Tax Gap estimate developed by the IRS was $450 billion for tax year 2006, which is an increase from the prior estimate of $345 billion for tax year 2001. The voluntary compliance rate[66] decreased slightly from 83.7 percent in 2001 to 83.1 percent in 2006.

The largest component ($376 billion or approximately 84 percent) of the Tax Gap is based on taxpayers' underreporting their taxes due. The IRS addresses this gap by attempting to identify questionable tax returns when they are received and processed and by conducting examinations of tax returns filed to determine if there are any adjustments needed to the information reported on the tax returns. Additional taxes are assessed and collected.

The next component ($46 billion or 10 percent) of the Tax Gap is based on taxpayers underpayment of taxes due. The IRS addresses this gap by issuing notices and contacting taxpayers to collect the delinquent taxes. The IRS is authorized to take enforcement action, such as filing liens and seizing assets, to collect the taxes.

The smallest component ($28 billion or 6 percent) of the Tax Gap is based on taxpayers who do not file tax returns when they are due. These taxpayers also may not have taxes withheld or make estimated taxes. The IRS analyzes data from third parties (such as Forms W–2 or Forms 1099) to identify taxpayers who should have filed a tax return, and either prepares a substitute tax return or contacts the taxpayer to obtain the delinquent tax return.

The scope, complexity, and magnitude of the international financial system also present significant enforcement challenges for the IRS. At the end of calendar year 2012, foreign business holdings and investments in the United States were $25.5 trillion, an increase of nearly $135 billion over calendar year 2011, while U.S. business and investments abroad grew to over $21.6 trillion, an increase of nearly $1.5 billion during the same period. The numbers of taxpayers conducting international business transactions continues to grow as technological advances provide opportu-

[62] TIGTA, Ref. No. 2013–23–119, *Affordable Care Act: Improvements Are Needed to Strengthen Systems Development Controls for the Premium Tax Credit Project* (Sep. 2013).

[63] The ACA created a new tax that is equal to 3.8 percent of an individual's net investment income for the tax year or the excess of the individual's Modified Adjusted Gross Income over $200,000 ($250,000 for married individuals filing jointly).

[64] The ACA increased the employee-share of the Medicare tax to 0.9 percent of an individual's covered wages in excess of $200,000 ($250,000 for married individuals filing jointly). The ACA also increased the Medicare tax on self-employment income to 0.9 percent of an individual's self-employment income over $200,000 ($250,000 for married individuals filing jointly).

[65] TIGTA, Audit No. 201440014, *2014 Filing Season Implementation,* report planned for September 2014.

[66] The voluntary compliance rate is an estimate of the amount of tax for a given year that is paid voluntarily and timely.

nities for offshore investments that were once only possible for large corporations and wealthy individuals.

The IRS is increasingly challenged by a lack of information reporting on many cross-border transactions that have been rendered possible by advancing technology. In addition, the varying legal requirements imposed by different jurisdictions lead to the creation of complex business structures that are not easy to understand, making the determination of the full scope and effect of cross-border transactions extremely difficult.

As this global economic activity increases, so do concerns regarding the International Tax Gap.[67] While the IRS has not developed an accurate and reliable estimate of the International Tax Gap, non-IRS sources estimate it to be between $40 billion and $133 billion annually. To address the International Tax Gap, the IRS developed an international tax strategy plan with two major goals: (1) to enforce the law to ensure that all taxpayers meet their obligations and (2) to improve service to make voluntary compliance less burdensome.

The IRS also currently faces the challenge of implementing the Foreign Account Tax Compliance Act (FATCA).[68] FATCA was enacted to combat tax evasion by U.S. persons holding investments in offshore accounts. Under FATCA, a United States taxpayer with financial assets outside the United States will be required to report those assets to the IRS. In addition, foreign financial institutions will be required to report to the IRS certain information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. The IRS is developing a new international system, the Foreign Financial Institution Registration System, to support the requirements of FATCA. This system is intended to register foreign financial institutions to assist in achieving the primary objective of FATCA which is the disclosure of U.S. taxpayer foreign accounts. TIGTA reviewed the development of this system and reported that the program management control processes did not timely identify or communicate system design changes to ensure its successful deployment.[69]

Concerns about the International Tax Gap have also led to increased enforcement efforts on international information reporting requirements and increased assessments of related penalties. For example, the IRS has automated the penalty-setting process for the Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, which has resulted in a total of $215.4 million in late-filed Form 5471 penalty assessments during fiscal years 2009 through 2012.[70]

In addition, the IRS established the International Campus Compliance Unit to expand its audit coverage of tax returns with international aspects and to increase compliance among international individual taxpayers. For fiscal year 2011 through March 13, 2013, the International Campus Compliance Unit conducted almost 18,000 audits and assessed approximately $36 million in additional tax. Despite its accomplishments, TIGTA found that the International Campus Compliance Unit has no specific performance measures for its operations.[71]

We reviewed enforcement revenue trends and noted that in fiscal year 2007, the IRS collected over $59 billion in taxes, penalties and interest, but the dollars collected dropped during the next 2 years before increasing again in fiscal year 2010. The, dollars collected decreased to just over than $50 billion in fiscal year 2012. While the IRS did not track the reason for the increase in fiscal year 2010, it did receive additional funds to hire more than 1,500 revenue officers between June 2009 and February 2010.

One enforcement program whose resources have been significantly reduced is the Automated Collection System (ACS). The ACS function attempts to collect taxes through telephone contact with taxpayers before cases are assigned to revenue officers who make in-person visits to collect delinquent taxes. The ACS has 16 call sites in the Small Business and Self Employed and the Wage and Investment Divisions. However, ACS staff was reduced by 24 percent, from 2,824 contact representatives in fiscal year 2010 to 2,140 contact representatives in fiscal year 2013. In addition,

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[67] The International Tax Gap is the taxes owed but not collected on time from a U.S. person or foreign person whose cross-border transactions are subject to U.S. taxation.

[68] Public Law No. 111–147, §§501–541, 124 Stat 71 *96–116 (2010) (codified in scattered sections of 26 U.S.C.).

[69] TIGTA Ref. No. 2013–20–118, *Foreign Account Tax Compliance Act: Improvements Are Needed to Strengthen Systems Development for the Foreign Financial Institution Registration System* (Sept. 2013).

[70] TIGTA, Ref. No. 2013–30–111, *Systemic Penalties on Late-Filed Forms Related to Certain Foreign Corporations Were Properly Assessed, but the Abatement Process Needs Improvement* (Sept. 2013).

[71] TIGTA, Ref. No. 2013–30–113, *The International Campus Compliance Unit Is Improving Individual Tax Compliance* (Sept. 2013).

three call sites were taken off-line in February 2013 to work Accounts Management inventory (other than identity theft cases) because Accounts Management began devoting more of its resources to work the growing inventory of identity theft cases. This shift in resources to Accounts Management was originally scheduled to continue for 3 months but was subsequently extended through the end of fiscal year 2013 and was still ongoing as of February 2014. As a result of these combined reductions, the number of ACS contact representatives in fiscal year 2013 was 41 percent fewer than in fiscal year 2010.

Another impact on the ACS program is how resources are applied to its growing workload. In fiscal year 2013, the ACS prioritized answering telephone phone calls from taxpayers over working delinquent accounts, which resulted in the ACS spending only 24 percent of its resources on working inventory and 76 percent on answering taxpayers' questions. The shift from working inventory has had consequences on the ACS's core mission of collecting delinquent taxes. In an ongoing audit, we reviewed ACS business results from fiscal year 2010 through fiscal year 2013 and determined:

—New inventory is outpacing closures, so the inventory is growing.
—Inventory is taking longer to close, and the cases are older.
—When cases are closed, more are closed as currently not collectible.
—Fewer enforcement actions are taken.
—More, and older, cases are being transferred to the growing inventory of cases available to be assigned to Collection Field personnel.[72]

Leveraging external resources, such as whistleblowers, can help improve tax compliance. The IRS Whistleblower Program also plays an important role in reducing the Tax Gap and maintaining the integrity of a voluntary tax compliance system. However, TIGTA reported that the program continued to have internal control weaknesses with respect to processing whistleblower claims. For example, information captured from multiple systems and entered into a single inventory control system was potentially erroneous, and the quality review process for the new inventory system was not sufficient to ensure that claims were accurately controlled. Additionally, TIGTA determined that timeliness standards for processing claims were not sufficient. Without adequate oversight of the Whistleblower Program, the IRS is not as effective as it could be in responding timely to tax noncompliance issues.[73]

Modernizing information systems could potentially allow the IRS to post more comprehensive tax return information to its computer systems, which could facilitate the examination process and expedite taxpayer contacts for faster resolution. The IRS considers the Customer Account Data Engine 2 (CADE 2) program to be critical to its mission and it is the IRS's most important information technology investment. TIGTA reported that the implementation of CADE 2 daily processing allowed the IRS to process tax returns for individual taxpayers more quickly by replacing existing weekly processing.[74] The CADE 2 system also provides for a centralized database of individual taxpayer accounts, which will allow IRS employees to view tax data online and provide timely responses to taxpayers once it is implemented. The IRS's modernization efforts also include developing computer programs to conduct predictive analytics to reduce refund fraud.[75] The successful implementation of the IRS's modernization program should significantly improve service to taxpayers and enhance Federal tax administration.

Simplifying the tax code could also help taxpayers understand and voluntarily comply with their tax obligations and limit opportunities for tax evasion. Finally, penalties are an important tool because they discourage taxpayer behavior that contributes to the Tax Gap. Congress provided numerous penalty provisions in the Internal Revenue Code that the IRS can use to help remedy the noncompliance that contributes to the Tax Gap. The IRS can assess accuracy-related penalties for negligence, substantial understatement of income tax, or substantial valuation misstatement. The IRS estimated that the underreporting of tax contributed $376 billion (84 percent) of the $450 billion total gross Tax Gap, including $235 billion from individual income taxes. To deter this type of behavior, the IRS reported that during fiscal year 2011 it assessed over 500,000 accuracy-related penalties, involving over $1 billion against individuals.

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[72] TIGTA, Audit No. 201330017, *Review of the Automated Collection System Inventory Management,* report planned for August 2014.

[73] TIGTA, Ref. No. 2012–30–045, *Improved Oversight Is Needed to Effectively Process Whistleblower Claims* (Apr. 2012).

[74] TIGTA, Ref. No. 2012–20–122, *Customer Account Data Engine 2 System Requirements and Testing Processes Need Improvements* (Sep. 2012).

[75] These are computer models that analyze extremely large quantities of data to seek out data patterns and relationships that could indicate potential tax fraud schemes.

MANAGEMENT ACTIONS IN RESPONSE TO PRIOR REPORTED ISSUES

TIGTA follows up regularly on management actions in response to recommendations in our reports. One notable example that we are currently following up on is the report on Exempt Organizations. TIGTA previously reported[76] that the IRS used inappropriate criteria for selecting and reviewing applications for tax-exempt status. This resulted in substantial delays in processing certain applications and the issuance of unnecessary information requests being issued to certain organizations.

The IRS Commissioner reported in January 2014 that the IRS completed action on all nine recommendations contained in our May 2013 report. TIGTA is currently assessing the actions the IRS has taken in response to our recommendations.[77]

TIGTA BUDGET REQUEST FOR FISCAL YEAR 2015

As requested by the subcommittee, I will now provide information on our budget request for fiscal year 2015.

TIGTA's fiscal year 2015 proposed budget requests appropriated resources of $157,419,000, an increase of 0.67 percent from the fiscal year 2014 enacted budget. TIGTA will continue to focus on its mission of ensuring an effective and efficient tax administration system in this lean budget environment. The fiscal year 2015 budget resources include funding to support TIGTA's critical audit, investigative, and inspection and evaluation priorities, while still maintaining a culture that continually seeks to identify opportunities to achieve efficiencies and cost savings.

During fiscal year 2013, TIGTA's combined audit and investigative efforts have recovered, protected, and identified monetary benefits totaling $16.6 billion,[78] including cost savings, increased revenue, revenue protection[79], and court-ordered settlements in criminal investigations, and affected approximately 3.9 million taxpayer accounts. Based on TIGTA's fiscal year 2013 budget of $143.8 million, this represents a Return on Investment of $116-to-$1.

In fiscal year 2014, TIGTA received approximately $7 million above its requested amount of $149.4 million. This additional funding will enable TIGTA to (1) restore staffing to pre-sequestration levels; (2) increase training expenditures for auditors and special agents to meet required standards; and (3) upgrade and improve our technology infrastructure. The additional funding will allow TIGTA to continue to support critical audit, investigative, and inspection and evaluation priorities. The additional funds have also enabled the Office of Audit to immediately initiate audits that require travel to various IRS locations—travel that had previously been placed on hold due to budget constraints. In addition, the Office of Audit has been able to immediately initiate audits in critical areas such as international tax compliance and identity theft. As additional law enforcement staff is hired, the Office of Investigations will be able to conduct more proactive initiatives to uncover fraud in IRS operations and identify threats to IRS employees and infrastructure. In addition, the Office of Investigations will be able to investigate more complaints of IRS employee misconduct, fraud, waste, and abuse.

IRS Implementation of the ACA

Several key ACA provisions will become effective in fiscal year 2014, and the IRS must ensure that the taxpayer system is able to fully implement these provisions. TIGTA's oversight requires close coordination among the Audit, Investigations, and Inspections and Evaluations functions. Each program office brings unique skills and experience, but TIGTA's overall success depends greatly upon these offices' close collaboration. As such, TIGTA has implemented a multi-year oversight strategy that includes audits, evaluations, and investigative resources to assess and to proactively deter efforts to impede the IRS's implementation of the ACA. This strategy includes coordination with other agencies, including the Department of Health and Human Services Office of Inspector General.

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[76] TIGTA, Ref. No. 2013–10–053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 2013).

[77] TIGTA, Audit No. 201410009, *Status of Actions to Improve Identification and Processing of Applications for Tax-Exempt Status—Follow-Up*.

[78] This figure includes dollars potentially compromised by bribery; dollar amount of tax liability for taxpayers who threaten and/or assault IRS employees; dollar value of IRS and resources protected against malicious loss; dollar amount of embezzlement or taxpayer remittance theft; dollar value of Government property recovered; dollar value of court ordered criminal and civil penalties, fines, and restitution; and dollar value of seizures, forfeitures, and recoveries from contract fraud.

[79] Recommendations made by TIGTA to ensure the accuracy of the total tax, penalties, and interest paid to the Federal Government.

For example, TIGTA is conducting or planning to initiate 10 ACA-related audits during fiscal year 2014 and fiscal year 2015. For TIGTA's investigators, our experience has shown that the IRS's expanded role under the ACA may spark a new wave of animosity directed toward IRS employees that could result in threats of violence, or the actual assault of IRS employees and attacks on IRS facilities. For example, TIGTA has investigated threats made by taxpayers to IRS employees as a result of the IRS offsetting their Federal tax refunds for the repayment of student loans or court-ordered child support payments. As ACA provisions start to take effect, additional resources will be dedicated to investigating related threats.

Shortly after the Supreme Court upheld the constitutionality of the ACA, the media reported that criminals impersonated a Federal agency in an attempt to fraudulently obtain personally identifiable information from unsuspecting taxpayers to further their identity theft schemes and other crimes under the guise that the sensitive information was required for ACA compliance. Based upon our experience investigating this type of criminal activity, TIGTA anticipates a significant increase in the number of ACA-related impersonation attempts as the IRS begins its role in ACA compliance activity.

TIGTA's Audit Priorities

TIGTA's audit priorities include mitigating risks associated with tax refund fraud and identity theft, monitoring the IRS's implementation of the Affordable Care Act and other tax law changes, and assessing the IRS's ability to provide quality taxpayer service and address the Tax Gap.

Recent audit work has shown that the IRS could develop or improve processes that will increase its ability to detect and prevent the issuance of fraudulent tax refunds resulting from identity theft. In addition, TIGTA has concerns over the security of tax data provided to the Exchanges and is also concerned that the potential for refund fraud and related schemes could increase as a result of processing ACA Premium Tax Credits.

TIGTA's Investigative Priorities

TIGTA's investigative priorities include investigating allegations of serious misconduct and criminal activity by IRS employees; ensuring IRS employees are safe and IRS facilities, data and infrastructure are secure and not impeded by threats of violence; and protecting the IRS against external attempts to corrupt or otherwise interfere with tax administration.

IRS employees are entrusted with the sensitive personal and financial information of taxpayers. It is particularly troubling when IRS employees misuse their positions in furtherance of identity theft and other fraud schemes. TIGTA will continue to proactively review the activities of IRS employees who access taxpayer accounts for any indication of unauthorized accesses that may be part of a larger fraud scheme and conduct investigations into suspected wrongdoing.

Between fiscal years 2010 and 2013, TIGTA processed over 11,391 threat-related complaints and conducted over 5,500 investigations of threats made against IRS employees. TIGTA will continue to aggressively investigate individuals who threaten the safety and security of the IRS and its employees.

As mentioned earlier, the TIGTA Hotline has received over 30,000 reports from taxpayers victimized by individuals impersonating IRS employees in an effort to defraud them. To date, thousands of victims have paid over $2 million to the scammers. TIGTA will continue to investigate these crimes against taxpayers and alert the public to this scam to ensure that innocent taxpayers are not harmed by these criminals.

We at TIGTA take seriously our mandate to provide independent oversight of the IRS in its administration of our Nation's tax system. As such, we plan to provide continuing audit coverage of the IRS's efforts to operate efficiently and effectively and investigate any instances of IRS employee misconduct.

Chairman Udall, Ranking Member Johanns, and members of the subcommittee, thank you for the opportunity to share my views.

STATUS OF IRS CORRECTIVE ACTION ON TIGTA TAX-EXEMPT ORGANIZATIONS WORK

Senator UDALL. Thank you for your testimony today. And, Inspector General George, I want to focus on this issue again of these tax exempt applications. Last May, your office published an audit and made findings delineating the use of inappropriate case screening criteria in 501—in processing IRS processing of applications for

tax exempt under Section 501(c)(4) of the Tax Code. TIGTA's report outlined delays in case disposition, weak internal controls, communications breakdowns, and management deficiency.

Your report recommended nine specific corrective actions, including the issuance of procedures and guidance and development of training to address the problems identified. I note particularly recommendation number eight directing that guidance on how to measure the "primary activity of IRC Section 501(c)(4), social welfare organizations, be included for consideration in the Department of the Treasury priority guidance plan."

A couple of questions. It has been nearly a year since the report was issued. What is the status of the IRS' efforts to address the problems? How has the IRS satisfactorily implemented all of the corrective actions TIGTA recommended? And if no, what remains uncompleted, and what other actions would you recommend the IRS undertake to correct any deficiencies in this area?

Mr. GEORGE. Very important questions, Senator. I have to make it clear that the Department of the Treasury has a directive that limits that tax policy is within the ambit of the Assistant Secretary for Tax Policy—final tax policy, and I would have to defer to him to give you a definitive response to some of the questions that you raised. Other parts I can address.

We are in the process now of conducting an assessment of the IRS' implementation of our recommendations. As you know, one, and you pointed this out at the outset, was that clarification be given as to the amount of activity that can take place. That is most definitely a tax policy question, but there is no question that their proposal, which has gone much further than the nine recommendations that we made did include that recommendation amongst one or two others.

The Commissioner, and to his credit, the Acting Commissioner, Danny Werfel, and this current Commissioner, Mr. Koskinen, have made repeated public comments that they were going to fully address our recommendations. And I anticipate conducting that review on an expedited basis, and will not wait another year to get back to you on it, and I will let you know as soon as we get the information from that review.

Senator UDALL. Great. Thank you very much. Senator Johanns.

Senator JOHANNS. Mr. Inspector General, good to see you here today.

Mr. GEORGE. Thank you, sir.

Senator JOHANNS. Soon after your report came out in that early timeframe, the—kind of the response of certain people with the IRS and I think others was this is a limited group, they are in the Cincinnati office, very, very closely confined problem. Did you agree with that assessment based upon your investigation?

Mr. GEORGE. Sir, this is—I have to be very diplomatic here because, one, I cannot acknowledge that there is an ongoing investigation by my office. I can acknowledge obviously that the FBI is undertaking an investigation. We are helping in their review on this matter.

This was such a fluid situation, and then there was some very inaccurate statements, and you were right about that. But I to this day hold the position that it is too premature to come to any con-

clusive finding as to what happened here. We did—because we conducted an audit and not a review/investigation at the outset of this, and our audit did find, you know, inappropriate criteria used. We did conclude that there was gross mismanagement on the part of senior IRS executives. As the Commissioner has pointed out, actions were taken against those individuals who were a part of that. But this is still an ongoing matter, sir.

Senator JOHANNS. The actions taken did extend beyond the Cincinnati office, though. Is that fair to say?

Mr. GEORGE. Oh, yes. Yes.

Senator JOHANNS. As you know, this matter has also been the subject of numerous hearings, and I have seen you on TV. You have participated in some of those hearings, a lot of those on the House with the House Oversight. Have you cooperated with that committee in terms of their request for information, documents? Are you assisting that process in any way?

Mr. GEORGE. To the extent that we are allowed to. Title 26 of the United States Code, section 6103 places severe restrictions on the type of information that my organization and the IRS can hand over to various committees in Congress. Namely, it says that we can only provide taxpayer information to the chairman of the Senate Finance Committee and the chairman of the House Ways and Means Committee. They in turn can determine what type of information they would like to share.

If I were to share 6103 information with either the chairman of the House Oversight Committee or every other committee except for the one that I noted, I am subject to criminal penalties. And so, if there is a document that has non-6103 information on it and they are simply asking for clarification, while I personally have not had, especially during the course of the audit, had no contact with them directly, members of my staff have. And so, and then to the extent of those communications, I would defer to them, some of whom are in the room, sir, but——

IRS PROCEDURES FOR PROCESSING 501(C)(4) APPLICATIONS

Senator JOHANNS. During the Commissioner's testimony, he talked about his attempt to clarify the 501(c)(4) application process, I guess. He stated now—surprised me; I was not aware of this—that the IRS now has a rule that if, I think to paraphrase his testimony, if you are using less than 40 percent of your resources for "political activity," then, man, your application zips on through.

Do you find any support that you are aware of in the tax laws, regulations that would allow that kind of division? I mean, I tried to ask, so 41 percent is a problem, but 39 percent is not a problem. Do you know of anything that would support the IRS handling applications really for any tax exempt status with—and create a rule of that nature? It struck me as arbitrary and capricious.

Mr. GEORGE. To directly answer your question, I am not aware of any rule that either permits nor prohibits it, so I would not be clear about that. And as you may know, this was an attempt by Danny Werfel, the Acting Commissioner, to address the backlog, and it was a severe backlog some years in the making for applicants of the 501(c)(4) status.

So this was, I believe, an attempt on his part to be even-handed. I am sure he worked with the Office of Chief Counsel at the IRS. But it is something that I have no additional information about, sir.

EARNED INCOME TAX CREDIT

Senator JOHANNS. Mr. Inspector General, let me, if I might, go to another topic here, not that I might not return to this. But the earned income tax credit has been subject to a lot of analysis and criticism by your office. And if I remember the numbers correctly, about 20 percent of what is paid out annually is fraudulently sought and paid out, totaling $15 billion or some huge amount of money.

Give us your best advice as to how we can address that issue. There was a piece of legislation recently that was going to be used as an offset on something. And my goodness, the debate was you are taking food out of the mouths of children. Well, nobody wants to do that, but I think we should not be paying out taxpayer money that is fraudulent, if you know what I am saying, that is fraudulently sought. Give us your best advice on that.

Mr. GEORGE. Once again, sir, I have to preface that is a tax policy question. So I am going to answer your question, but I would have to defer to the Assistant Secretary for Tax Policy. You are right, it is in the tens of billions. It is under $20 billion, so the teens.

Senator JOHANNS. Fifteen to $18 billion.

Mr. GEORGE. Yes, something like that. It has, believe it or not, gone down in recent years. But with any credit, especially a refundable credit, it is extraordinarily hard for the IRS to administer this because that means, again, you may not owe taxes, but the money, you can claim it, and the money goes out. And as the Commissioner noted, when they sometimes do not have third party information from people until months after these checks have gone out the door, it is almost impossible to reclaim the money, to claw it back. And that is part of the problem here.

Senator JOHANNS. Would it help to just require that the name of the person, the individual involved that qualifies for that credit be listed together with a social security number?

Mr. GEORGE. Not only would that be helpful, but a truly troubling aspect, because we made recommendations on this for quite some time. A lot of the individuals who use this credit, and I do not know if you have seen the instructions. I think they are about 30 pages long on how to apply for the earned income tax credit, which means that a lot of the individuals who receive this have the benefit of outside or third party people assisting them with their taxes.

And we have found examples of those individuals whether on purpose or not, you know, in cahoots with the individuals or not, siphoning money off to the side. This is not just one individual, one family engaged in, you know, inappropriate tax behavior, sir. It is more than that. And so, this is something that demands to be looked at. It is not the only one. There are other refundable credits out there that have similar problems.

The Congress did change the law so that it made it clear who was eligible for that whereas in the past it was not clear whether somebody who was not entitled to certain public benefit could not receive them. That has been clarified. There are other refundable credits where that is still not clarified. So this is a big issue.

Senator JOHANNS. You know, my—and I am going over my time, I hope you do not mind. It is just the two of us here.

Senator UDALL. That is all right.

Senator JOHANNS. But I think this is an enormously, enormously important discussion. I do not want one single American who is entitled to a tax credit not to get it. The law provides to it. They are entitled to get it. They apply for it. We should send it to them. I have got no issue with that whatsoever.

I get crazy over this notion, and I think people figure this out. And they make application fraudulently, and the money goes out the door, and chances of recovery are very, very slim, as you know. I do not know if this subcommittee is the appropriate subcommittee, but this warrants a hearing process where we ask you and others at the IRS how do we fix this, because I think the fixes would be pretty straightforward.

And here we are fighting with each other over revenue necessary to run the Agency, while billions of dollars are slipping out the door. It makes no sense to me. Like I said, it drives me crazy. It is such a waste of money.

Mr. GEORGE. Sir, there are two—and, again, I do not want to belabor the chairman's—step on his time either. But giving the IRS quicker access to information and actually giving them access to a database that is run by the Department of Health and Human Services, which would assist them in gathering third party information. The earlier the third party information is available to the IRS, the quicker they can help address and stem some of these problems.

Senator JOHANNS. Yes, great. Thank you, Mr. Chairman.

Senator UDALL. Thank you very much, Senator Johanns. Just a quick comment on the earned income tax credit. The earned income tax credit is one of the Federal Government's largest benefit programs for low income working families and individuals. You know that very well. Workers, self-employed people, and farmers who earn $51,567 or less last year could receive larger refunds if they qualify for the EITC.

The EITC has been making the lives of workers a lot easier for more than 38 years. Yet there have been challenges in the implementation of this credit, and that is what we have been talking about here. We have recently heard of examples of fraud and misuse that are troubling, and I know that you are working to address that.

On the flip side, the IRS also estimates that nationwide, one in five eligible workers still miss out on the EITC either because they do not claim it when filing or do not file a tax return. I think it is critical we ensure that this credit is reaching those in the most need and protected for the hardworking families struggling to make ends meet. And very much appreciate, Senator Johanns, your comments on that.

IDENTITY THEFT AND REFUND FRAUD

Inspector General George, the question, you heard me have a discussion with the Commissioner on refund fraud and identity theft. Do you consider IRS' current strategy for dealing with identity theft and refund fraud to be satisfactory? What measures should the IRS pursue with greater vigor to improve its response to the growing problem of refund fraud and identity theft?

Mr. GEORGE. As I have indicated in various public settings, this is one of the fastest-growing threats to our systems—our Nation's system of tax administration. As I pointed out in my written testimony, the IRS has made progress in identifying tax returns that should not go out that some of which have characteristics of identity theft and others, for example, people in jail who may not be claiming to be someone else, may be claiming to be themselves, but claiming refunds for money they are not entitled to. So this is an amazingly growing problem.

I, my mother, my father, we have all gotten these phone calls demanding that we pay the IRS money, or they are going to—all three of us were going to be arrested. So I mean, I know we are not the only ones. We have reported over 1 million or 2 million calls requesting millions of dollars, tens of thousands of dollars in these types of fraud. And this thing is just growing exponentially.

So it is almost like a moving—excuse me—almost like a moving target for the IRS. They can skim it down. They can put clamps down here, and then the balloon expands or it goes to this other area. This is not solely a domestic problem. It is an international problem. But this is something that if we do not want to completely undermine people's trust in their Nation's system of tax administration, you know, the IRS with declining resources and additional responsibilities is truly going to have to make some tough choices, sir.

Senator UDALL. Do you share the concern expressed by the National Taxpayer Advocate that victims still face the same, and they use this language, a labyrinth of procedures and drawn-out timeframes for resolution that they faced 5 years ago?

Mr. GEORGE. We actually issued an audit more recently which reconfirmed her findings. So the answer is an unqualified yes.

SECURITY OF TAXPAYER INFORMATION

Senator UDALL. Now, computer security has been problematic for the IRS since 1997. The Treasury Inspector General for Tax Administration has identified security of taxpayer data employees is one of the top three management challenges facing the IRS. The Government Accountability Office (GAO) has highlighted the need for improvements as well. Significant deficiencies make the IRS systems vulnerable to unauthorized access. This can adversely affect the confidentiality, integrity, and availability of financial and sensitive taxpayer information.

What are your key concerns about the adequacy of information security measures IRS has put in place to protect its systems from the threat of cyber attack?

Mr. GEORGE. Well, once again, and this ties into the issue of identity theft and the massive increase in the number of those

cases. As a matter of fact, we are required every year under the Reports Consolidation Act to list the top 10 management challenges confronting the IRS, every IG of major agencies. For years, the IRS' tax systems modernization was the number one concern that we had, but in the recent years, they have made improvements. I am not in the position at this very moment to outline exactly what those improvements are, sir, but they have made improvements.

But again, with technology growing in a nano second, they are going to have to stay on top of this, and in an environment of declining resources they have some tough choices to make. But it is still a problem. I mean, but it is not the same—to the same extent. You may recall the tax system modernization effort, billions of dollars were expended on a system that did not work. And so, they had to recreate the entire thing from the get-go, and they were able to do so.

Senator UDALL. Great. Thank you very much for that answer. Senator Johanns.

Senator JOHANNS. If I could just offer kind of a concluding comment. First of all, I just want you to know I respect what you folks do. I have worked with the Inspector General myself, and, you know, and sometimes that oversights gets a little irritating, if you know what I am saying, if you are the person in charge. But having said that, it is the right thing because it forces people to be paying attention.

The second thing I wanted to say on this earned income tax credit, again I want to make this very clear. I want every person in America who is entitled to receive it under the law to get it. And if there are people not getting it, we should do whatever we can to do outreach or whatever to properly inform them that it is available and they have a right to claim it.

But 20 percent of the earned income tax credit under your own analysis, 20 percent of the payments each year are improperly paid out. That is appalling, and it is not a small amount of money. It is $13 billion to $15 billion according to my notes. We cannot justify that. We cannot justify that, and if that can be fixed, and I believe it can quite easily be fixed, we in Congress should be fixing it. It is as simple as that.

So that, again, drives me crazy that deserving people are not getting it. Undeserving people are fraudulently claiming it and receiving it. We pay it out to them, and I just think that is flat wrong. Just flat wrong. Thank you.

Senator UDALL. Senator Johanns, thank you so much today for your participation and involvement here. We have almost gone two full hours, and I just want to tell you how much I appreciate it.

I want to echo his comments on the inspectors general. I mean, I think they play a tremendously important function in our government and a real watchdog out there and help us. And I very much appreciate the Commissioner staying and listening to your testimony. It shows his commitment, I think, to try to get things right there at the IRS.

I want to thank all who participated in preparing for this hearing. I appreciate the hearing from the top officials, so the Treasury Department, about resource needs and the opportunity to explore

a number of important and, I think, very timely issues. Today's discussion has provided helpful insights into the Treasury and IRS' critical operations and challenges. This information will be instructive as Congress moves forward with our work on the fiscal year 2015 funding.

The other thing I want to say is I think the staff has done on both sides excellent work in preparing us for this hearing.

ADDITIONAL COMMITTEE QUESTIONS

The hearing record will remain open until next Wednesday, May 7, at noon for subcommittee members to submit statements and questions to be submitted to the witnesses for the record. And we would very much appreciate you giving timely responses to those.

[The following questions were not asked at the hearing, but were submitted to the Departments for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO HON. JACOB LEW

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

FINANCIAL STABILITY OVERSIGHT COUNCIL

Question. Secretary Lew, when the Financial Stability Oversight Council (FSOC) released its final rule for the designation of nonbank financial firms, it acknowledged that the asset management industry was different and instructed the Office of Financial Research (OFR) to do a report on the industry. Specifically, the FSOC asked the OFR to determine whether any threats to financial stability could arise from asset management; whether they are significant enough to warrant a regulatory response; and what form that response should take.

—What risks have the FSOC or OFR identified?

—Why does the FSOC believe designation of one or two asset management firms is a more effective solution to address these risks than an activity-based approach by the primary regulator?

Answer. The Council is still evaluating the extent to which there are potential threats to U.S. financial stability arising from asset management companies or their activities and what, if any, measures are appropriate to address those threats. I would not want to prejudge the outcome of that analysis while it is still ongoing.

The September 2013 Office of Financial Research (OFR) study on asset management is only one of many inputs that the Council will consider as it continues its review of the asset management industry and its various activities. Further, it is important to note that the Council did not ask the OFR to make recommendations regarding any regulatory response that the Council or other regulators should take in response to any risks in the asset management industry. The Council hosted a public conference on May 19 to discuss the asset management industry and its activities. At the conference, we heard directly from the industry and other stakeholders, including academics and public interest groups, on this issue, and we welcome continued engagement from across the spectrum as the Council continues its careful assessment of potential risks to U.S. financial stability.

To the extent that the Council identifies risks posed by asset managers or their activities that could pose a threat to financial stability, the Council has a number of potential responses, including highlighting potential emerging threats in its annual reports to Congress, making recommendations to existing primary regulators to apply heightened standards and safeguards, and designating individual firms on a company-specific basis. If the Council identifies risks that require action, it will seek to deploy the most appropriate remedy.

CYBERSECURITY

Question. The Treasury Department and financial sector have access to a significant amount of personal and sensitive data that must be protected from both external and internal threats. However, over the past few years, the Treasury Inspector General has audited the Department's cyber security and repeatedly found vulnerabilities, particularly within the Office of the Comptroller of the Currency.

The President's budget requests a significant increase of $11 million dollars to combat these cyber security threats.

—Please explain how the funds would be used to address cyber security threats, and in particular, the vulnerabilities identified by the Inspector General.

Answer. There are many cyber threats confronting Treasury. The $10.9 million requested is directed at four key areas within Departmental Offices (DO) and the Department-wide Systems and Capital Investments Program:

1. Insider Threat Monitoring, $3.3 million;
2. DO Local Area Network Cybersecurity Improvements, $2.6M;
3. Government Security Operations Center, $3.5 million; and
4. Data Leakage Protection System, $1.5 million.

The Department's Insider Threat Program is being implemented in accordance with Executive Order 13587, the National Insider Threat Policy and Minimum Standards, and Treasury Order 105-20, and in coordination with the National Insider Threat Task Force (NITTF). To comply with these authorities, Treasury intends to institutionalize its insider threat audit and monitoring system on its top secret/secret compartmented information network and build an insider threat analysis cell to review data from all parts of the Department. This will assist the Office of the Comptroller of the Currency (OCC) as well as all other Bureaus.

The DO local area network (LAN) cybersecurity improvements will provide comprehensive network access control to mitigate cybersecurity risks against the DO Local Area Network. The DO LAN is the primary computing network used by DO. Its current cybersecurity features are robust, but they require improvement to address the ever-increasing worldwide cyber threat. Funds will support hardware, system audit and monitoring software, password management software, and FTEs.

The Government Security Operations Center currently serves as the Department-wide cyber incident response organization, responsible for monitoring, detecting, and addressing incidents, which includes monitoring the Department's Trusted Internet Connections and Managed Trusted Internet Protocol Service gateways. It works in coordination with Bureau security organizations to defend against traditional and advanced cyber attacks directed at the Department's systems and users, most notably advanced phishing-type attacks. Funds will be used, in part, to recruit technical analysts focused on data mining, who will analyze the technical aspects of cyber attacks in order to formulate detection, actionable defense, and mitigation strategies, which are generally outside the scope of the analytical work performed elsewhere in the Department. Funds will also support security intelligence analysis and advance cyber threat detection.

Data Leakage Protection System funds in the amount of $1,500,000 are requested in fiscal year 2015 budget for specialized technical services to implement a Data Leakage Protection (DLP) tool at non-IRS Internet perimeter points. The DLP will examine data, including e-mail being sent from the Department, to identify whether any sensitive data, such as personally identifiable or classified information, is being inadvertently transmitted.

Separately, OCC-specific investments include an increased focus by the Comptroller and OCC's senior IT staff on the effectiveness of OCC's cybersecurity program. OCC recently hired a new Chief Information Security Officer (CISO) with extensive cybersecurity experience in the banking, financial, and payment services sectors. Through the new CISO's leadership, OCC is pursuing several new cybersecurity technology initiatives in fiscal year 2015 and fiscal year 2016 to improve its capabilities to monitor and protect its sensitive information and data. OCC has also begun recruiting additional cybersecurity professionals with new skill sets needed to update and manage its security-related processes related to improving OCC's risk-based information security continuous monitoring capabilities.

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

Question. Treasury's Alcohol and Tobacco Tax and Trade Bureau (TTB) regulates alcohol and tobacco products by approving product labels and formulas to protect consumers from unsafe products, and collect significant revenue for the Treasury. In fiscal year 2013, TTB collected nearly $23 billion in excise taxes, which is a return of $243 dollars for every dollar spent to operate the bureau. However, the fiscal year 2015 budget proposes to cut funding for the TTB by $3 million, and then provide an additional $5 million under the program integrity cap adjustment.

—Why does the budget cut funding for this bureau— while the alcohol market continues to grow rapidly, and this bureau continues to collect significant revenue for the Treasury?

—Why is the budget cutting funding in the base budget, while proposing an increase under a cap adjustment that is not currently authorized?

Answer. The fiscal year 2015 President's budget includes a proposal to amend section 251 of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, to provide a program integrity cap adjustment of $5 million (of which $2 million will be used for agent support) for the Alcohol and Tobacco Tax and Trade Bureau (TTB)'s tax enforcement and compliance program to narrow the tax gap in the tobacco and alcohol industries and reduce the deficit through revenue collections. The budget proposes an increase in its alcohol and tobacco enforcement program, while working to increase operational efficiencies to support businesses getting their products to market. We recommend that Congress pass the proposed program integrity cap adjustment for both TTB and the Internal Revenue Service. The proposed cap adjustment for TTB tax enforcement and compliance activities includes $5 million in new revenue-producing tax compliance initiatives in fiscal year 2015 and $5 million in new initiatives each year from fiscal year 2016 to fiscal year 2019 and continued through fiscal year 2024. TTB will target known points in the supply chain that are susceptible to diversion activity and prioritize forensic audits and investigations of high-risk entities in the alcohol and tobacco industries. Because these new initiatives, as well as current enforcement activities, must be sustained over time in order to maximize their potential taxpayer returns, the total above-base adjustment funding is $193 million over the 10-year period. These additional investments will generate $285 million in additional tax revenue over the 10-year period. The net savings from these investments is $92 million.

HOUSING MARKET

Question. The Troubled Assets Relief Program of 2008, known as TARP, created several programs at Treasury to stabilize the housing market. The Making Homes Affordable program and Hardest Hit Fund help homeowners avoid foreclosure through refinancing and other mortgage relief. Though the housing market is showing signs of recovery, many homeowners are still struggling. The Government Accountability Office (GAO) recently reported that participation rates in these programs are declining.

—Do you believe these TARP programs continue to effectively help struggling homeowners?

—As the remaining TARP funds are expended and these programs begin to wind down, what will be the ongoing role of the Treasury Department in the housing market?

Answer. Under Making Home Affordable (MHA), there have been over 2 million homeowner assistance actions, including more than 1.3 million permanent mortgage modifications, to date. In addition, MHA has indirectly assisted millions more by setting new standards and prompting changes in industry practices that have led to more affordable and sustainable private modifications. In total, through government programs and additional private sector efforts, more than 6.9 million families have received help.

Although the housing market is recovering, many homeowners and communities are still dealing with the aftermath of the housing crisis. On average, 15,000 homeowners entered the program each month in 2013. The extension of MHA to December 31, 2015 will benefit many additional families, while maintaining clear standards, consumer protections, and accountability for the mortgage servicing industry.

Treasury remains focused on helping as many people as possible through the housing programs under TARP. We will continue to evaluate our programs in an effort to assist homeowners and communities who still need help. We will also ensure that as the programs wind down, they are done so in an efficient and well organized manner.

"MY RA" AND RETIREMENT SAVINGS

Question. This year's State of the Union address, the President announced a new initiative to encourage Americans to save for retirement. The "My RA" program would allow employees to set up automatic contributions from their paychecks to an IRA account, backed by the Government with the same interest rate offered to Federal employees.

—When will this program be available to employees and employers that want to use it?

—How much will it cost the Treasury Department to implement this new initiative?

Answer. Treasury is working to launch *my*RA in late 2014 with broader and scaled rollouts occurring in intervals over 2015 and 2016.

Treasury is currently in the process of evaluating proposals from potential financial agents to manage the program, and we are unable to provide an estimate of such costs until that process is complete. Treasury expects that there will be a minimal cost to operating the program, but we cannot provide an accurate estimate until we have actual data, including take up by *my*RA savers and the average duration of time these securities are held by participants.

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. A proposal requiring the Secretary of Treasury to enter into contracts with private collection agencies (PCAs) to collect Federal taxes is included in Sec. 6304 of the draft "Tax Reform Act of 2014" introduced by Chairman Camp, as well as in Sec. 305 of S. 2260, the "Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act" now pending in the Senate.

What was the result of a similar initiative that was in effect from 2006 to 2009?

Answer. The IRS has determined that the previous PCA initiative in effect actually lost money because the initiative imposed significant administrative costs on the IRS and resulted in the IRS' resources being diverted from higher priority collection cases to lower priority collection cases. To prepare for the 2006 to 2009 initiative, the IRS expended significant start-up costs. Although the Internal Revenue Code permits the IRS to retain 25 percent of the amount collected by PCAs, this amount proved insufficient to cover the costs of the 2006 to 2009 initiative and the IRS needed to use appropriated funds to maintain the initiative, decreasing the amount of funds the IRS could use to collect taxes from higher priority cases. During the 2006 to 2009 initiative, the IRS had a policy of attempting to resolve any cases that came back unresolved from the PCAs. IRS collection employees were therefore assigned to work lower-priority collection cases where the PCAs were unsuccessful. Ultimately, after taking all costs into account, the IRS concluded that the program lost revenue.

Question. Is it true that the IRS currently has the authority to use PCAs, but has chosen not to use that authority? Why?

Answer. Section 6306 of the Internal Revenue Code, which was added to the Code in 2004, permits, but does not require, the Secretary to enter into a "qualified tax collection contract." The 2006 to 2009 initiative was undertaken pursuant to this authority. As noted in the previous response, the 2006 to 2009 initiative lost revenue, taking all activities into account. In addition, taxpayers are not entitled to the same protections when PCAs attempt to collect tax debts as they are when the IRS does so. For example, the IRS is required to make its processes and procedures public, which it does by issuing the Internal Revenue Manual (IRM). IRS employees are required to follow the IRM, which prohibits aggressive collection practices. PCAs are not required to make their processes public, nor are they required to follow the IRM. During the 2006 to 2009 initiative, at least some PCAs were accused of using aggressive collection practices, such as exerting psychological pressure on taxpayers. In addition, IRS employees can be fired, fined, and/or imprisoned for the improper use or disclosure of tax return information; PCAs are not subject to these consequences for the improper use or disclosure of tax return information. So for reasons of revenue outcomes and taxpayer service, IRS has not chosen to use PCAs in the last few years.

Question. What are your agencies' positions on the proposal to require Treasury to use PCAs to collect Federal taxes?

Answer. Treasury has both administrative and policy concerns with the proposal requiring Treasury to use PCAs to collect Federal taxes, and does not support the proposal. From an administrative standpoint, requiring Treasury to use PCAs would impose significant start-up costs on the IRS to evaluate PCAs and enter into qualified tax collection contracts, and ongoing costs to monitor PCAs' collection activities. Because the proposal does not provide additional funding for the IRS, these costs would decrease the funds available to the IRS for other priorities, including its ongoing enforcement activities. Moreover, previous experience with PCAs has taught us that the IRS has a much higher return on investment than PCAs, making this proposal a less effective use of taxpayer dollars. We are especially concerned that making the use of PCAs mandatory requires the Treasury to continue using the program, even if the evidence demonstrates that using PCAs loses revenue. From a policy perspective, we have several concerns with the proposal. Most significantly, the types of tax receivables excluded from qualified tax collection contracts are too limited (for example, the proposal does not exclude cases where collection could result

in economic hardship). In addition, the proposal does not contain adequate safeguards to protect taxpayer rights. PCAs are not subject to the same requirements as the IRS for safeguarding tax return information and are not subject to the same consequences as IRS employees if they improperly use or disclose tax return information.

Question. What impact could this requirement to use PCAs to collect Federal taxes have on taxpayers, specifically low-income taxpayers?

Answer. We have several concerns about the impact of this requirement, including that (1) it could result in economic hardship for taxpayers who have an outstanding tax liability that they cannot currently afford to pay in full, and (2) the lack of due process and other taxpayer protections similar to those that apply when the IRS collects a tax liability could lead to potential abuse by PCAs and reduce future voluntary compliance by affected taxpayers.

To determine the extent to which the proposal would affect low-income taxpayers, IRS used parameters similar to those in the proposal and prepared a preliminary estimate of individual taxpayers who could be affected by the proposal. This analysis determined that the overwhelming majority of individual income taxpayers potentially affected by the proposal would have incomes below 250 percent of the Federal poverty level. We are concerned that low-income taxpayers could be pressured into committing to payment schedules that they cannot afford to keep, which could damage their credit rating and their ability to remain current with respect to their tax liabilities. Moreover, unlike the IRS, PCAs have no incentive to engage in taxpayer outreach and education, which is particularly beneficial to low-income taxpayers and other underserved populations and which may help promote future tax compliance.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

Question. Describe the role of your agency's Chief Information Officer (CIO) in the oversight of IT purchases. How is the CIO involved in the decision to make an IT purchase, determine its scope, oversee its contract, and oversee the product's continued operation and maintenance?

Answer. The Deputy Assistant Secretary (Information Systems)/CIO is responsible for implementing Federal policy contained in the Clinger-Cohen Act, Federal Information Security Management Act, Paperwork Reduction Act, E-Government Act, Government Paperwork Elimination Act, and other IT-related statutes and Executive Orders. The CIO's functions and responsibilities include:

1. providing advice and other assistance to the Secretary of the Treasury and other senior management personnel of the Department to ensure that information technology is acquired and information resources are managed consistent with the policies and procedures of Clinger-Cohen;
2. developing, maintaining, and facilitating implementation of a sound and integrated information technology architecture for the Department;
3. promoting effective and efficient design and operation of all major information resources management processes for the Department;
4. chairing the Treasury CIO Council and Treasury Technical Investment Review Board to ensure sound decisionmaking;
5. developing, maintaining, and facilitating implementation of Departmental IT guidance, including policies, procedures, manuals, and/or guidelines relative to the Department of the Treasury classified and sensitive but unclassified telecommunications security and unclassified computer security programs of all Departmental elements;
6. promoting effective use of information technology for public access to public information and facilitating Treasury-wide electronic information dissemination programs in accordance to statutes and regulations;
7. establishing and implementing sound information management activities as they relate to the Department's records management and information collection programs;
8. monitoring the performance of information technology programs of the agency, evaluating the performance of those programs on the basis of the applicable performance measurements, and advising the Secretary regarding whether to continue, modify, or terminate a program or project;
9. assessing and determining the strategy for ensuring adequate IT workforce capabilities; and
10. partnering with the Department's Chief Financial Officer (CFO) to ensure that the capital planning and investment are integrated into the budget process.

Question. Describe the existing authorities, organizational structure, and reporting relationship of the IRS Chief Information Officer. Note and explain any variance from that prescribed in the Information Technology Management Reform Act of 1996 (aka, The Clinger-Cohen Act) for the above.

Answer. The IRS Chief Technology Officer reports directly to the IRS Deputy Commissioner and has a dotted line relationship with the Treasury Deputy Assistant Secretary for Information Services and Chief Information Officer. Coordination, oversight, and compliance are conducted in part through the Treasury Technology Investment Review Board (TTIRB), which is a monthly review by a committee composed of officials from across the Department. Further coordination and consolidated Department-wide reporting is managed through the TTIRB and Treasury CIO Council, which includes all bureau-level CIOs and is chaired by the Treasury CIO. In addition to reporting in accordance with the Clinger-Cohen Act, Federal Information Security Management Act, Paperwork Reduction Act, E-Government Act, Government Paperwork Elimination Act, and other IT-related statutes and Executive Orders, the Treasury CIO has embedded annual performance metrics into the bureau CIOs/Chief Technology Officers (CTOs) performance plans, including the IRS CTO's plan. The IRS's separate appropriation provides the IRS with significant independence in managing their IT portfolio in the context of supporting their unique mission.

Question. What formal or informal mechanisms exist in your agency to ensure coordination and alignment within the CXO community[1] (i.e., the Chief Information Officer, the Chief Acquisition Officer, the Chief Finance Officer, the Chief Human Capital Officer, and so on)? How does that alignment flow down to agency subcomponents?

Answer. Treasury's new 2014–2017 strategic plan represents the goals and strategies for the diverse financial and economic activities of the Department, including achieving organizational excellence in support of Treasury's operational mission. The plan enables members of the CXO community to align themselves to a clear set of Departmental management goals and corresponding strategies, including increasing workforce engagement, performance, and diversity; supporting effective data-driven decisionmaking; promoting efficient use of resources; and creating a culture of customer service.

To improve alignment of these Departmental goals and priorities, it is Treasury policy that the functional program heads at Departmental Offices establish additional Department-wide strategic goals and objectives, as well as individual performance expectations and uniform language, which is incorporated into the performance plans of Bureau functional program heads (CXOs).

Finally, there are numerous forums, councils, and policies that enable coordination and alignment across the CXO community and within each functional area, including alignment from headquarters to bureaus. For example, since 2010, Treasury has been conducting quarterly performance reviews in support of Government Performance and Results Act (GPRA)-Modernization Act to drive accountability and produce results in the management space. Departmental program heads also regularly convene their bureau counterparts through forums such as "HR Stat" and the "CFO council" to discuss policy and ongoing events in each CXO area of expertise.

Question. How much of the agency's budget goes to Demonstration, Modernization, and Enhancement of IT systems as opposed to supporting existing and ongoing programs and infrastructure? How has this changed in the last 5 years?

Answer. In fiscal year 2015, 23 percent of Treasury's IT budget will go to Development, Modernization, and Enhancement (DME). Generally Treasury has seen an increase in DME spending from fiscal year 2011 where 19 percent of Treasury's IT Budget was applied to DME.

Question. Where and how is the IRS taking advantage of this administration's "shared services" initiative? How do you identify and utilize existing capabilities elsewhere in government or industry as opposed to recreating them internally?

Answer. IRS has actively participated in the Federal Government Shared Services initiative over the past several years. Currently IRS primarily utilizes Federal Government shared services through the Treasury Franchise Fund (TFF) that is supervised and managed by the Department of the Treasury. The fiscal year 2014 estimate for the IRS shared services provided by the TFF is $95 million. Some of the services IRS receives through the TFF include:

[1] The CXO Community is a peer-to-peer community exclusively for C-Level executives (CEO, COO, CPO, CFO, CIO, CTO, CKO, CMO, CAO, CVO, CRO, CLO, CSO, CDO, President, Chairman and MD).

—HR Connect, which delivers human capital services and interfaces with the Department of Agriculture's National Finance Center, which provides payroll processing and support;
—Web Solutions, which provides collaboration sites and support for IRS Webmasters and content managers;
—Treasury Enterprise Identity Credential & Access Management provides Personal Identification Verification, Physical Access Controls, Logical Access Controls for local, remote & mobile devices;
—Government Secure Operations Center serves as the focal point for management of cyber incidents and is responsible for security detection, analysis & incident management lifecycle practices; and
—A number of other smaller programs that provide non-IT services, including the Office of Small and Disadvantaged Business Utilization, which advises and aids the bureaus on small business policies and initiatives; Treasury Operations Excellence, which provides Lean Six Sigma training and other services to help Treasury and other Federal agencies use entrusted resources more effectively and efficiently; and the Privacy, Transparency, and Records program, which provides assistance to Treasury customers to collect, protect, retain, preserve, disclose, and provide access to Treasury's information resources pursuant to U.S. laws.

IRS also offers shared services to other agencies through Reimbursable Agreements. These include procurement services and use of Call Centers by FEMA for disasters.

Question. Provide short, two-page, summaries of three recent IT program successes—projects that were delivered on time, within budget, and delivered the promised functionality and benefits to the end user. How does the IRS define "success" in IT program management?

Answer.—

Project #1: IRS.gov/Enterprise Portal

In August of 2011, the IRS Information Technology organization set out to deploy enhanced Web services including a straightforward, manageable Web environment, established end-to-end operational accountability and visibility, and a cost-effective program structure.

Additionally, the IRS sought to address the following challenges:
—Exponential growth of online electronic filings and taxpayer access to information;
—Difficulty balancing system capability to meet demand (scaling horizontally);
—Inconsistent user experiences for the taxpayer and tax preparer;
—Limited ability to share data and content between the IRS user communities;
—Difficulty focusing on serving end users (taxpayers and preparers) in an end-to-end fashion, and
—Multiple portals with numerous services to maintain.

The solution was the Integrated Enterprise Portal (IEP), an innovative, cost-effective system that provides a scalable, managed private cloud capability to the IRS, enabling one-stop, Web-based services to internal and external users. The IEP has transformed the way the agency creates, launches and administers its taxpayer- and employee-facing applications. At its most basic operational level, it allows the IRS to get business-critical applications to the live environment more quickly, while enhancing cost predictability and security.

Recent IEP Program Successes:
—*Registered User Portal (RUP) Deployment*.—RUP, deployed on-time and within budget in September 2013, implemented a secure, FISMA-moderate (Federal Information Security Management Act framework risk classification), scalable, managed private cloud which provides a shared portal infrastructure that consolidates the IRS platforms under a single, flexible, and scalable platform. The RUP is the IRS external portal that allows registered individuals and third party users, where registration and login authentication are required for access, to interact with selected tax processing and other sensitive systems, applications, and data.
—*Filing Season 2014*.—The 2014 tax filing season marked the IRS's first season fully "in the cloud." Going into tax season there was uncertainty driven by the fact that deployment occurred just a few short months earlier—a period of time made even shorter by a 3-week Government shutdown. Additionally, the IEP was predicted to face an unprecedented amount of traffic and filings. Despite these circumstances, the IEP not only delivered, but exceeded expectations han-

dling the highest number of electronic returns and traffic ever—all with 100 percent availability and zero Priority 1 or Priority 2 incidents. This was a season of unprecedented peaks for the IRS that set a new standard for tax seasons to come. For example, on 2/6/14 the IEP successfully handled the "Where is My refund" application peak of 5.8 million unique daily visitors at a peak volume of 15,000 transactions/minute. Detailed statistics are as follows:

Portal key performance metrics January 11 to April 17, 2014:

—224.1 million total returns submitted (Federal + State);
—1.025 billion IRS.gov page views/263 million IRS.gov site visits; and
—132.7 million page views during seasonal peak week.

"Where's My Refund" accessed via IRS.gov Web site:

—136 million page views;
—112 million site views; and
—15,000 peak transactions/minute.

—*New Technical Capabilities to support the Affordable Care Act (ACA) effort*.—A new Transactional Portal Environment (TPE), which is a series of capabilities that reside within the IEP, was needed to support the new Affordable Care Act (ACA) program. The ACA TPE supports secure Application-to-Application (A2A) interfaces between Health and Human Services (HHS) Centers for Medicare & Medicaid Services (CMS) and the IRS. The new portal solution was implemented on-time and on-budget to support the beginning of open enrollment in the Marketplaces in October 2013. The IRS achieved the business objective to deploy a TPE solution providing CMS access to ACA services and providing 24/7 monitoring and support, daily reporting, and confirmation that initial traffic was within anticipated thresholds.

Key metrics for October 1, 2013 to April 15, 2014:

—TPE successfully processed 45 million requests for Income and Family Size Verification (IFSV) and Premium Tax Credit (PTC) computation services in real time from CMS.

—*Employee User Portal (EUP)*.—In late December 2013, a production IRS Employee User Portal (EUP) environment was successfully transitioned to the IEP. The IRS completed this transition ahead of schedule in response to a request by the IEP Governance Board to pull in the transition schedule in order to begin transitioned production operations prior to the beginning of Tax Filing Season 2014. Production operations of the newly transitioned environment were supported without a Priority 1 or 2 incident throughout the 2014 Tax Filing Season (January 2014 to April 2014). In addition to supporting transition and filing season operations of the existing EUP infrastructure, the IRS conducted initial analysis and concept of operations discussions about the future state of the EUP that would align with the goals of data center optimization and consolidation.

Definition of "Success"

Success was clearly defined on this program with deliverables completed on time, within budget, and with the promised functionality to achieve the Authority to Operate (ATO) recommendation from Cyber Security and planned business results.

Project #2: CADE 2

The Customer Account Data Engine 2, known as the CADE 2 program, is implementing a single, data-centric solution that provides daily processing of taxpayer accounts.

A critical component of the CADE 2 program is an authoritative database for individual taxpayers that provides more efficient and effective tax administration. The new database is the heart of the solution. It will transform the way the IRS approaches tax administration into the future. It improves taxpayer services by providing the capability to view taxpayer account data stored in the CADE 2 database with on-line viewing by IRS customer service representatives, as well as analytical reporting for more meaningful business intelligence and expanded opportunities to increase compliance.

As the IRS continues to invest in its data-centric vision in fiscal year 2015, CADE 2 will enable an enterprise-wide data environment that extends business capabilities, promotes efficiency, and increases productivity by ensuring the fidelity, security, and understanding of IRS data. This is essential to effectively enable the IRS to leverage 21st century technologies such as cloud computing, Web services, elec-

tronic submissions, e-Authentication, big data and data analysis, and computing as a commodity, to name a few.

With deployment of CADE 2 Transition State 1 (TS1), the IRS took a leap forward from a technology standpoint, moving the management of IRS's individual taxpayer account data from 1960's sequential flat-files stored on magnetic tapes, to state-of-the-art relational database technology. The IRS is now conducting transactional processing of account data for over 270 million individual taxpayers and over a billion tax modules on a modernized DB2 relational database. The IRS data is now stored in relational formats dictated by a state-of-the-art data model that maintains historical values never before retained on taxpayer account transactions and facilitates daily viewing of taxpayer account data by IRS customer service representatives. CADE 2 TS1 is offering faster refunds, faster notices, faster payment postings, and improved service for millions of taxpayers as well as a solid foundation for our data-centric vision. As of the end of April 2014, CADE 2 had posted 116.97 million returns and issued 101.67 million refunds totaling $269.30 billion for filing season 2014.

The IRS is now well positioned to take the essential next step in its data-centric vision—rewriting its core taxpayer account processing applications so they can leverage the benefits of the new, high-powered CADE 2 relational database environment. Prototypes are being conducted to validate our assumptions about our approach to this effort. Once our applications are re-written into a modern programming language and are able to effectively populate the new CADE 2 relational database based on its modernized data model, it will become the authoritative source for individual taxpayer account data for the IRS. This CADE 2 effort, called Transition State 2 (TS2), will enable the IRS to address its longstanding unpaid assessments financial material weakness which has added substantial risk to IRS custodial accounting and clean audit opinion for nearly 20 years.

TS2 will ensure the long-term viability of the IRS tax processing systems by addressing the limitations and risks associated with the aging architecture and the design of our legacy core tax processing systems, as well as the outdated programming languages that are difficult to maintain.

Investments in CADE 2 TS2 are already delivering benefits to taxpayers with the rollout of the Penalty & Interest (P&I) common code base on January 2, 2014. After years and years of discrepancies among various systems in calculating penalty and interest, a new application is now calculating penalty and interest consistently on individual and business accounts for taxes that are not received by the due date across our master files (Business Master Files and Individual Master Files). It is also providing service improvements for taxpayers such as more accurate notices, consistent penalty and interest calculations, and enhanced service, as Customer Service Representatives have more accurate information and are better able to assist taxpayers in meeting their tax filing and payment obligations. The solution uses the existing master file common code modules as baselines and incorporates additional requirements for the Integrated Data Retrieval System (IDRS).

CADE 2 is a game changer for the IRS, and once complete it will enable many opportunities for the IRS to transform the way we approach tax processing today and into the future.

Project #3: Filing Season

At the core of the IRS's operations is an IT infrastructure that has been foundational to administering the U.S. Federal tax code since the early 1960's. Deployment of IT infrastructure in support of Filing Season 2014 resulted in many successes, in spite of a tough budget environment that resulted in three agency furlough days, hiring freezes and a 16-day Government shut down that delayed the opening of filing season. Through collaborative efforts of hundreds of IT and Business staff and consistent assessment of risks and mitigation of impacts, the IRS was able to continue its record of timely deployment of IT systems for filing season 2014, enabling improved taxpayer services, increased compliance, and enhanced security against threats to the Nation's tax system, with marked improvements in production statistics over previous years.

The IT infrastructure for Filing Season 2014 is extraordinarily large and complex, putting it in a class of its own in comparison to other tax systems around the world. The IRS deployed 67 critical filing season systems comprised of thousands of programs written in many programming languages and technology platforms that have been developed over decades to support the growing tax code. These complex systems provided the intelligence and capacity to process about 250 million tax returns submitted electronically and on paper between January 2 and April 15, filtering out fraud and generating over a million refunds totaling roughly $250 billion. These systems capture and move massive amounts of data from program to program under

strict limitations set by service level agreements that govern the complex tax return process. They support filing season core tax processing, collection, and exam activities for every taxpayer in the country, and then send the appropriate financial data to IRS's general ledger to execute fiduciary responsibilities and ensure integrity in management of U.S. Government funds. Underlying the critical systems is a complex communications infrastructure of local and wide area networks, with computer hardware and other IT devices and supporting systems that successfully routed over 58 million taxpayer telephone calls with 100 percent system uptime, providing 24x7 taxpayer access to the IRS for Filing Season 2014. The IRS also maintains various technology components and processes that mitigated hundreds of cyber incidents and ensured the continued security posture of our systems, networks, computers and printers, including thwarting three serious cyber threats (e.g., "Heart-bleed", Microsoft Word and Microsoft Internet Explorer) during peak tax processing season.

Readiness activities to prepare the IRS's labyrinth of IT systems and processes for Filing Season 2014 included identifying and training IT specialists to implement world class system end-to-end monitoring, control room 24x7 coverage, and enhanced incident management to support filing season execution. Modernized systems using new technologies were developed and successfully deployed in Filing Season 2014, and hundreds of programming changes were made to our core systems, updating them to incorporate changing tax law. Updates to infrastructure configurations and upgrades to hundreds of computer hardware components, software applications, databases, operating systems, networks, communication devices, and procedures were necessary for smooth execution and protection from hackers and intruders. Systems Acceptability Testing (SAT) and Final Integration Testing (FIT) was completed for 133 projects, including execution of 62,000 test cases to provide assurance of a successful launch.

A Processing Year Delivery Assurance Executive and program management office provided leadership over the Filing Season 2014 activities within the IT organization, and over the many suppliers who assumed responsibilities in development and execution. An integrated Filing Season 2014 governance framework provided enterprise risk and readiness assessments to address and mitigate every issue. Filing Season readiness standard operating procedures were followed, with weekly and then daily operational meetings across the breadth and depth of the enterprise using red/yellow/green reporting for each critical system. Readiness certifications were required at all levels of the organization to signify readiness and ensure stakeholder accountability in execution.

Operational results in Filing Season 2014 show many successes and significant improvements over Filing Season 2013:

—Priority One incidents were down 42 percent from previous Filing Season.

—Modernized e-File (MeF) system had one of the best filing seasons on record, enabling taxpayers to electronically submit over 221 million individual returns along with over 12.5 million Business Master File returns (as of 5/27/2014)—an increase of 3.08 percent for submitted returns compared to the same period in 2013.

—CADE 2 had a smooth filing season launch of its core processing systems in Filing Season 2014 and continues to demonstrate full integration into Filing Season Operations.

  —CADE 2 database is feeding 16 downstream systems, and allowing over 50,000 Customer Service Representatives and other IRS users to view CADE 2 data.

—IRS.gov enabled more taxpayers to avoid wait times on phones. With no interruption in service, usage on the Web site from 3/1–5/31/2014 includes 595 million IRS.gov page views and 143.2 million Web site visits.

—"Where's My Refund" inquiries using IRS.gov equated to 6.7 million page views and 5.8 million site visits from 3/1–5/31/2014.

—The "Get Transcript" application delivered over 11 million transcripts to taxpayers and IRS customers from 1/13–5/28/2014, allowing them to view/print a PDF file of their transcript.

—E-Services enhancements enabled State users to get copies of transcripts for individuals who are victims of ID Theft. Previously, only IRS employees could request these transcripts.

—Enhancements to Enterprise eFax service (EEFax) increased the number of faxes that can be delivered to taxpayers at one time and reduce annual expenses for hardware, software and telecommunication lines.

—New End to End (E2E) application and infrastructure monitoring and auto-ticketing enhanced operation of many Filing Season Critical Systems.

—Enhancements to the Online Payment Agreement (OPA) program were successfully implemented in Filing Season 2014 making it easier for the online user to navigate the OPA Web page and establish installment agreements.

Question. What "best practices" have emerged and been adopted from these recent IT program successes? What have proven to be the most significant barriers encountered to more common or frequent IT program successes?

Answer. Many IT best practices have emerged from our successes at the IRS, particularly in the last few years when IRS executives, architects, engineers, and subject-matter experts have taken more of a lead role in program leadership, systems design, applications development, and systems integration. While many of the best practices are shared across various program management offices—enabled by sharing of toolkits, post-implementation reviews, and collaboration (cross-membership) among governance bodies, etc.—the following are best practices reported by the three specific program offices that reported their successes in the previous question above:

Project #1: IRS.gov/Enterprise Portal

The portal team used best practices such as:

—*Elastic Scalability*.—A recent best practice that resulted in an IT program success was our use of elastic scalability on demand. This "on-demand" capability was successfully utilized to scale the "Where's My Refund?" application on a peak day by 300 percent in a matter of hours. This approach is being successfully applied to business critical applications inside the IRS firewall for Filing Season 2015.

—*Overcoming Barriers*.—One of the key barriers to adopting rapid cloud provisioning was overcome by striking a good balance between maintaining the stability of the applications and limiting the changes during filing season.

Project #2: CADE 2

With regard to best practices, CADE 2 was sponsored at the highest level . In 2009, the IRS Commissioner himself formally launched the CADE 2 program and each Commissioner since then has strongly endorsed it since its inception.

CADE 2 has been managed under a delivery partner operating model, jointly led and governed by IRS executives across Information Technology and the technology industry. With the flexibility, to use critical pay and other authorities to recruit industry leaders and experts with a mix of knowledge in legacy and modernized systems, augmented by a small cadre of in-house subject matter experts, the program was staffed with the right mix of people.

—CADE 2 established a governance model that includes an Executive Steering Committee with representation at the highest levels of the organizations; a Governance Board that has the expertise to enable them to make critical decisions and assume accountability for the outcome of the program; an Executive Oversight Team that meets regularly with accountability for day-to-day identification of risks and progress in addressing those risks across the program; and advisory councils that provide technical advice and subject matter expertise as needed.

—The CADE 2 Program Management Office (PMO) serves with clear authority and lines of accountability assigned to the Business and IT delivery partners. This collaborative program management model was supplemented by high performing workshops early on in the program to develop techniques such as granted trust, generous listening, and rules of effective engagement, which has resulted in growing an in-house capability to manage complex systems using industry best practices that keeps decisionmaking on the side of the government.

—The CADE 2 PMO produced four foundational documents that drive the program:

  —Program Charter describes who we are—mission, goals, operating principles;

  —SolutionsArchitecture documents where we are now and where we are going—aligned with agency architecture;

  —Program Roadmap outlines how we are going to transition to target state; and

  —Program Management plan defines management principles, practices, and processes that will be used.

—The program institutionalized a solid process around messaging to ensure open, accurate and consistent communication with regular report-outs to ensure full transparency and ongoing understanding of progress and risks on the program by all oversight bodies, audit agencies, agency top executive team, delivery and business partner executives, and stakeholders.

—The CADE 2 PMO engaged people IRS-wide in an organizational readiness plan to support the new solution in order to gain maximum benefits and results. Many organizational readiness activities were conducted, such as training sessions on the new production process and how to address and resolve issues within a short timeframe, a control room staffed 24x7 with subject matter experts to provide production support, and formulation of special teams charged with driving testing to complete prior to deploying.

Overcoming Barriers:

—Previous barriers such as getting the business to the table to build requirements and own decisions along the way were mitigated through the comprehensive governance model.
—Burden from audits and other oversight reporting requirements was mitigated by inviting the Treasury Inspector General for Tax Administration (TIGTA) and the Government Accountability Office (GAO) to partner with us throughout the full life-cycle of the program to address risks and building solutions to mitigate them in real-time.
—Issues around funding were managed at the highest levels of the IRS, to get the resources that were needed in a timely manner to meet the program objectives.
—Cultural issues around "change" and "ownership" were addressed by the CADE 2 program manager and other IRS executives encouraging shared commitment for the success of the program.
—Individuals and work teams that previously worked with siloed knowledge of IRS systems were brought together to understand the "big picture" to effectively implement the CADE 2 integrated solution.
—The CADE 2 program manager and other IRS executives personally conducted workshops and coaching sessions using high performance communications techniques and contextual leadership to provide the vision and "line of sight" to break down silos and barriers within the IRS.

Project #3: Filing Season 2014

Many of the best practices used in other large IT programs have been adopted by the Filing Season Readiness program, including:

—Right-sized governance bodies that included stakeholders from IT and business organizations that are at the appropriate level of their organizations where they can readily represent their organization's interest and make decisions.
—Dedicated Filing Season program management office (called the Processing Year Delivery Assurance function) with lead executive that assumed point of accountability for success:
  —Enabled strengthened supplier management and engagement resulting in more tightly integrated incident and problem management.
  —Used various disciplines to promote data-based decisionmaking, such as Filing Season Readiness dashboards, and simulation/predictive modeling to project volumes and impacts.
  —Conducted regular preparatory meetings with all stakeholders, with accelerated frequency as filing season approached, where action items with tracked to completion.
—Enhanced organizational readiness with tabletop exercises to help anticipate Filing Season operational organization and process issues.
—Lessons Learned captured that resulted in over 250 recommendations for improvement/action in 31 areas:
  —Implemented IT Filing Season Readiness Framework—a repeatable process for cross-organizational management of readiness—including defining Filing Season Readiness SOP.
  —Created and validated a Control Room SOP based on experience and best practices that is now available to guide establishment of Control Rooms for other business systems.
—Obstacles were overcome using aggressive risk mitigation framework:
  —Integrated risk and readiness assessments into the Filing Season delivery cadence, strengthening evidence-based decisionmaking capabilities.

Question. Describe the progress being made in your agency on the transition to new, cutting-edge technologies and applications such as cloud, mobility, social networking, and so on. What progress has been made in the CloudFirst and ShareFirst initiatives?

Answer. In 2010, Treasury was the first civilian agency to move key Web assets to a commercial cloud provider with the launch of Treasury.gov, as well as other

Web sites. It has become the go-to solution for offices and Bureaus within Treasury needing to establish Web sites or Web applications, and it is poised to grow further. Treasury is also currently working to establish a private (Treasury) cloud infrastructure so that any application or data hosted by a Treasury bureau can quickly be migrated to the private cloud and be securely provisioned for use by Treasury's many constituencies.

Treasury has a long history of being a shared services provider offering essential services (both business and technical) to constituencies both within and external to our Department. HR Connect is one of the six approved Federal Office of Personnel Management (OPM) Human Resource Lines of Business (HR LoB) Shared Service Centers providing HR-related services in the Federal Government. HR Connect currently services 22 entities, 6 of which have been fully integrated in the last 5 years. BPD's Administrative Resource Center (ARC) is recognized across government as a leader in multiple service lines. Of particular note, ARC is approved by OMB as a Center of Excellence for Financial Management and a public key infrastructure shared service provider. Additionally, ARC is designated as a Human Resource Line of Business Shared Service Center, through its partnership with Treasury's HR Connect, and recognized by the General Services Administration (GSA) as an Information Systems Security Line of Business Shared Service Center for Security Assessment services.

Question. How does your agency implement acquisition strategies that involve each of the following: early collaboration with industry; Request for Proposals (RFP) with performance measures that tie to strategic performance objectives; and risk mitigation throughout the life of the contract?

Answer. The Department of the Treasury strongly encourages early collaboration with industry to facilitate best meeting customer requirements through effective planning and contracting. As appropriate for the complexity and dollar value of a specific procurement, Contracting Officers may utilize one or more tools to facilitate early communications with industry, to include (but not be limited to) meetings with vendors, issue of a Request for Information (RFI), and/or hosting of a pre-solicitation conference or Industry Day. Collaborative actions most suitable to a requirement should be identified early in the acquisition process and addressed in the acquisition plan.

In coordination with the internal customer (requiring activity), the Contracting Officer develops specific deliverables and metrics appropriate for the type, complexity, strategic objectives, and desired outcomes of each contract to ensure the best outcome for the Government.

By focusing pre-award and post-award, we can help mitigate risk. Prior to issue of a solicitation and subsequent contract, the Contracting Officer works with the internal customer to ensure use of the most appropriate contract type, inclusion of appropriate internal controls and risk-mitigating strategy in the performance work statement and/or solicitation, and development of a comprehensive and effective plan for Government monitoring of contractor performance. These decisions and actions should be addressed in the acquisition plan for the specific procurement. After award of a contract, risk mitigation is achieved primarily through performance monitoring conducted by the Contracting Officer Representative (COR); immediate Government action on any unsatisfactory performance issues; and, a thorough review by the Contracting Officer prior to the exercise of any option on a multiple year contract to ensure that the Government's requirement remains unchanged and the vendor is performing in accordance with the contract.

Question. According to the Office of Personnel Management, 46 percent of the more than 80,000 Federal IT workers are 50 years of age or older, and more than 10 percent are 60 or older. Just 4 percent of the Federal IT workforce is under 30 years of age. Does your agency have such demographic imbalances? How is it addressing them? Does this create specific challenges for attracting and maintaining a workforce with skills in cutting-edge technologies? What initiatives are underway to build your technology workforce's capabilities?

Answer. Treasury has similar demographic imbalances. In September 2013, 3 percent of Treasury's IT workforce was under the age of 30 versus 54 percent being over the age of 50 and 13 percent being over the age of 60. Over the last several years, Treasury has utilized buyouts as a method for addressing this imbalance in the workforce. Treasury uses the Pathways program, including internships, recent graduates, and the Presidential Management Fellows program as a method to build the technology workforce.

It is Treasury's human capital vision to be widely recognized as an employer of choice and to employ an engaged workforce that sets the standard for excellence in the Federal Government. Treasury will develop and manage innovative human capital business practices that help supervisors/managers and employees deliver re-

sults—focused outcomes that support the strategic goals and objectives of the Department by improving workforce productivity, diversity, leadership effectiveness, and individual development.

Question. What information does your agency collect on its IT and program management workforce? Please include, for example, details about current staffing versus future needs, development of the talent pipeline, special hiring authorities, and known knowledge gaps.

Answer. Treasury's Office of the Chief Human Capital Officer (CHCO) is piloting a workforce-planning model that uses a guided inquiry approach to assist managers in evaluating their current workforce and to make projections regarding future workforce requirements. The approach relies on identification of staffing levels and competencies needed in the future; analysis of the present workforce; comparison of the present workforce to future workforce needs in order to identify gaps and surpluses; development of strategies for building the workforce needed in the future; and an evaluation process to assure that the workforce plan remains valid and that objectives are being met to ensure the long-term sustainability of the organization.

Once the data is consolidated, it will be aggregated to create a strategic action plan that will be provided to the CIO and the CHCO for review and analysis of crosscutting issues. Such issues could result, for example, in the identification of opportunities to realign employees across bureaus or identify efficiencies that might be gained through restructuring, e.g., consolidating multiple bureau contracts into a single Department-wide contract.

Treasury utilizes the Federal Acquisition Certification for Program and Project Managers (FAC–P/PM) program for its acquisition and project management workforce. FAC–P/PM tracks program and project managers' certifications and skills through training, experience, and other developmental activities related to acquisition and project management. Tracking of FAC–P/PM training and certification is done in the Federal Acquisition Institute Training Application System (FAITAS).

QUESTIONS SUBMITTED TO HON. JOHN KOSKINEN

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

RESTORING IRS STREAMLINED CRITICAL PAY AUTHORITY

Question. As part of the 1998 restructuring of the IRS, Congress authorized some special personnel flexibilities to help the IRS recruit and retain highly skilled employees with specialized expertise.

"Streamlined critical pay authority" permits the IRS Commissioner to bring in up to 40 uniquely qualified experts for 4 year appointments to revitalize and enhance the IRS workforce.

Use of the authority is permitted only under certain conditions: (1) the positions must require expertise of an extremely high level in an administrative, technical, or professional field and critical to the IRS's successful accomplishment of an important mission; and (2) exercise of the authority must be necessary to recruit or retain an individual exceptionally well-qualified for the position.

The original authority had a 10 year sunset and was renewed in 2008 for 5 additional years, but has now lapsed as of September 30, 2013. The President's fiscal year 2015 budget seeks language to reinstate the authority.

How has the IRS used streamlined critical pay authority?

Answer. The IRS has found streamlined critical pay (SCP) authority to be an enormously useful tool in recruiting top-tier talent, especially in helping us to recruit information technology experts from the private sector. The IRS used SCP authority to attract executives for high-demand Information Technology (IT) programs, as well as other specialized functions requiring state-of-the art skills and specialized expertise. SCP authority allowed the IRS to streamline the hiring process and offer additional incentives to high-level executives and technical experts needed for key positions. It was included in the Internal Revenue Service Restructuring and Reform Act of 1998 as a means of assisting the IRS in attracting private-sector experts to bring their knowledge and skills to the IRS for a period of time.

Question. What types of positions has this authority enabled the IRS to fill?

Answer. Currently, over 82 percent of SCP positions are related to IT areas, such as: systems architecture development, migration of new integrated processing systems, design and delivery of innovative Web capabilities and mobile applications, cybersecurity, risk management, infrastructure support, and Enterprise Portfolio Management.

The IRS also used SCP authority to recruit for key positions outside the IT field which include: Director of the Office of Professional Responsibility/Standards of Tax Practice, Senior Advisor to the IRS Commissioner (Compliance Analytics Initiatives), Director of Compliance Analytics, Strategy and Implementation Program, and the Senior Technical Advisor to the Deputy Commissioner for Services and Enforcement.

Question. What have been the benefits to the IRS and the public it serves?

Answer. SCP authority enabled the IRS to meet the challenge of recruiting executives with certain high-demand skills. It has clearly helped to improve, modernize and secure the information technology capabilities of the IRS. Executives the IRS brought in under the SCP authority have significantly updated the core tax processing system, developed and implemented Modernized e-file systems, and implemented the Treasury Network (TNET). One of the best examples of the benefits achieved through use of SCP talent was the implementation of the Customer Account Data Engine, Transition State 1 (CADE TS1). CADE2 TS1 changed a 50-year-old weekly batch cycle processing design into a daily processing system and moved the data of over 140 million taxpayers to an updated computer system. This achievement transformed the way the IRS serves our Nation's taxpayers by providing faster access to data and the ability to issue tax refunds more quickly.

SCP Executives bring a talent that is highly complementary to the talent already on board within the IRS. This melding of career Federal Executives and expertise from the private sector has been instrumental in moving the IT organization to be world-class in the people process and technology areas. Another example of the success of this approach was demonstrated in January 2013 when the Government Accountability Office (GAO) removed the IRS Modernization from their Federal High-Risk Programs list. GAO acknowledged that the IRS took necessary steps to fix weaknesses by creating cross-functional working groups to fix at-risk control areas, improved the encryption of information transferred between accounting systems and upgraded the Cybersecurity of internal systems. Additionally, the IRS addressed its outdated operating system and application software, improved its auditing and monitoring capabilities of its general support system and tested its general ledger system for tax transactions in its current operating environment. These accomplishments were a direct result of the collaboration and leadership provided by a combination of Senior Executive Service (SES) and SCP Executives. Without this authority, the IRS's ability to successfully deliver critical functions is at risk.

Question. What are your concerns if this now-expired authority is not renewed?

Answer. Absent the SCP authority, the IRS's ability to attract and recruit individuals, especially in the IT field, who have current, relevant private-sector experience in successfully developing and delivering cutting edge projects and programs has been hampered significantly.

The IRS utilized the SCP authority to not only meet its short and long range goals, but also to keep pace with the technological advances needed to provide world class services to America's taxpayers. Without SCP authority, the IRS's ability to perform certain vital functions will be hampered, including:

—Ensuring the IRS has top talent required by components of the IRS mission that need cutting edge talent in technology;
—Providing executive leadership for all highly complex, mission critical information systems that underpin our Nation's tax administration system;
—Administering internal IRS systems, as well as driving changes for the interface of the IRS information systems with those of multiple external partners;
—Applying state-of-the-art tools and industry best practices to implement robust programs to meet increased challenges of cybersecurity as the agency continues to make progress toward the goal of increasing use of the Internet as a primary means of taxpayer contact; and
—Performing compliance analytics and implementing related strategy solutions, as well as administering and enforcing the regulations established for the legal and tax professional community.

TELEPHONE LEVEL OF SERVICE—ENHANCED ONLINE SERVICES

Question. Providing access to quality customer service helps taxpayers understand their obligations so they can pay the right amount on time. Staffing shortages due to budget cuts in recent years coupled with increased call volumes have adversely impacted IRS's capacity to respond to taxpayers' phone calls. The level of service has been severely declining. In 2004, the IRS answered 87 percent of calls seeking to reach a phone assister, with an average wait time of 2½ minutes. In 2013, IRS answered just 61 percent of its calls, and those who got through spent an average of nearly 17 minutes waiting on hold.

What does the IRS consider to be an "acceptable" level of service for taxpayers calling for assistance on the toll-free phones?

How will the funding increase of $137.3 million dollars in the IRS's fiscal year 2015 request help attain an acceptable level of service?

What factors could impede the IRS from attaining its level of service goal of 71 percent for 2015?

What setbacks might the IRS experience if resources in 2015 fall short of the request? What are the practical consequences of those setbacks for taxpayers?

Answer. The IRS strives to provide high-quality service to as many taxpayers as possible, given limited resources. The agency develops telephone plans after consideration of many factors, including: historical demand adjusted for known anomalies; the types and anticipated lengths of calls we expect to receive; assumptions concerning upcoming events, such as known or pending legislation or trends in customer behavior; and the availability of existing or new automation and other alternative services. These plans are then matched with available or anticipated resources to determine the level of service (LOS) the IRS can provide. For instance, this year the lower than anticipated filing season demand was likely due to relatively few tax law changes and more people using IRS.gov to get answers to many basic tax law questions. As a result, the IRS expects to exceed its projected fiscal year 2014 LOS of 61 percent.

The fiscal year 2015 budget request of $12.6 billion, including $165 million in additional investments through the Opportunity, Growth and Security Initiative, would allow the IRS to increase the projected LOS in fiscal year 2015 from 53 percent to 80 percent. The IRS expects to receive additional assistor telephone contacts related to the Affordable Care Act (ACA) in fiscal year 2015. Other factors, such as known or pending legislative changes, could also adversely affect the IRS's ability to deliver the planned LOS.

Without the funding requested in the President's budget, we estimate the increase in demand will result in a 53 percent LOS. This means approximately five out of every 10 taxpayers who call the IRS for service would not get through to an assistor. Those who do get through will then be subjected to long wait times. Because of this extraordinarily low projected LOS, the IRS expects that a higher than normal number of taxpayers will call back when they are unable to reach an assistor. These additional callbacks or re-tries will further compound the strain on the IRS telephone systems and may drive the LOS even lower than the projected levels. Also, taxpayers abandoning the telephone lines will likely turn to walk-in services or send correspondence, straining other IRS service channels.

Each year, taxpayers call the IRS for assistance expecting a prompt and accurate response to their questions. The IRS continually explores improvement opportunities to provide customers with easy access to accurate, user-friendly account services. Our objective is to proactively manage customer demand by improving contact center efficiency, referring customer demand to the most efficient service resource, and equipping the workforce with the tools to be productive. To continue to efficiently serve the maximum number of taxpayers possible, the IRS implemented the 2014 Service Approach to align taxpayer demand with the most cost-effective resource to provide the needed service. The 2014 Service Approach accomplished this by referring taxpayers to self-service resources, such as Where's My Refund and Get Transcripts via www.irs.gov while preserving telephone and in-person service for taxpayers that needed to speak to an assistor.

In a recent report, the GAO identified some opportunities for the IRS to potentially realize hundreds of millions of dollars in cost savings and increased revenues. One such idea is by enhancing online and interactive Web services to improve service to taxpayers and encourage greater tax law compliance.

Question. Commissioner Koskinen, is it your view that advancements to IRS online services would improve service to taxpayers and encourage greater tax law compliance?

Answer. Yes, the easier it is for taxpayers to get the information they need, the more likely it is that taxpayers will be compliant and online services make it easier for taxpayers to get the information they need. Over the past few years, there has been a significant expansion in the use of IRS online services, such as Where's My Refund, to provide account information to taxpayers. For example, the Where's My Refund service had 136 million page views and 112 million site views via our IRS.gov Web site from January 11–April 17, 2014 and enabled millions of taxpayers to avoid the long wait times when calling the IRS. The IRS also offers several online options for tax law assistance on IRS.gov, such as the Interactive Tax Assistant, IRS tax publications, the IRS Tax Map, Tax Topics, and Frequently Asked Questions. Taxpayers can also download the IRS2Go application on an iPhone or Android device to interact with the IRS using their mobile device. The widespread usage of

these various online options demonstrates that taxpayers have an appetite for expanded online capabilities.

Question. What initiatives is the IRS currently undertaking or contemplating to make progress in enhancing online services?

Answer. The IRS has recently launched several new applications, such as Direct Pay and Get Transcript, and we are working toward the creation of an interactive online account. This online account will serve as a platform for taxpayers to securely interact with the IRS to obtain historical tax return data, submit payments, and receive status updates. In addition to these new online tools, the IRS is working closely with external tax service providers (tax professionals, online service providers, transmitters, and third parties) to improve online service delivery to taxpayers.

Question. What impediments prevent the IRS from doing more to improve online services for taxpayers?

Answer. While the IRS has made great strides in improving online services, there are several impediments that slow the speed of development and deployment of new and improved services:

—Budgetary/resource constraints;
—Integrating online tools with legacy systems;
—Policy/regulatory restrictions;
—The need to protect privacy and prevent identity theft and fraud; and
—Competing mandates, such as the filing season and the implementation of new legislation.

Question. What resources would be required for the IRS to do more in this area?

Answer. The President's fiscal year 2015 budget requested $23 million within the Business Systems Modernization appropriation ($16.8 million capital and $6.2 million labor) for the continued development of Online Services applications, which would improve service to taxpayers and encourage greater tax law compliance. Due to budget cuts in recent years, the IRS has had to do significant re-planning, across the board, to address the stark realities around our capability to deliver our strategic priorities, along with the significant legislative requirements to which we were committed.

In addition, development of new online applications creates additional demand on our current IT infrastructure, which is already at risk due to inadequate funding needed to maintain, replace and upgrade the infrastructure. This additional demand threatens deployment of new capability and capacity upgrades needed to support the IRS's current business needs.

VOLUNTEER INCOME TAX ASSISTANCE (VITA) SERVICES FOR SMALL BUSINESS

Question. Almost all businesses (over 90 percent) start out as a sole proprietorship or as self-employed businesses. Unless incorporated or part of a partnership, self-employed business income is subject to taxation through calculations performed on "Schedule C" (or C–EZ). Each year, some 20 million self-employed businesses file a Schedule C or C–EZ. Schedule C is basically a one-page profit and loss statement that every business needs to understand.

In August 2010, the IRS, in partnership with the National Community Tax Coalition and Self-Employed Tax Initiative, launched the Schedule C VITA Pilot for the 2011 tax season. This pilot, conducted at 12 sites, was designed to determine the feasibility of restructuring IRS policies governing low-income self-employment tax preparation at VITA sites.

What were the findings of the Schedule C VITA pilots?

Answer. In 2010, the IRS collaborated with the National Community Tax Coalition and Corporation for Enterprise Development to develop a Schedule C Pilot. The purpose of the pilot was to test the effectiveness of possibly expanding the parameters of Schedule C tax return preparation by Volunteer Income Tax Assistance (VITA)/Tax Counseling for the Elderly (TCE) programs.

Currently, all VITA/TCE sites can provide basic income tax return preparation services to low to moderate income taxpayers who generally make $52,000 or less. These services include preparing Schedule C returns meeting the Schedule C–EZ $5,000 expense limitation (later increased to $10,000 for tax year 2013 returns). However, VITA/TCE sites cannot prepare a Schedule C–EZ or Schedule C return if:

—operating results of the business was a loss for the tax year;
—section 179 expense is claimed;
—the business has inventory;
—the business has employees;
—the business operations on the accrual method of accounting; or
—the taxpayer claims depreciation or vehicle expenses other than the standard mileage rate.

The Schedule C pilot was limited to participating VITA sites. TCE sites did not participate in the pilot. The pilot allowed participating VITA sites to prepare returns with the following characteristics, as long as total business expenses did not exceed $25,000:

—business losses confined to the current tax year;
—business use of home by day care providers; and
—section 179 expenses.

The following table provides the results from the pilot for Tax Years 2010–2012.

SCHEDULE C PILOT TAX YEARS 2010–2012

	Tax Year 2012	Tax Year 2011	Tax Year 2010
Total Schedule C Returns prepared by all VITA/TCE sites (including pilot returns)	196,349	195,020	184,853
Number of participating Schedule C pilot partners	16	16	12
Number of participating Schedule C pilot sites	32	32	24
Number of Schedule C pilot returns	4,656	4,033	4,160
Accuracy of Schedule C pilot returns [1]	Not available	90%	94.7%

[1] IRS employees conducted return reviews of 20 Schedule C pilot returns reviewing the accuracy of the returns' expenses and income. These reviews determined the accuracy of results.

Question. What steps or initiatives can be taken to reach more of America's underserved business start-ups, many of whom have no place to turn for affordable and competent business tax preparation assistance?

Answer. The IRS offers a wide range of products, tools and initiatives designed to assist business start-ups in understanding and meeting their Federal tax responsibilities. On IRS.gov, small businesses have access to valuable information and resources 24 hours a day, 7 days a week. For example, Small Business Taxes: The Virtual Workshop explains how to meet Federal tax obligations in nine easy-to-understand lessons. The IRS.gov Small Business Tax Center provides free educational products and services via numerous online resources including videos, Webinars, and multiple social media outlets. Small businesses can also subscribe to E-News for Small Businesses, an electronic newsletter with helpful information, including reminders and tips to assist small businesses with tax compliance. For example, for Small Business Week, May 12–16, 2014, the IRS provided the following:

—Two informational Webinars for small business owners (which are archived on IRS.gov and available through the IRS Video Portal):
  —Payments to Independent Contractors.
  —Avoiding the Biggest Tax Mistakes.
—Video that provides tour of the online Small Business Tax Center.

The IRS provides E-News to almost 306,000 subscribers. E-News is also used to increase awareness of the tools and products available to small businesses. The IRS also provides on IRS.gov the Online Small Business Tax Calendar, with links to due dates and events to help small business owners meet tax deadlines.

The IRS continues to develop and implement compliance assistance programs to assist business start-ups and improve their knowledge of the tax code. For example, when users apply for a new employer identification number (EIN) via IRS.gov, we provide a link to a one-stop resource, the Small Business Tax Center which is the small business/self-employed landing page on IRS.gov. We provide small business tax workshop training materials in English, Spanish and new for 2014, Chinese for our partners, such as SCORE (a nonprofit dedicated to helping small businesses succeed), Small Business Development Centers (SBDC), Latino Tax Professional Association, and many others (to use in presenting these workshops). We also identify small business issues for review by Federal advisory groups and implement approved recommendations. In 2013, Federal advisory groups (Internal Revenue Service Advisory Group, Information Reporting Program Advisory Committee, Taxpayer Advocacy Panel, and Electronic Tax Administration Advisory Committee) worked the following issues: Online Payment Agreements, Business Identity Theft, Decreasing Non-Filers, and Bankruptcy Compliance. Implemented recommendations include improvements to the Voluntary Classification Settlement Program (VCSP). The VCSP assisted thousands of small business owners in correctly making employee determinations. The above Federal advisory groups assisted with the IRS's implementation of the Fresh Start Initiative, which, for the first time, allows businesses to apply for streamlined installment agreements.

The IRS routinely partners with agencies that interact with start-up businesses (e.g., State and local government agencies, local SCORE and SBDC) to place the IRS tax center links on their Web sites.

The IRS has also developed outreach initiatives for new entrepreneurial businesses, including young entrepreneurs under the age of 30 who are starting new businesses in increasing numbers. These initiatives include establishing partnerships with entrepreneurial organizations that will include IRS information in their curriculum and publications, and will leverage our partnerships with schools/educational ventures that promote an entrepreneurial skill set to include how to develop a business plan, recordkeeping and other necessary skills to establish a successful and compliant business. During this fiscal year so far, we developed customized materials, such as Small Business Taxes—the Virtual Workshop, and coordinated small business key message delivery for over 162 small business forums reaching over 3,100 participants, including many new business owners. Through our leveraged partnerships with industry leaders, we have distributed materials to over 100 national, State, and local organizations via email distribution lists. Future plans include identifying and partnering with additional industry and business organizations and delivering more customized outreach materials.

Question. Does the IRS plan to extend and expand the original pilot project more broadly to other VITA sites to reach more small businesses?

Answer. The IRS is conducting an assessment of the Tax Year 2013 Self-Employment Tax Initiative (SETI). The assessment includes evaluation of date and demographic/filing profiles of all VITA/TCE Schedule C filers, the accuracy of the Schedule C returns prepared under the program, and the quality of the training and certification test for VITA/TCE preparers participating in the program. We anticipate completing the assessment in August 2014.

HELPING OUR MIDDLECLASS ENTREPRENEURS (HOME) ACT

Question. Last year I introduced a bipartisan bill to help business owners who operate primarily out of their homes deal with the often-complicated process of filing income taxes. Under the current system, home-office business owners often struggle to calculate expenses, depreciation, and carryovers on their homes.

The IRS has recently made claiming the home office deduction easier but that was not a permanent fix. I believe our Nation's entrepreneurs deserve the certainty of knowing that they can continue claiming the home office deduction without complicated bureaucratic red-tape. My proposal would allow business owners to take an optional standard deduction of $1,500 dollars.

How have the recent changes affected the number of filers claiming the home office deduction?

Answer. The Tax Year 2013 filing season, the first year that the Office in the Home (OIH) optional safe harbor method (as allowed by Revenue Procedure 2013-13, 2013-6 I.R.B. 478) was available, has not yet concluded (generally October 15 is the last day individuals can file with an extension). Given taxpayers taking an OIH deduction may have a more complex return, it is likely many OIH filers may still be on extension. Therefore, we do not have the complete information upon which to perform an analysis.

Question. Is the IRS planning to make further improvements to claiming the home office deduction?

Answer. As stated in response to question above, we do not have complete information upon which to make a determination on what improvements, if any, need to be made at this time. However, the regulations under Internal Revenue Code section 280A (relating to expenses in connection with business use of a home or rental of vacation homes) regarding deductions for expenses attributable to the business use of homes and rental of vacation homes is an item on the Treasury/IRS's Priority Guidance Plan. This guidance will be in addition to, but will not replace, the guidance provided under Revenue Procedure 2013-13.

GENERAL WELFARE EXEMPTION

Question. I recently met with tribal leaders from across Indian Country to discuss economic development challenges and successes. During these discussions, tribal leaders raised concerns with the IRS audits of services to tribal members. In particular, several leaders expressed their frustration in working with the IRS as it develops clear and appropriate guidelines for tribal application of the General Welfare Exemption.

For several years now, the IRS has been engaged in a consultation process with tribal leaders. Where in this consultation and guidance process is the IRS?

Answer. In response to concerns raised by Indian tribal members in consultation with Treasury and the IRS, Notice 2012-75 and Revenue Procedure 2014-35 were issued to provide guidance and safe harbors for the general welfare exclusion to income. The Department of Treasury and the IRS issued the Notice in 2012 as interim guidance on which tribes could rely. The Notice addressed comments and concerns expressed by tribal leaders and others during previous consultation sessions and set forth a list of programs that would qualify under the general welfare exclusion to income. It also asked for comments prior to the guidance being issued in its final form. In all, over 120 comments were received and consultations were held, which were taken into account in preparing final guidance, Revenue Procedure 2014-35, which was issued on June 3, 2014. Based on the submitted comments, we think the recently issued final guidance addresses the key questions raised by Indian tribes and organizations. Treasury and the IRS will continue communicating with Indian tribal representatives and organizations to ensure clarity in this and other areas of tax policy.

Question. What does it expect the timeline going forward to be?

Answer. The final guidance, Revenue Procedure 2014-35, was released June 3, 2014 and will be printed in the June 23, 2014 edition of the Internal Revenue Bulletin.

Question. Additionally, does the IRS have a summary of the outreach efforts, including a list of the tribal entities consulted, that it has undertaken as part of this process that it can share with the committee?

Answer. The IRS, through its Indian Tribal Governments Office, in conjunction with the Treasury point-of-contact for tribal matters, has made itself available, formally and informally, throughout the process. Representatives of the IRS and the Treasury Department consulted with tribal leaders and members of Indian tribes concerning application of the general welfare exclusion to programs of Indian tribal governments. In Notice 2011-94, 2011-49 I.R.B. 834, the IRS invited comments concerning the application of the general welfare exclusion to Indian tribal government programs that provide benefits to tribal members.

The IRS received over 85 comments from Indian tribal governments and other individuals and groups describing various Indian tribal government programs for tribal members and how the general welfare exclusion should apply to those programs. In response to those comments, the IRS issued Notice 2012-75, 2012-51 I.R.B. 715, which proposed a revenue procedure that would provide safe harbors under which the IRS would conclusively presume that (i) the individual need requirement of the general welfare exclusion would be met for specific benefits provided under described Indian tribal governmental programs, and (ii) certain benefits an Indian tribal government provides under other described programs are not compensation for services. In response to Notice 2012-75, the IRS received over 40 comments from Indian tribal governments and other individuals and groups. The more than 120 comments and consultations were very helpful in preparing Revenue Procedure 2014-35.

Throughout the process, the IRS and Treasury engaged in face-to-face consultations that were open to the public. We also conducted call-in consultations in order to be available to individuals, tribes and organizations that were unable to travel. In addition to those formal consultation efforts, we met on an informal basis with Indian tribal leaders and organizations at various gatherings such as those conducted by the National Congress of American Indians (NCAI), the Native American Finance Officers Association (NAFOA), and the United South and Eastern Tribes (USET). Since December 2012, we have consulted with over 700 individuals, Indian tribes, and Indian tribal organizations.

ASSISTING VICTIMS OF TAX-RELATED IDENTITY THEFT AND REFUND FRAUD

Question. The National Taxpayer Advocate has recommended that the Internal Revenue Service establish a meaningful single point of contact for taxpayers who become victims of identity theft. According to the Taxpayer Advocate, 21 separate units handle different aspects of identity theft and no employee has the authority to coordinate the entirety of the taxpayer/victim's case if, as is common, more than one of the 21 units is involved.

What is the current process and timetable that a victim of tax-related identity theft or refund fraud experiences in resolving their case with the IRS and securing the refund to which they are entitled?

Does the IRS agree with the Taxpayer Advocate's recommendation that the IRS should designate a single point of contact with an IRS staff representative to a victim of tax-related identity theft and/or refund fraud?

What are the IRS's plans for adopting the single-point-of-contact recommendation?

What are the impediments for instituting a process whereby a victim of identity theft and refund fraud is assigned a single point of contact within the IRS to guide the casework through the process to resolution?

Answer. Refund fraud caused by identity theft is one of the biggest challenges facing the IRS today, and the harm it inflicts on innocent taxpayers is a problem we take very seriously. The IRS has a comprehensive and aggressive identity theft strategy focusing on preventing refund fraud, investigating these crimes, and assisting taxpayers victimized by identity theft. The IRS's Identity Protection Specialized Unit (IPSU) is critical to our efforts to assist identity theft victims. The IPSU provides taxpayers with a consolidated office to contact at the IRS via a distinct toll-free telephone line that specializes in identity theft victim assistance. Budgetary constraints do not allow for a single individual to be assigned to each victim of identity theft. In addition, specialized teams throughout the enterprise acknowledge identity theft claims and provide contact information. The point of contact may be an individual or group of individuals trained and able to provide the information on the victim's case.

The IRS continues to explore opportunities to improve the services available to victims of identity theft and the time it takes to resolve their cases. In calendar year 2013, the IRS worked with victims to resolve and close approximately 963,000 cases, and the time for resolving these cases is decreasing. During the past fiscal year, taxpayers who became identity theft victims had their situation resolved in roughly 120 days, far more quickly than in previous years, when cases could take over 300 days to resolve.

The IRS recently proposed further centralization of identity theft victim casework in the Wages and Investment (W&I) Division in May 2014. If adopted, the proposal would position W&I as wholly responsible for all identify theft victim assistance work. By further centralizing this function, we anticipated that service to victims of identity theft will continue to improve. While budgetary and resource constraints do not allow a single individual point of contact from receipt of the claim through determination and/or account resolution, the centralized W&I process will serve victims more timely and completely by ensuring consistency of the processes.

PROCESSING OF APPLICATIONS FOR TAX EXEMPT STATUS UNDER I.R.C. SECTION 501(C)(4)

Question. In May 2013, the Treasury Inspector General for Tax Administration published audit findings delineating the use of inappropriate case screening criteria in IRS's processing of applications for tax-exempt status under section 501(c)(4) of the Tax Code. I have long supported the need to make meaningful changes to ensure that the rules to qualify for tax-exempt status are abundantly clear. It is 100 percent unacceptable for the IRS to ever unevenly enforce rules based on ideology, politics, or other bases.

In June 2013, the IRS initiated a new process whereby certain taxpayers whose applications for section 501(c)(4) tax-exempt status as a social welfare organization have the option of obtaining an approval if they self-certify that they will meet certain guidelines. An organization is permitted to self-certify if they represent that the organization devotes 60 percent or more of both spending and time to activities that promote social welfare as defined by section 501(c)(4), that the organization devotes less than 40 percent of both spending and time to political campaign intervention, and that the organization ensures the above thresholds apply for past, current and future activities.

Initially, optional expedited processing was offered to 501(c)(4) applicants whose applications had been pending for more than 120 days as of May 28, 2013. This applied to organizations whose showed potential involvement in political campaign involvement or issue advocacy, and did not present any private inurement issues. In guidance issued in December 2013, the IRS extended the optional expedited processing to all 501(c)(4) applicants whose applications indicate that the organization may be involved in political campaign intervention or in providing private benefit to a political party and that otherwise do not present any issue with regard to exempt status.

What benefits are available to an organization by securing tax-exempt status approval from the IRS through either the traditional application process or the self-certification process?

Answer. Organizations that have received a determination letter from the Internal Revenue Service stating that they are described in section 501(c)(4) of the Code, as well as those that hold themselves out as described in section 501(c)(4), can claim exemption from Federal income tax (other than tax on unrelated business income).

An organization that has received a determination letter is entitled to rely upon that determination, provided there is no relevant change in the applicable law and

the organization did not omit or misstate material information or operate in a manner materially different from that originally represented in its exemption application (and, in the case of participants in the optional expedite process, from the signed representations). If the organization is later examined by the IRS, this reliance limits the retroactive application of a revocation.

Organizations that have not received a determination letter do not have the protection against retroactive revocation of their exempt status that such a letter can afford.

Question. May an organization operate as 501(c)(4), including publicly describing itself as a 501(c)(4) organization, without having to apply for or receive formal approval from the IRS?

Answer. Yes. An organization that meets the requirements of exemption under section 501(c)(4) may operate as such without applying for recognition of that status by the Internal Revenue Service. Such an organization must comply with the requirements of tax-exempt status each taxable year in order to be tax-exempt during that year. In addition, if a section 501(c)(4) organization does not file the annual return or notice it is required to file (Form 990, Form 990-EZ or the Form 990-N e-Postcard) for three consecutive years, its tax-exempt status is automatically revoked as of the due date for the third annual return or notice.

Question. In each of the past 3 tax years, of the total number of organizations filing an annual Form 990 and claiming section 501(c)(4) status, what proportion have been formally granted such status through a favorable determination letter or other written approval issued by the IRS?

Answer. In fiscal year 2010, 72,693 organizations claiming 501(c)(4) status filed annual Forms 990, of which 7,065, or 10 percent were from organizations whose status as 501(c)(4) organizations formally had been approved by the IRS. In fiscal year 2011, 69,255 organizations claiming 501(c)(4) status filed annual Forms 990, of which 7,815, or 11 percent were from organizations whose status as 501(c)(4) organizations formally had been approved by the IRS. In fiscal year 2012, 71,643 organizations claiming 501(c)(4) status filed annual Forms 990, of which 9,185, or 13 percent were from organizations whose status as 501(c)(4) organizations formally had been approved by the IRS.

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. A proposal requiring the Secretary of Treasury to enter into contracts with private collection agencies (PCAs) to collect Federal taxes is included in sec. 6304 of the draft "Tax Reform Act of 2014" introduced by Chairman Camp, as well as in sec. 305 of S. 2260, the "Expiring Provisions Improvement Reform and Efficiency (EXPIRE) Act" now pending in the Senate.

What was the result of a similar initiative that was in effect from 2006 to 2009?

Answer. The Government lost money as a result of the PCA initiative in effect from September 2006 to February 2009. During the previous initiative, the IRS assigned balance due accounts with the lowest priority to PCAs for collection. Assigning these cases to PCAs resulted in collections of $98.2 million in revenue, $63.4 million of which was remitted to the Treasury, with the PCAs receiving $16.5 million and the IRS retaining $18.3 million. However, the IRS incurred direct costs of $30.7 million to administer the program. We therefore absorbed the difference of $12.4 million out of appropriated funds. The $30.7 million also does not include start-up costs of approximately $55.4 million for business and information technology development. Thus, the IRS spent $67.8 million of appropriated funds on this initiative, which exceeded the $63.4 million that was remitted to the Treasury, resulting in a $4.4 million loss to the Government.

In addition, during the previous initiative, taxpayers were not entitled to the same protections when PCAs attempted to collect tax debts as they are when the IRS is collecting the debt. For example, the IRS is required to make our processes and procedures public, which we do by issuing the Internal Revenue Manual (IRM). PCAs are not required to make their processes public, nor are they required to follow the IRM. During the 2006 to 2009 initiative, some PCAs were accused of using aggressive collection practices, such as exerting psychological pressure, on taxpayers. These practices are prohibited by the IRM and IRS employees can be fired for using them.

Question. Is it true that the IRS currently has the authority to use PCAs, but has chosen not to use that authority? Why?

Answer. Yes, section 6306 of the Internal Revenue Code, which was added to the Code in 2004, permits, but does not require, the Secretary to enter into a "qualified tax collection contract." The 2006 to 2009 initiative was undertaken pursuant to this

authority. The IRS has not undertaken to exercise this authority since 2009 because of revenue outcomes, taxpayer service and cost effectiveness.

The 2006–2009 initiative lost revenue, taking all activities into account. Additionally, the PCAs do not provide the same protections to taxpayers from aggressive collection practices and anecdotal evidence suggested some taxpayers were being subjected to aggressive collection practices by at least some PCAs. Further, the results of an internal cost-effectiveness study of the 2006–2009 Private Debt Collection program, which was published in March 2009, showed that when working similar inventory, collection efforts are more cost-effective using IRS employees rather than outside contractors. IRS employees also have a much wider range of options available to them to resolve difficult collection cases. This internal study was supported by an independent review.

Question. What are your agencies' positions on the proposal to require Treasury to use PCAs to collect Federal taxes?

Answer. The IRS has administrative and policy concerns with the proposal and does not support it. Requiring the IRS to use PCAs would impose significant start-up costs on the IRS to evaluate PCAs and enter into qualified tax collection contracts, and additional costs to monitor the PCAs' collection activities. Because the proposal does not provide additional funding for the IRS, these costs would decrease the funds available to the IRS for other priorities, including its ongoing enforcement activities. Moreover, previous experience with PCAs has taught us that the IRS has a much higher return on investment than PCAs, making this proposal a less effective use of taxpayer dollars. The proposal also does not provide the IRS with sufficient discretion on the types of cases that should be referred to PCAs. For example, the proposal does not exclude cases where collection could result in economic hardship to the taxpayer.

Additionally, the proposal does not protect taxpayers from certain aggressive collection practices employed by at least some PCAs, but prohibited by IRS processes and procedures. Further, a comprehensive review shows that IRS collection practices are more cost effective than PCAs. Thus, more revenue would be generated and taxpayers would receive better service if Congress would provide additional funding for IRS collection activities, not by diminishing our already limited resources to implement another PCA initiative.

Question. What impact could this requirement to use PCAs to collect Federal taxes have on taxpayers, specifically low-income taxpayers?

Answer. The IRS did not study the impact PCA use had on taxpayers generally or low-income taxpayers specifically in connection with the PCA legislation in the American Jobs Creation Act; however, when we decided not to continue with the PCA initiative in 2009, we were aware of taxpayer complaints that at least some PCAs had used overly aggressive collection practices (for example, intimidation, harassment, or violation of taxpayers' rights, the Fair Debt Collection Practices Act, or the Privacy Act). Additionally, our most recent analysis of the potential impact of assigning all inactive cases to PCAs, based on data we extracted on April 28, 2014, estimates that 79 percent of individuals in 2013 and 77 percent of individuals in 2014 who had inactive delinquent accounts had an adjusted gross income less than 250 percent of poverty level.

We also are concerned that the use of PCAs could result (1) in economic hardship for taxpayers who have an outstanding tax liability that they cannot currently afford to pay in full, and (2) in a reduction in future voluntary compliance by taxpayers who are subjected to overly aggressive collection activities by PCAs. And, unlike the IRS, PCAs have no incentive to engage in taxpayer outreach and education, which is particularly beneficial to low-income taxpayers and other underserved populations and which may help promote future tax compliance.

QUESTIONS SUBMITTED BY SENATOR MIKE JOHANNS

Question. To what extent and how could the IRS use social security numbers as an enforcement tool to reduce improper payments to filers receiving payments because of a claim made pursuant to a refundable tax credit?

Answer. There are numerous refundable credits currently administered by the IRS, including the Earned Income Tax Credit (EITC), the Additional Child Tax Credit (ACTC) and the American Opportunity Tax Credit (AOTC). The IRS has a dual mission when it is administering refundable credits. We must balance ensuring that those who qualify claim and receive the credit with ensuring that the money goes only to those eligible to receive it.

When the law requires a valid Social Security Number (SSN) for a refundable credit, the IRS uses its current math error authority to prevent improper payments

during return processing. However, a valid SSN is not a requirement for all refundable credits. Current law does not require the taxpayer or a qualifying child to have an SSN to be eligible to receive the Child Tax Credit (CTC), ACTC or AOTC. For those credits, the taxpayer and each qualifying child are only required to have a taxpayer identification number (TIN). For this purpose, a TIN can be an individual taxpayer identification number (ITIN).

An individual is eligible to obtain an ITIN only if the individual is ineligible to obtain an SSN and requires a number for Federal tax purposes. This means that current law does not prohibit a resident alien, who does not have an SSN, from being eligible to claim the CTC/ACTC or AOTC.

In addition to the SSN issue, the rules for children for EITC and CTC/ACTC are also not consistent. There is no uniform definition of a qualifying child that would make it easier for taxpayers to understand and claim the credits (if they are eligible) and avoid errors, and for the IRS to administer the credits. The age, residency, and support requirements for children, as well as rules for divorced or separated parents, under these provisions vary.

Another challenge faced by the IRS is the inability to correct clear errors related to refundable credits. Providing the IRS with correctable error authority, a proposal included in the General Explanations of the Administration's fiscal year 2015 Revenue Proposals (the "Greenbook"), would allow us to correct clear errors without lengthy and expensive audits if:

—the information provided by the taxpayer does not match the information contained in a Government database;

—the taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or

—the taxpayer has failed to include with his/her return documentation required by statute.

Through existing math error authority, the IRS protects almost $300 million in EITC refund claims annually; however, we believe that correctable error authority would greatly improve our efforts in this area.

Question. At the hearing on April 30, 2014, you mentioned that applicants for 501(c)(4) status that certify that no more than 40 percent of their resources would be devoted to political activity would be granted the status sought.

In response to a question from Senator Udall, you noted that

> ". . . if you will simply state and affirm that you are not going to spend more than 40 percent of your resources and revenues on 8 political activities, you could, in fact, pass through."

Are you concerned that applicants that may not so certify will be subject to additional scrutiny despite being well within their legal rights to claim the status?

Answer. We have taken steps to ensure that we provide uniform and fair treatment to organizations that choose not to use the optional expedited process. We have done this by issuing written procedures that now guide the processing of all such applications. In brief, our procedures provide that any issues presented by these applications will be analyzed as quickly as possible under current law. The specific procedures are set forth in Interim Guidance Memo TEGE–07–0613–08 (June 25, 2013), as amended by Interim Guidance Memo TEGE–07–0713–12 (July 18, 2013), and in Interim Guidance Memo TEGE–07–1213–24 (December 23, 2013), all of which are available in the electronic reading room at IRS.gov.

Further, on May 19, 2014, we issued Interim Guidance Memo TEGE–07–0514–0012 (also available in the electronic reading room at IRS.gov). This memo provides that an organization—including organizations eligible for the optional expedited process—that receives a proposed adverse determination letter will have the right to request the Office of Appeals to review its application for recognition of tax-exempt status.

Additionally, we have closed 130 cases in the original backlog (nearly 90 percent of the total), as of April 18, 2014. Ninety-nine of these cases received favorable determination letters, including 56 applicants that chose not to participate in the optional expedited process.

Question. What rationale, if any, did the IRS use in its selection of the 40 percent threshold?

Answer. The IRS selected the 40 percent threshold to balance reasonable standards for a safe harbor with appropriate use of resources for tax administration.

Question. Please provide an update regarding the IRS' multi-year agreement with the free-file alliance, including the IRS' intent to conclude a new agreement or otherwise continue the program.

Answer. In February 2014, IRS leadership met with the leaders of Free File, Incorporated (FFI), formerly known as the Free File Alliance, to discuss a 1-year ex-

tension of the expiring Memorandum of Understanding (MOU) to allow time for negotiations on a new multi-year Agreement/MOU. The extension was signed on May 2, 2014 and is valid from October 30, 2014, to October 30, 2015.

The 1-year extension agreement includes specific language that a full renegotiation of the 5 year Agreement/MOU will begin in June 2014 with a goal to conclude those negotiations by December 2014 and enter into a new multi-year Agreement/MOU before the expiration of the 1-year extension on October 30, 2015. FFI has played a key role in the IRS's strategy for growing e-file. The 1-year extension provides the IRS and FFI time to shape a longer term agreement to include innovations to the 12-year-old Free File program.

Question. In your testimony, you mentioned the need to ". . . move the receipt for W–2s to the IRS from mid-March to the end of January." Have you made this request in pursuit of the capacity within the IRS to prepare returns or portions of returns for filers?

Answer. No, the IRS is not pursuing and has no plans to implement a system to create pre-filled forms or software/products for simple tax return preparation.

During my testimony, I referenced the administration's fiscal year 2015 Revenue Proposal "Rationalize Tax Return Filing Due Dates So They Are Staggered." This proposal would require information returns to be filed with the IRS (or Social Security Administration, in the case of Form W–2) by January 31. Accelerating the IRS's receipt of third-party information will facilitate detection of non-compliance earlier in the filing season and allow the IRS to address identity theft and refund fraud more effectively before refunds are paid.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

Question. Describe the role of your agency's Chief Information Officer (CIO) in the oversight of IT purchases. How is the CIO involved in the decision to make an IT purchase, determine its scope, oversee its contract, and oversee the product's continued operation and maintenance?

Answer. The IRS Chief Technology Officer (CTO) has the authority to govern all areas related to information resources and technology management, including acquisition of information technology (IT) and the management of information resources. The CTO has management and oversight responsibility for both the IT organizational functions and the evaluation, selection and management of vendors, ensuring that the goods and services received not only align with, but can help drive forward, the critical operational and information technology (IT) priorities of the business strategy.

This responsibility combines a thorough knowledge of the Federal acquisition system and a deep understanding of the dynamic commercial IT marketplace. The Vendor Management Organization (VMO), which is under the authority of the CTO, is solely focused on this activity and has a straightforward mission—to maximize IT investments. This is accomplished by developing a set of repeatable, sustainable processes with goals that focus on:

—Achieving greater transparency around organizational structures, roles, and responsibilities to ensure accountability and limit "surprises";
—Committing more time and energy to limit supplier advantage, e.g., through competitive bidding processes, market research on rates, and internal staff training;
—Cultivating existing vendor relationships that drive value by effectively managing the vendor throughout the contract lifecycle, from sourcing and selecting the vendor, to establishing contracts, purchasing and managing payments;
—Maintaining focus on value delivery by making sure that the benefits promised are the beginning of a project or investment are delivered; and
—Managing spending to create visibility that enables repeatable savings opportunities.

The CTO also has a well-established IT Governance structure to align IT with business strategy and to ensure that investments stay on track to achieve our strategies and goals, with measures to monitor performance.

The Infrastructure Executive Steering Committee (IESC) within the CTO organization ensures that project objectives are met, risks are managed appropriately, and the expenditure of IRS resources is fiscally sound. The CTO has also established an Enterprise Software Governance Board (ESGB) to develop a standardized approach to software acquisition management practices. An ESGB working group is also in place to gather and document existing software acquisition processes, document a proposed software lifecycle, gather software usage metrics, and evaluate and recommend a software asset/license management tool, all of which will identify in-

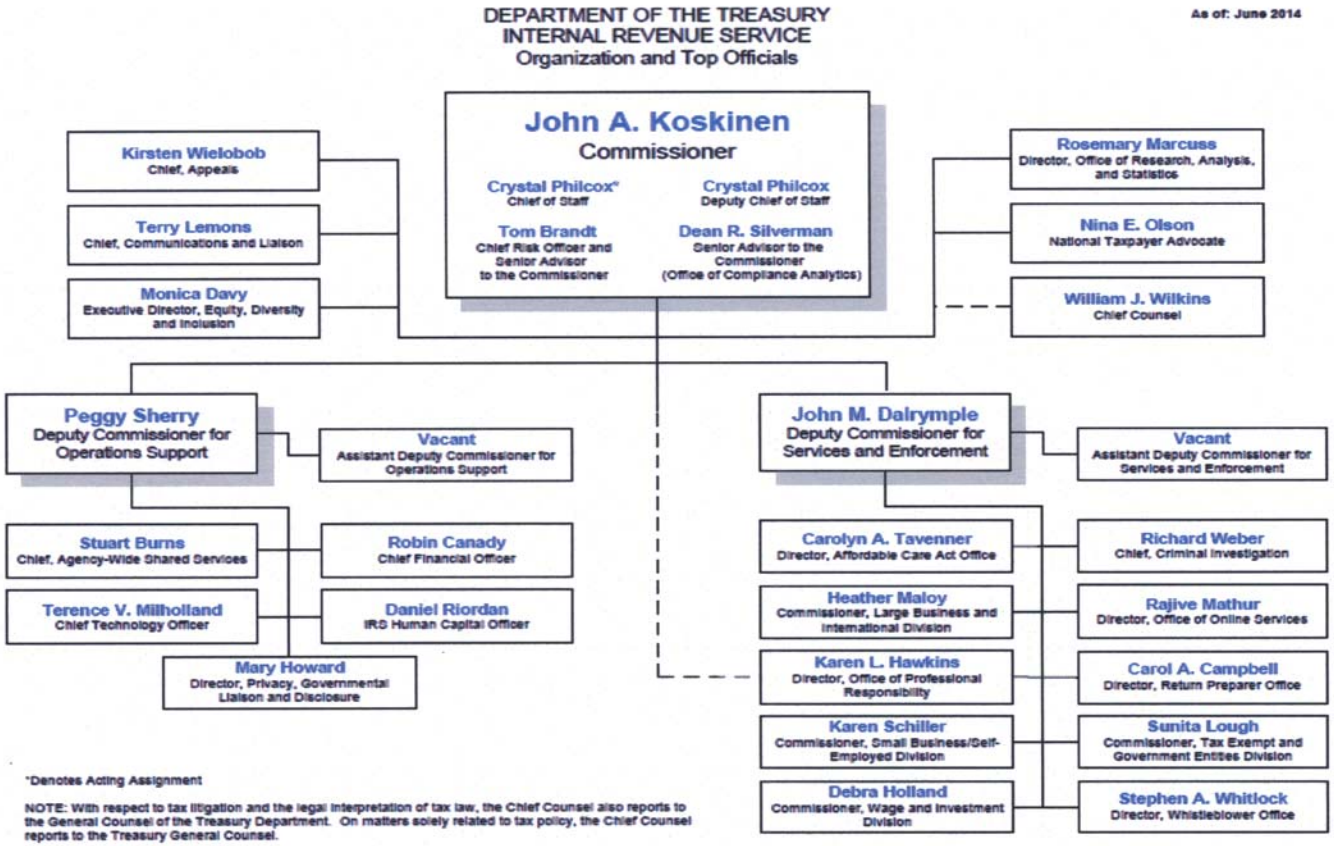
stalled software products, match products to licenses and confirm compliance status of those products. This governance ensures that all stakeholders' interests are taken into account and that processes provide measurable results.

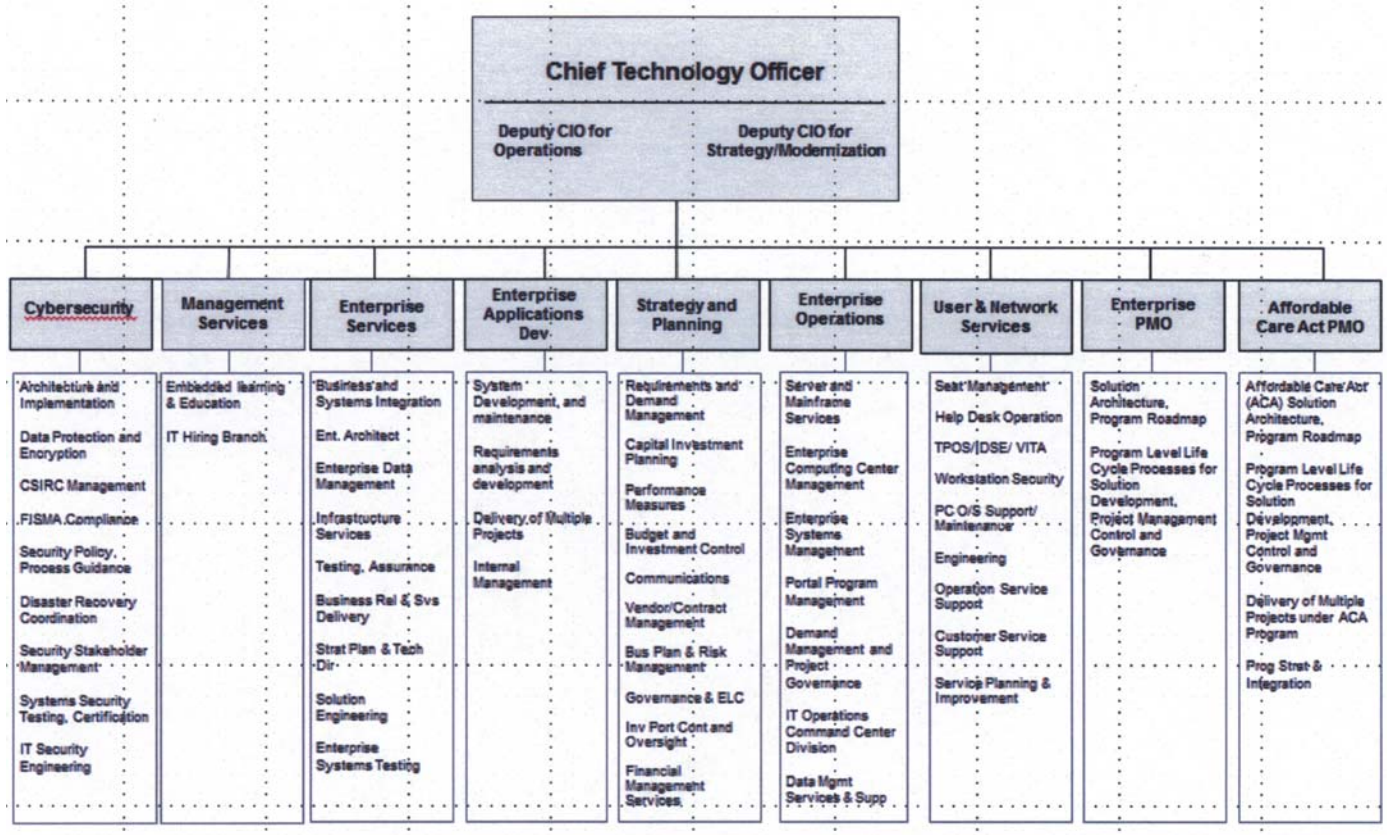
Question. Describe the existing authorities, organizational structure, and reporting relationship of the IRS Chief Information Officer. Note and explain any variance from that prescribed in the Information Technology Management Reform Act of 1996 (aka, The Clinger-Cohen Act) for the above.

Answer. Pursuant to Delegation Order 2–1 (formerly DO–261, Rev. 1), Internal Revenue Manual Section 1.2.41.2 (08–17–2000), the IRS Commissioner gives the IRS CTO authority to govern all areas related to information resources and technology management, and authority to perform those functions that the Commissioner is authorized to perform having Servicewide impact and relating to, or concerning, the acquisition of information technology (IT) and the management of information resources, other than the duties delegated to the Assistant Commissioner (Procurement).

With regard to organizational structure and reporting relationship, under Internal Revenue Manual Section 1.1.12.1 (05–19–2012), the IRS CTO is accountable to the Commissioner of the IRS to lead the IT organization. While the CTO performs and is accountable to the Commissioner as outlined in the IRM and in accordance with the Information Technology Reform Act of 1996 (Clinger Cohen Act), the CTO also has line reporting to the Deputy Commissioner for Operations Support, along with the Chief Officers, i.e., Chief Financial Officer; Human Capital Officer; Chief, Agency-wide Shared Services; and Director, Privacy, Governmental Liaison and Disclosure. This enables collaboration and alignment among the Chief Officers in building a strategic foundation for organizational excellence. This strategic foundation is critical in delivering the IRS's objectives and goals outlined in the IRS strategic plan.

There are no variances from the requirements of the Information Technology Management Reform Act of 1996 (aka, the Clinger-Cohen Act). Following are charts that show organizational structure:


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Organization and Top Officials
As of: June 2014
John A. Koskinen
Commissioner
Crystal Philcox*
Chief of Staff
Crystal Philcox
Deputy Chief of Staff
Tom Brandt
Chief Risk Officer and Senior Advisor to the Commissioner
Dean R. Silverman
Senior Advisor to the Commissioner (Office of Compliance Analytics)
Kirsten Wielobob
Chief, Appeals
Terry Lemons
Chief, Communications and Liaison
Monica Davy
Executive Director, Equity, Diversity and Inclusion
Rosemary Marcuss
Director, Office of Research, Analysis, and Statistics
Nina E. Olson
National Taxpayer Advocate
William J. Wilkins
Chief Counsel
Peggy Sherry
Deputy Commissioner for Operations Support
Vacant
Assistant Deputy Commissioner for Operations Support
Stuart Burns
Chief, Agency-Wide Shared Services
Robin Canady
Chief Financial Officer
Terence V. Milholland
Chief Technology Officer
Daniel Riordan
IRS Human Capital Officer
Mary Howard
Director, Privacy, Governmental Liaison and Disclosure
John M. Dalrymple
Deputy Commissioner for Services and Enforcement
Vacant
Assistant Deputy Commissioner for Services and Enforcement
Carolyn A. Tavenner
Director, Affordable Care Act Office
Richard Weber
Chief, Criminal Investigation
Heather Maloy
Commissioner, Large Business and International Division
Rajive Mathur
Director, Office of Online Services
Karen L. Hawkins
Director, Office of Professional Responsibility
Carol A. Campbell
Director, Return Preparer Office
Karen Schiller
Commissioner, Small Business/Self-Employed Division
Sunita Lough
Commissioner, Tax Exempt and Government Entities Division
Debra Holland
Commissioner, Wage and Investment Division
Stephen A. Whitlock
Director, Whistleblower Office
*Denotes Acting Assignment
NOTE: With respect to tax litigation and the legal interpretation of tax law, the Chief Counsel also reports to the General Counsel of the Treasury Department. On matters solely related to tax policy, the Chief Counsel reports to the Treasury General Counsel.


Chief Technology Officer
Deputy CIO for Operations
Deputy CIO for Strategy/Modernization
Cybersecurity
Architecture and Implementation
Data Protection and Encryption
CSIRC Management
FISMA Compliance
Security Policy, Process Guidance
Disaster Recovery Coordination
Security Stakeholder Management
Systems Security Testing, Certification
IT Security Engineering
Management Services
Embedded learning & Education
IT Hiring Branch
Enterprise Services
Business and Systems Integration
Ent. Architect
Enterprise Data Management
Infrastructure Services
Testing, Assurance
Business Rel & Svs Delivery
Strat Plan & Tech Dir
Solution Engineering
Enterprise Systems Testing
Enterprise Applications Dev
System Development, and maintenance
Requirements analysis and development
Delivery of Multiple Projects
Internal Management
Strategy and Planning
Requirements and Demand Management
Capital Investment Planning
Performance Measures
Budget and Investment Control
Communications
Vendor/Contract Management
Bus Plan & Risk Management
Governance & ELC
Inv Port Cont and Oversight
Financial Management Services
Enterprise Operations
Server and Mainframe Services
Enterprise Computing Center Management
Enterprise Systems Management
Portal Program Management
Demand Management and Project Governance
IT Operations Command Center Division
Data Mgmt Services & Supp
User & Network Services
Seat Management
Help Desk Operation
TPOS/IDSE/ VITA
Workstation Security
PC O/S Support/ Maintenance
Engineering
Operation Service Support
Customer Service Support
Service Planning & Improvement
Enterprise PMO
Solution Architecture, Program Roadmap
Program Level Life Cycle Processes for Solution Development, Project Managament Control and Governance
Affordable Care Act PMO
Affordable Care Act (ACA) Solution Architecture, Program Roadmap
Program Level Life Cycle Processes for Solution Development, Project Mgmt Control and Governance
Delivery of Multiple Projects under ACA Program
Prog Strat & Integration

Question. What formal or informal mechanisms exist in your agency to ensure coordination and alignment within the CXO[1] community (i.e., the Chief Information Officer, the Chief Acquisition Officer, the Chief Finance Officer, the Chief Human Capital Officer, and so on)? How does that alignment flow down to agency subcomponents?

Answer. The Commissioner chairs an agency Senior Executive Team (SET) meeting monthly. It includes the Deputy Commissioner for Services and Enforcement (DCSE), Deputy Commissioner for Operations Support (DCOS), and Functional Operating Division Chiefs and their deputies, including the entire CXO community. The SET meetings are designed to ensure top-level strategies and policies are driven down into the organization with consistency, and to enable coordination and alignment on enterprise and cross-organizational initiatives, risks, and current events facing the agency.

The DCOS also meets each week with her direct team, which includes CXO community chiefs. These meetings are conducted to build a collaborative community of leaders under the DCOS to ensure coordination and alignment as a strategic foundation for organizational excellence and in delivering on the objectives and goals outlined in the IRS strategic plan. Cross-organizational strategies and priority initiatives are discussed, organizational risks, impacts, and mitigation strategies are brought to the table for discussion, administrative requirements and recent items of significance are shared, and general updates on current events are covered during these meetings.

DCOS also holds working sessions with the CXO community several times a year. These sessions are designed to build and gain alignment on various themes/strategies that require concerted time, deeper thinking and cross-coordination among the team members. Subject matter discussed in these meetings is usually specialized and high priority with potentially large impacts on the CXO community and the entire IRS.

DCOS conducts quarterly Business Process Reviews (BPRs) with each of the individual organizations within the CXO community. These reviews enable the DCOS to get a comprehensive update on high-priority programs and initiatives, to review program results and performance measures, and to drive down guidance and preferences in managing various aspects of the programs. Action items are noted in BPRs and implemented with follow-up reporting at subsequent meetings.

Actions, initiatives, and messaging from the above framework of meetings are driven down within the CXO community through weekly senior staff meetings and numerous working groups. The senior staff, in turn, drives any formal guidance and direction down through their organizations as part of their direct reports meetings, functional area reviews, and communications strategies. Ongoing functional responsibilities that need cross-organizational coordination and alignment among CXO community organizations and beyond are handled with an additional level of structure via governance boards and working groups.

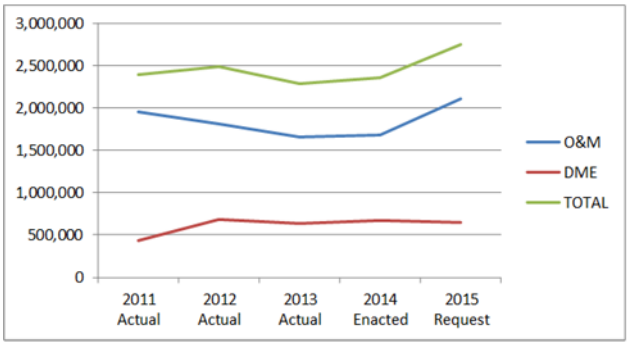
Question. How much of the agency's budget goes to Demonstration, Modernization, and Enhancement of IT systems as opposed to supporting existing and ongoing programs and infrastructure? How has this changed in the last 5 years?

Answer. The Chart below depicts the IRS spending for Development, Modernization, and Enhancement (DME) and Operations and Maintenance (O&M) for the past 5 years. The trend shows higher spending in DME and less O&M. Due to the IRS's budget cuts for the past several years, decreased spending in O&M has created a critical need to invest in the aging IT infrastructure. Inadequate spending to replace and maintain the IT infrastructure will not only increase maintenance costs, system downtime, and availability, but threatens deployment of new capability and capacity upgrades needed to support operational resiliency and security. This creates risk for disaster recovery, information security and encryption.

The fiscal year 2015 Budget Request reflects the IRS's plan to increase investment in infrastructure, causing a deviation from the downward spending trend. If sufficient funding is provided in fiscal year 2015, we expect to get back on track with a higher allocation of our budget in DME in the out years.

[Dollars are in thousands]

	O&M	DME	Total	DME %	O&M %
2011 Actual	1,960,391	428,262	2,388,653	17.93	82.07
2012 Actual	1,807,405	679,898	2,487,303	27.33	72.67
2013 Actual	1,652,447	632,382	2,284,829	27.68	72.32
2014 Enacted	1,684,867	668,733	2,353,600	28.41	71.59
2015 Request	2,104,831	650,225	2,755,056	23.60	76.40



In 2011, IRS spent 18 percent of its total budget on DME. Since 2011, DME spending has increased to approximately 28 percent of IRS IT spending due to legislated programs and decreasing budgets. In 2015, assuming above the budget cap funding is provided, this percentage will decrease to 24 percent to accommodate the need to invest in IT Infrastructure.

[Dollars are in thousands]

	O&M	DME	Total	DME %	O&M %
2015 Request	2,104,831	650,225	2,755,056	23.60	76.40
2014 Enacted	1,684,867	668,733	2,353,600	28.41	71.59
2013 Actual	1,652,447	632,382	2,284,829	27.68	72.32
2012 Actual	1,807,405	679,898	2,487,303	27.33	72.67
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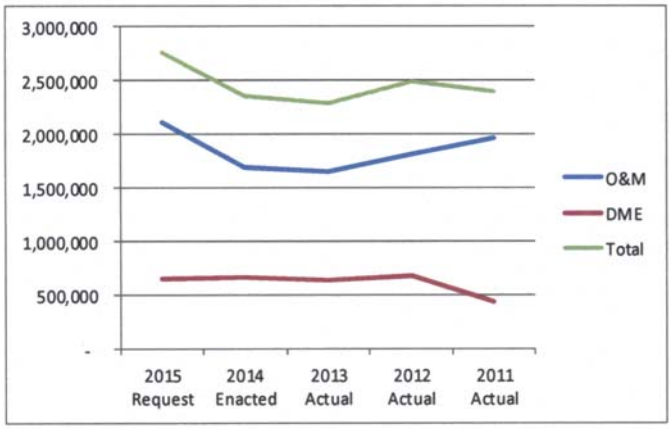

In 2011, IRS spent 18 percent of its total budget on DME. Since 2011, DME spending has increased to approximately 27 percent of IRS IT spending due to legislated programs and decreasing budgets. In 2015, assuming above the budget cap funding is provided, this percentage will decrease to 24 percent to accommodate the need to invest in IT Infrastructure.

Note: Above includes all IT funds, including ACA activity.

Question. Where and how is the IRS taking advantage of this administration's "shared services" initiative? How do you identify and utilize existing capabilities elsewhere in government or industry as opposed to recreating them internally?

Answer. The IRS has actively participated in the Federal Government Shared Services initiative over the past several years. Currently the IRS primarily utilizes Federal Government shared services through the Treasury Franchise Fund (TFF) that is supervised and managed by the Department of the Treasury. The fiscal year 2014 estimate for the IRS shared services provided by the TFF is $95 million. Some of the services IRS receives through the TFF include:

—HR Connect, which delivers human capital services and interfaces with the Department of Agriculture's National Finance Center providing payroll processing and support;

—Web Solutions, which provides collaboration sites and support for IRS Webmasters and content managers;

—Treasury Enterprise Identity Credential & Access Management provides Personal Identification Verification, Physical Access Controls, Logical Access Controls for local, remote & mobile devices;

—Government Secure Operations Center serves as the focal point for management of cyber incidents and is responsible for security detection, analysis and incident management lifecycle practices; and

—A number of other smaller programs that provide non-IT services, including the Office of Small and Disadvantaged Business Utilization, which advises and aids the bureaus on small business policies and initiatives; Treasury Operations Excellence, which provides Lean Six Sigma training and other services to help Treasury and other Federal agencies use entrusted resources more effectively and efficiently; and the Privacy, Transparency, and Records program, which provides assistance to Treasury customers to collect, protect, retain, preserve, disclose, and provide access to Treasury's information resources pursuant to U.S. laws.

The IRS also offers shared services to other agencies through Reimbursable Agreements. These include procurement services and use of Call Centers by FEMA for disasters.

Question. Provide short, two-page, summaries of three recent IT program successes—projects that were delivered on time, within budget, and delivered the promised functionality and benefits to the end user. How does the IRS define "success" in IT program management?

Answer.—

Project #1: IRS.gov/Enterprise Portal

In August of 2011, the IRS Information Technology organization set out to deploy enhanced Web services including a straightforward, manageable Web environment, established end-to-end operational accountability and visibility, and a cost-effective program structure.

Additionally, the IRS sought to address the following challenges:

—Exponential growth of online electronic filings and taxpayer access to information;

—Difficulty balancing system capability to meet demand (scaling horizontally);

—Inconsistent user experiences for the taxpayer and tax preparer;

—Limited ability to share data and content between the IRS user communities;

—Difficulty focusing on serving end users (taxpayers and preparers) in an end-to-end fashion; and

—Multiple portals with numerous services to maintain.

The solution was the Integrated Enterprise Portal (IEP), an innovative, cost-effective system that provides a scalable, managed private cloud capability to the IRS, enabling one-stop, Web-based services to internal and external users. The IEP has transformed the way the agency creates, launches and administers its taxpayer- and employee-facing applications. At its most basic operational level, it allows the IRS to get business-critical applications to the live environment more quickly, while enhancing cost predictability and security.

Recent IEP Program Successes:

—*Registered User Portal (RUP) Deployment*.—RUP, deployed on-time and within budget in September 2013, implemented a secure, FISMA-moderate (Federal Information Security Management Act framework risk classification), scalable, managed private cloud which provides a shared portal infrastructure that consolidates the IRS platforms under a single, flexible, and scalable platform. The RUP is the IRS external portal that allows registered individuals and third party users, where registration and login authentication are required for access,

to interact with selected tax processing and other sensitive systems, applications, and data.

—*Filing Season 2014*.—The 2014 tax filing season marked the IRS's first season fully "in the cloud." Going into tax season there was uncertainty driven by the fact that deployment occurred just a few short months earlier—a period of time made even shorter by a 3-week Government shutdown. Additionally, the IEP was predicted to face an unprecedented amount of traffic and filings. Despite these circumstances, the IEP not only delivered, but exceeded expectations handling the highest number of electronic returns and traffic ever—all with 100 percent availability and zero Priority 1 or Priority 2 incidents. This was a season of unprecedented peaks for the IRS that set a new standard for tax seasons to come. For example, on 2/6/14 the IEP successfully handled the "Where is My refund" application peak of 5.8 million unique daily visitors at a peak volume of 15,000 transactions/minute. Detailed statistics are as follows:

Portal key performance metrics January 11 to April 17, 2014:

—224.1 million total returns submitted (Federal + State);
—1.025 billion IRS.gov page views/263 million IRS.gov site visits; and
—132.7 million page views during seasonal peak week.

"Where's My Refund" accessed via IRS.gov Web site:

—136 million page views;
—112 million site views; and
—15,000 peak transactions/minute.

—*New Technical Capabilities to support the Affordable Care Act (ACA) effort*.—A new Transactional Portal Environment (TPE), which is a series of capabilities that reside within the IEP, was needed to support the new Affordable Care Act (ACA) program. The ACA TPE supports secure Application-to-Application (A2A) interfaces between Health and Human Services (HHS) Centers for Medicare & Medicaid Services (CMS) and the IRS. The new portal solution was implemented on-time and on-budget to support the beginning of open enrollment in the Marketplaces in October 2013. The IRS achieved the business objective to deploy a TPE solution providing CMS access to ACA services and providing 24/7 monitoring and support, daily reporting, and confirmation that initial traffic was within anticipated thresholds.

Key metrics for October 1, 2013 to April 15, 2014:

—TPE successfully processed 45 million requests for Income and Family Size Verification (IFSV) and Premium Tax Credit (PTC) computation services in real time from CMS.

—*Employee User Portal (EUP)*.—In late December 2013, a production IRS Employee User Portal (EUP) environment was successfully transitioned to the IEP. The IRS completed this transition ahead of schedule in response to a request by the IEP Governance Board to pull in the transition schedule in order to begin transitioned production operations prior to the beginning of Tax Filing Season 2014. Production operations of the newly transitioned environment were supported without a Priority 1 or 2 incident throughout the 2014 Tax Filing Season (January 2014 to April 2014). In addition to supporting transition and filing season operations of the existing EUP infrastructure, the IRS conducted initial analysis and concept of operations discussions about the future state of the EUP that would align with the goals of data center optimization and consolidation.

Definition of "Success"

Success was clearly defined on this program with deliverables completed on time, within budget, and with the promised functionality to achieve the Authority to Operate (ATO) recommendation from Cyber Security and planned business results.

Project #2: CADE 2

The Customer Account Data Engine 2, known as the CADE 2 program, is implementing a single, data-centric solution that provides daily processing of taxpayer accounts.

A critical component of the CADE 2 program is an authoritative database for individual taxpayers that provides more efficient and effective tax administration. The new database is the heart of the solution. It will transform the way the IRS approaches tax administration into the future. It improves taxpayer services by providing the capability to view taxpayer account data stored in the CADE 2 database with on-line viewing by IRS customer service representatives, as well as analytical

reporting for more meaningful business intelligence and expanded opportunities to increase compliance.

As the IRS continues to invest in its data-centric vision in fiscal year 2015, CADE 2 will enable an enterprise-wide data environment that extends business capabilities, promotes efficiency, and increases productivity by ensuring the fidelity, security, and understanding of IRS data. This is essential to effectively enable the IRS to leverage 21st century technologies such as cloud computing, Web services, electronic submissions, e-Authentication, big data and data analysis, and computing as a commodity, to name a few.

With deployment of CADE 2 Transition State 1 (TS1), the IRS took a leap forward from a technology standpoint, moving the management of IRS's individual taxpayer account data from 1960's sequential flat-files stored on magnetic tapes, to state-of-the-art relational database technology. The IRS is now conducting transactional processing of account data for over 270 million individual taxpayers and over a billion tax modules on a modernized DB2 relational database. The IRS data is now stored in relational formats dictated by a state-of-the-art data model that maintains historical values never before retained on taxpayer account transactions and facilitates daily viewing of taxpayer account data by IRS customer service representatives. CADE 2 TS1 is offering faster refunds, faster notices, faster payment postings, and improved service for millions of taxpayers as well as a solid foundation for our data-centric vision. As of the end of April 2014, CADE 2 had posted 116.97 million returns and issued 101.67 million refunds totaling $269.30 billion for filing season 2014.

The IRS is now well positioned to take the essential next step in its data-centric vision—rewriting its core taxpayer account processing applications so they can leverage the benefits of the new, high-powered CADE 2 relational database environment. Prototypes are being conducted to validate our assumptions about our approach to this effort. Once our applications are re-written into a modern programming language and are able to effectively populate the new CADE 2 relational database based on its modernized data model, it will become the authoritative source for individual taxpayer account data for the IRS. This CADE 2 effort, called Transition State 2 (TS2), will enable the IRS to address its longstanding unpaid assessments financial material weakness which has added substantial risk to IRS custodial accounting and clean audit opinion for nearly 20 years.

TS2 will ensure the long-term viability of the IRS tax processing systems by addressing the limitations and risks associated with the aging architecture and the design of our legacy core tax processing systems, as well as the outdated programming languages that are difficult to maintain.

Investments in CADE 2 TS2 are already delivering benefits to taxpayers with the rollout of the Penalty & Interest (P&I) common code base on January 2, 2014. After years and years of discrepancies among various systems in calculating penalty and interest, a new application is now calculating penalty and interest consistently on individual and business accounts for taxes that are not received by the due date across our master files (Business Master Files and Individual Master Files). It is also providing service improvements for taxpayers such as more accurate notices, consistent penalty and interest calculations, and enhanced service, as Customer Service Representatives have more accurate information and are better able to assist taxpayers in meeting their tax filing and payment obligations. The solution uses the existing master file common code modules as baselines and incorporates additional requirements for IDRS.

CADE 2 is a game changer for the IRS, and once complete it will enable many opportunities for the IRS to transform the way we approach tax processing today and into the future.

Project #3: Filing Season

At the core of the IRS's operations is an IT infrastructure that has been foundational to administering the U.S. Federal tax code since the early 1960's. Deployment of IT infrastructure in support of Filing Season 2014 resulted in many successes, in spite of a tough budget environment that resulted in three agency furlough days, hiring freezes and a 16-day Government shut down that delayed the opening of filing season. Through collaborative efforts of hundreds of IT and Business staff and consistent assessment of risks and mitigation of impacts, the IRS was able to continue its record of timely deployment of IT systems for filing season 2014, enabling improved taxpayer services, increased compliance, and enhanced security against threats to the Nation's tax system, with marked improvements in production statistics over previous years.

The IT infrastructure for Filing Season 2014 is extraordinarily large and complex, putting it in a class of its own in comparison to other tax systems around the world.

The IRS deployed 67 critical filing season systems comprised of thousands of programs written in many programming languages and technology platforms that have been developed over decades to support the growing tax code. These complex systems provided the intelligence and capacity to process about 250 million tax returns submitted electronically and on paper between January 2 and April 15, filtering out fraud and generating over a million refunds totaling roughly $250 billion. These systems capture and move massive amounts of data from program to program under strict limitations set by service level agreements that govern the complex tax return process. They support filing season core tax processing, collection, and exam activities for every taxpayer in the country, and then send the appropriate financial data to IRS's general ledger to execute fiduciary responsibilities and ensure integrity in management of U.S. Government funds. Underlying the critical systems is a complex communications infrastructure of local and wide area networks, with computer hardware and other IT devices and supporting systems that successfully routed over 58 million taxpayer telephone calls with 100 percent system uptime, providing 24x7 taxpayer access to the IRS for Filing Season 2014. The IRS also maintains various technology components and processes that mitigated hundreds of cyber incidents and ensured the continued security posture of our systems, networks, computers and printers, including thwarting three serious cyber threats (e.g., "Heart-bleed", Microsoft Word and Microsoft Internet Explorer) during peak tax processing season.

Readiness activities to prepare the IRS's labyrinth of IT systems and processes for Filing Season 2014 included identifying and training IT specialists to implement world class system end-to-end monitoring, control room 24x7 coverage, and enhanced incident management to support filing season execution. Modernized systems using new technologies were developed and successfully deployed in Filing Season 2014, and hundreds of programming changes were made to our core systems, updating them to incorporate changing tax law. Updates to infrastructure configurations and upgrades to hundreds of computer hardware components, software applications, databases, operating systems, networks, communication devices, and procedures were necessary for smooth execution and protection from hackers and intruders. Systems Acceptability Testing (SAT) and Final Integration Testing (FIT) was completed for 133 projects, including execution of 62,000 test cases to provide assurance of a successful launch.

A Processing Year Delivery Assurance Executive and program management office provided leadership over the Filing Season 2014 activities within the IT organization, and over the many suppliers who assumed responsibilities in development and execution. An integrated Filing Season 2014 governance framework provided enterprise risk and readiness assessments to address and mitigate every issue. Filing Season readiness standard operating procedures were followed, with weekly and then daily operational meetings across the breadth and depth of the enterprise using red/yellow/green reporting for each critical system. Readiness certifications were required at all levels of the organization to signify readiness and ensure stakeholder accountability in execution.

Operational results in Filing Season 2014 show many successes and significant improvements over Filing Season 2013:

—Priority One incidents were down 42 percent from previous Filing Season.

—Modernized e-File (MeF) system had one of the best filing seasons on record, enabling taxpayers to electronically submit over 221 million individual returns along with over 12.5 million Business Master File returns (as of 5/27/2014)—an increase of 3.08 percent for submitted returns compared to the same period in 2013.

—CADE 2 had a smooth filing season launch of its core processing systems in Filing Season 2014 and continues to demonstrate full integration into Filing Season Operations.

  —CADE 2 database is feeding 16 downstream systems, and allowing over 50,000 Customer Service Representatives and other IRS users to view CADE 2 data.

—IRS.gov enabled more taxpayers to avoid wait times on phones. With no interruption in service, usage on the Web site from 3/1–5/31/2014 includes 595 million IRS.gov page views and 143.2 million Web site visits.

—"Where's My Refund" inquiries using IRS.gov equated to 6.7 million page views and 5.8 million site visits from 3/1–5/31/2014.

—The "Get Transcript" application delivered over 11 million transcripts to taxpayers and IRS customers from 1/13–5/28/2014, allowing them to view/print a PDF file of their transcript.

—E-Services enhancements enabled State users to get copies of transcripts for individuals who are victims of ID Theft. Previously, only IRS employees could request these transcripts.

—Enhancements to Enterprise eFax service (EEFax) increased the number of faxes that can be delivered to taxpayers at one time and reduce annual expenses for hardware, software and telecommunication lines.
—New End to End (E2E) application and infrastructure monitoring and auto-ticketing enhanced operation of many Filing Season Critical Systems.
—Enhancements to the Online Payment Agreement (OPA) program were successfully implemented in Filing Season 2014 making it easier for the online user to navigate the OPA Web page and establish installment agreements.

Question. What "best practices" have emerged and been adopted from these recent IT program successes? What have proven to be the most significant barriers encountered to more common or frequent IT program successes?

Answer. Many IT best practices have emerged from our successes at the IRS, particularly in the last few years when IRS executives, architects, engineers, and subject-matter experts have taken more of a lead role in program leadership, systems design, applications development, and systems integration. While many of the best practices are shared across various program management offices—enabled by sharing of toolkits, post-implementation reviews, and collaboration (cross-membership) among governance bodies, etc.—the following are best practices reported by the three specific program offices that reported their successes in the previous question above:

Project #1: IRS.gov/Enterprise Portal

The portal team used best practices such as:

—*Elastic Scalability*.—A recent best practice that resulted in an IT program success was our use of elastic scalability on demand. This "on-demand" capability was successfully utilized to scale the "Where's My Refund?" application on a peak day by 300 percent in a matter of hours. This approach is being successfully applied to business critical applications inside the IRS firewall for Filing Season 2015.
—*Overcoming Barriers*.—One of the key barriers to adopting rapid cloud provisioning was overcome by striking a good balance between maintaining the stability of the applications and limiting the changes during filing season.

Project #2: CADE 2

With regard to best practices, CADE 2 was sponsored at the highest level . In 2009, the IRS Commissioner himself formally launched the CADE 2 program and each Commissioner since then has strongly endorsed it since its inception.

CADE 2 has been managed under a delivery partner operating model, jointly led and governed by IRS executives across Information Technology and the technology industry. With the flexibility, to use critical pay and other authorities to recruit industry leaders and experts with a mix of knowledge in legacy and modernized systems, augmented by a small cadre of in-house subject matter experts, the program was staffed with the right mix of people.

—CADE 2 established a governance model that includes an Executive Steering Committee with representation at the highest levels of the organizations; a Governance Board that has the expertise to enable them to make critical decisions and assume accountability for the outcome of the program; an Executive Oversight Team that meets regularly with accountability for day-to-day identification of risks and progress in addressing those risks across the program; and advisory councils that provide technical advice and subject matter expertise as needed.
—The CADE 2 Program Management Office (PMO) serves with clear authority and lines of accountability assigned to the Business and IT delivery partners. This collaborative program management model was supplemented by high performing workshops early on in the program to develop techniques such as granted trust, generous listening, and rules of effective engagement, which has resulted in growing an in-house capability to manage complex systems using industry best practices that keeps decisionmaking on the side of the Government.
—The CADE 2 PMO produced four foundational documents that drive the program:
  —Program Charter describes who we are—mission, goals, operating principles;
  —SolutionsArchitecture documents where we are now and where we are going—aligned with agency architecture;
  —Program Roadmap outlines how we are going to transition to target state; and
  —Program Management plan defines management principles, practices, and processes that will be used.
—The program institutionalized a solid process around messaging to ensure open, accurate and consistent communication with regular report-outs to ensure full

transparency and ongoing understanding of progress and risks on the program by all oversight bodies, audit agencies, agency top executive team, delivery and business partner executives, and stakeholders.

—The CADE 2 PMO engaged people IRS-wide in an organizational readiness plan to support the new solution in order to gain maximum benefits and results. Many organizational readiness activities were conducted, such as training sessions on the new production process and how to address and resolve issues within a short timeframe, a control room staffed 24x7 with subject matter experts to provide production support, and formulation of special teams charged with driving testing to complete prior to deploying.

Overcoming Barriers:

—Previous barriers such as getting the business to the table to build requirements and own decisions along the way were mitigated through the comprehensive governance model.

—Burden from audits and other oversight reporting requirements was mitigated by inviting TIGTA and GAO to partner with us throughout the full life-cycle of the program to address risks and building solutions to mitigate them in real-time.

—Issues around funding were managed at the highest levels of the IRS, to get the resources that were needed in a timely manner to meet the program objectives.

—Cultural issues around "change" and "ownership" were addressed by the CADE 2 program manager and other IRS executives encouraging shared commitment for the success of the program.

—Individuals and work teams that previously worked with siloed knowledge of IRS systems were brought together to understand the "big picture" to effectively implement the CADE 2 integrated solution.

—The CADE 2 program manager and other IRS executives personally conducted workshops and coaching sessions using high performance communications techniques and contextual leadership to provide the vision and "line of sight" to break down silos and barriers within the IRS.

Project #3: Filing Season 2014

Many of the best practices used in other large IT programs have been adopted by the Filing Season Readiness program, including:

—Right-sized governance bodies that included stakeholders from IT and business organizations that are at the appropriate level of their organizations where they can readily represent their organization's interest and make decisions.

—Dedicated Filing Season program management office (called the Processing Year Delivery Assurance function) with lead executive that assumed point of accountability for success:

  —Enabled strengthened supplier management and engagement resulting in more tightly integrated incident and problem management.

  —Used various disciplines to promote data-based decisionmaking, such as Filing Season Readiness dashboards, and simulation/predictive modeling to project volumes and impacts.

  —Conducted regular preparatory meetings with all stakeholders, with accelerated frequency as filing season approached, where action items with tracked to completion.

—Enhanced organizational readiness with tabletop exercises to help anticipate Filing Season operational organization and process issues.

—Lessons Learned captured that resulted in over 250 recommendations for improvement/action in 31 areas:

  —Implemented IT Filing Season Readiness Framework—a repeatable process for cross-organizational management of readiness—including defining Filing Season Readiness SOP.

  —Created and validated a Control Room SOP based on experience and best practices that is now available to guide establishment of Control Rooms for other business systems.

—Obstacles were overcome using aggressive risk mitigation framework:

  —Integrated risk and readiness assessments into the Filing Season delivery cadence, strengthening evidence-based decisionmaking capabilities.

Question. Describe the progress being made in your agency on the transition to new, cutting-edge technologies and applications such as cloud, mobility, social networking, and so on. What progress has been made in the CloudFirst and ShareFirst initiatives?

Answer. With regard to new technologies, the IRS embraces every opportunity to be a leader in Government. The pace in which we can embrace new practices, technologies, and tools must be balanced against the existing funding and resource capacities. Even with these constraints, the IRS has made significant investments in end-to-end lifecycle traceability, data architecture, security tools, and internal collaboration tools.

In the spirit of CloudFirst, the IRS already embraces an internal cloud concept with infrastructure-as-a-service virtualization. The same principle of elasticity is gained by being able to increase hardware for critical filing season needs and reallocating hardware to other purposes outside of filing season. IRS.gov is already using a private cloud for all non-personally identifiable information (PII). We have used the FedRAMP approved public cloud offerings for several tests, including performance testing of end-to-end filing season systems and scaling of new applications. We continue to leverage the cloud offerings where it makes the best sense according to a project's lifecycle, type of data and privacy considerations, and integration with existing IRS applications.

Regarding ShareFirst, we have regular meetings with the Treasury Department to discuss opportunities to leverage work between the IRS and the other bureaus. Beyond Department-wide sharing, we have an extensive program and governance mechanism for intra-agency sharing. The IRS has a standards-based enterprise architecture that ensures adoption of common platforms and tools to minimize product sprawl. The IRS also has a software lifecycle with the appropriate checks in place to ensure new initiatives leverage existing products, licenses and services.

Beyond intra-agency sharing, the IRS participates in inter-agency sharing by using Data.gov. Data.gov is the central repository for the Federal Government to post free datasets for the public to research and develop Web and mobile applications. The IRS posts aggregate data cleansed of any personally identifiable information (PII). Examples include summary tax data by zip code, and tax exempt statistics of the changes in the numbers of tax and exemptions across States/counties. This type of information can be used to create new visualizations and can be combined with other data from across the Federal Government.

The IRS has over 30 datasets posted on data.gov, which are shared with the public, as well as other government agencies.

Question. How does your agency implement acquisition strategies that involve each of the following: early collaboration with industry; RFP's with performance measures that tie to strategic performance objectives; and risk mitigation throughout the life of the contract?

Answer. To bring these increased capabilities online at the IRS, we created standardized training and development opportunities and established the Vendor Management Organization (VMO), a small cadre of acquisition professionals with the specialized knowledge and experience to expedite complex IT acquisitions across the enterprise. The VMO has an over-arching organizational concept of strategically managing procurements and suppliers to maximize IT investments in key commodities, while at the same time minimizing business risk. The VMO manages all vendor relationships and all IT contracts, using a single system for documentation, tracking vendor contract renewal dates and option years, and developing metrics and measuring vendor performance.

The VMO also use a Performance-Based Acquisition strategy for most acquisitions. This technique structures all aspects of an acquisition around the purpose and outcome desired, as opposed to the process by which the work is to be performed. Under this technique, the VMO develops a Statement of Objectives (SOO), which describes the requirements in terms of measurable outcomes rather than by prescriptive methods. The VMO then develops Measurable Performance Standards defining what is considered acceptable performance to determine whether performance outcomes have been met.

A more strategic relationship with our vendors using this technique enables us to use remedies or procedures to manage performance that does not meet standards. To this end, the VMO has developed a Supplier Assessment Management tool, which is a scorecard that tracks performance based on set criteria which was developed and is overseen by the Supplier Management Advisory Board. This governance is essential to ensure that the IRS is maximizing the value of its vendor relationships, reducing risks, and measuring performance to achieve desired results.

Question. According to the Office of Personnel Management, 46 percent of the more than 80,000 Federal IT workers are 50 years of age or older, and more than 10 percent are 60 or older. Just 4 percent of the Federal IT workforce is under 30 years of age. Does your agency have such demographic imbalances? How is it addressing them? Does this create specific challenges for attracting and maintaining

a workforce with skills in cutting-edge technologies? What initiatives are underway to build your technology workforce's capabilities?

Answer. The IRS Information Technology organization performs extensive ongoing workforce analyses. Below is a summary of the IRS's IT organization's demographics, which reflects a somewhat higher percentage of older IT workers at IRS than OPM's analysis of the overall Federal IT workforce:

—The number of IT workers who are over 50 years of age is 4222 (out of 7294 total employees), or 58 percent of the current workforce.
—The number of IT workers who are over 60 years of age is 979 (out of 7,294 total employees), or 13 percent of the current workforce.
—Two percent of the IRS IT workforce is under 30 years of age (132 employees out of 7294 total).

The IRS pursues the following to ensure the proper technology capabilities for its workforce:

—IT performs extensive contractor-provided and on-the-job training and coaching where needed to ensure skills of the existing workforce are commensurate with work demands;
—IT has active frontline and senior leadership readiness programs to ensure there are leadership candidates in the pipeline;
—IT has an active leadership-mentoring program in place;
—IT has an active "ambassador" program for new hires to link new employees with seasoned employees for mentoring and coaching;
—IT's recent Direct Hire Authority provides IT with increased abilities to hire employees with specific skills for critical projects such as in support of the Affordable Care Act;
—Where possible and when funding allows, IT seeks new external talent while adhering to Federal recruitment practices such as "veteran's preference";
—Having recently completed negotiations with our union, special appointing authorities (such as "Pathways") will provide more flexibility to IT to attract students into entry-level positions;
—IT has launched a competency/skill/proficiency assessment process for all technical employees. The data will help IT make decisions about needed training and development; and
—IT is in the process of implementing a workforce planning tool concept, which would allow for an enterprise-wide view of talent, skills, capacity, and availability for better utilization of current staff across organizational boundaries.

Question. What information does your agency collect on its IT and program management workforce? Please include, for example, details about current staffing versus future needs, development of the talent pipeline, special hiring authorities, and known knowledge gaps.

Answer. The IRS currently performs IT workforce analyses about:

—IRS population trends, retirements, and other attrition losses, including those that affect the IT organization.
—Competency, skill, and proficiency information on the existing workforce. We are currently linking such information to position and business process to help analyze where development might be needed or where shifts in IT priorities are required.
—Hiring demand. The date is collected and mapped to business processes, competency and skill. Unfunded hiring needs tell us where gaps in IT positions and skills exist.
—Legacy systems requiring skills that are not readily available outside of the IRS (e.g., older programming languages such as COBOL and ALC).
—The IRS's need for JAVA-programmers, which continues to be a much needed skill. Our Direct Hire Authority has assisted us in improving on this skill-base.

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER A. COONS

Question. In fiscal year 2013, the telephone level of service for taxpayers trying to reach the IRS' toll-free lines dropped to 60.5 percent. Roughly 40 percent of taxpayers who called were unable to reach an IRS employee. Can you discuss what steps you are taking to solve this? We must ensure that taxpayers are able to communicate with the IRS in a timely and efficient way.

Answer. The IRS strives to serve as many taxpayers as possible, given limited resources. Telephone plans are developed after consideration of many factors, including: historical demand adjusted for known anomalies; the types and anticipated lengths of calls we expect to receive; assumptions concerning upcoming events, such

as known or pending legislation or trends in customer behavior; and the availability of existing or new automation and other alternative services. These plans are then matched with available or anticipated resources to determine a measure for the IRS's telephone level of service (LOS). For instance, this year there was a lower than anticipated filing season demand for telephone assistance, which was likely due to relatively few tax law changes and more people using IRS.gov to get answers to many basic tax law questions. As a result, the IRS expects to exceed its projected fiscal year 2014 LOS of 61 percent.

The fiscal year 2015 Budget request of $12.6 billion, including the Opportunity, Growth and Security Initiative, would allow the IRS to increase the projected LOS in fiscal year 2015 from 53 percent to 80 percent. The IRS projects demand related to the Affordable Care Act (ACA) to result in appropimately 10.5 million new calls to the IRS in fiscal year 2015. Without the funding requested in the President's budget, we estimate that nearly five out of every 10 taxpayers who call the IRS for service will not get through to an assistor. Those who do get through will then be subjected to long wait times. Because of this extraordinarily low projected LOS, the IRS expects that a higher than normal number of taxpayers will call back when they are unable to reach an assistor. These additional callbacks or re-tries will further compound the strain on the IRS telephone systems and may drive the LOS even lower than the projected levels. Also, taxpayers abandoning the telephone lines will likely turn to walk-in services or send correspondence, straining other IRS service channels. Other factors, such as legislative changes, could also adversely affect the IRS's LOS for fiscal year 2015.

Each year, taxpayers call the IRS for assistance expecting a prompt and accurate response to their questions. The IRS continually explores improvement opportunities to provide customers with easy access to accurate, user-friendly account services. Our objective is to proactively manage customer demand by improving contact center efficiency, referring customer demand to the most efficient service resource, and equipping the workforce with the tools to be productive. To continue to efficiently serve the maximum number of taxpayers possible, the IRS implemented the 2014 Service Approach to align taxpayer demand with the most cost-effective resource to provide the needed service. The 2014 Service Approach accomplished this by referring taxpayers to self-service resources while preserving telephone and in-person service for taxpayers that needed to speak to an assistor.

Question. I am concerned about some of the treatment that groups seeking 501(c)(4) status have received. I believe that we must ensure that staff that acted inappropriately are held accountable and correct any failures that allowed this behavior to happen. We have to be guaranteed that the IRS provides unbiased service to all taxpayers. Can you comment on the steps you have taken to ensure that this situation is fixed?

Answer. Last year, the Treasury Inspector General for Tax Administration (TIGTA) issued a report related to the determination process and the processing of applications for tax exempt status, Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review.

Since then, we have taken substantive corrective actions to address the problems TIGTA had identified. We have:

—Created an expedited approval process for 501(c)(4) organizations that has significantly reduced our backlog.
—Established an Accountability Review Board to assess individual employees' conduct and recommend discipline where appropriate.
—Installed a new management team in the Exempt Organizations (EO) division.
—Developed new training and conducted workshops on a number of critical issues, including the difference between issue advocacy and political campaign intervention, and the proper way to identify applications that require review of political campaign intervention activities.
—Established a new process to document the reasons why applications are chosen for further review.
—Issued guidelines for EO specialists on how to process requests for tax-exempt status involving potentially significant political campaign intervention.
—Created a formal, documented process for EO determinations personnel to request assistance from technical experts.

Additional detail on our efforts is available at: http://www.irs.gov/uac/Newsroom/IRS-Charts-a-Path-Forward-with-Immediate-Actions.

Subsequent to the TIGTA report, more than 250 IRS employees have spent more than 120,000 hours working directly on compliance with the six related investigations of the issues described in the TIGTA report—at a direct cost of nearly $10 million. I hope these investigations can be concluded in the very near future. Once we

have the resulting reports, we can then take further corrective action, where necessary. Completion of the reports is important for us to learn from, address, and move beyond the problems and concerns identified.

QUESTIONS SUBMITTED TO HON. J. RUSSELL GEORGE

QUESTIONS SUBMITTED BY SENATOR MIKE JOHANNS

Question. According to your audits the IRS continues to report that more than 20 percent of Earned Income Tax Credit (EITC) payments are issued improperly each year. In fiscal year 2013, the IRS estimates it issued between $13 and $15 billion in improper EITC payments.

Do you believe there is the potential for similar problems with implementation of the ACA's premium tax credits?

Answer. As is the case with other refundable credits, there is a risk for improper payments with the Premium Tax Credit. TIGTA is concerned that the potential for refund fraud and related schemes could increase as a result of processing Premium Tax Credits provided by the Affordable Care Act unless the IRS builds, implements, updates, and embeds Affordable Care Act predictive analytical fraud models into its tax filing process. In September 2013, we reported that a fraud mitigation strategy is not in place to guide Affordable Care Act systems development, testing, initial deployment, and long-term operations. The IRS informed us that two new systems are under development that will address Affordable Care Act tax refund fraud risk. However, until these new systems are successfully developed and tested, TIGTA remains concerned that the IRS's existing fraud detection system may not be capable of identifying Affordable Care Act refund fraud or schemes prior to the issuance of tax refunds.

Question. Are you aware of any effort on the part of the IRS to synthesize or otherwise generate the technical capacity or resources to perform full or partial return preparation for filers?

Answer. No. We are not aware of any such effort.

SUBCOMMITTEE RECESS

Senator UDALL. So with that, the subcommittee hearing is hereby adjourned.

[Whereupon, at 3:55 p.m., Wednesday, April 30, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2015

WEDNESDAY, MAY 7, 2014

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 1:57 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Tom Udall (chairman) presiding.

Present: Senators Udall, Johanns, Moran, and Mikulski.

THE PRESIDENT'S FISCAL YEAR 2015 FUNDING REQUEST FOR AND OVERSIGHT OF FEDERAL INFORMATION TECHNOLOGY INVESTMENTS

OPENING STATEMENT OF SENATOR TOM UDALL

Senator UDALL. Good afternoon. I am pleased to convene this hearing of the Appropriations Subcommittee on Financial Services and General Government on the request for and oversight of Federal information technology investments.

First I want to welcome my ranking member, Senator Mike Johanns, and I think we will have other colleagues joining us as we move through these proceedings.

And with us today are four distinguished witnesses, the Federal Chief Information Officer, Steve VanRoekel; the Administrator of the General Services Administration, Dan Tangherlini; the Director of the Office of Personnel Management, Katherine Archuleta; and the Director of Information Technology Management Issues at the GAO, the Government Accountability Office, David Powner.

Thank you for your service, and I look forward today to hearing all of your testimony.

With the agencies here today that all play a Governmentwide role, I want to mention that this week is Public Service Recognition Week. I would like to take this opportunity to salute our public servants and the valuable work they do. And I think many of you have many of those valuable public servants within your agencies and organizations.

Today's hearing is important because updating our information technology systems is crucial. Our Government should be using cutting-edge, 21st century technology. Too often, it isn't. And that affects all of us.

Across the Federal Government, agencies rely on information technology, including financial management systems to track payments and manage funds, handheld devices and e-mail systems to

communicate with each other, Internet Web sites to communicate with the public and share information on what the Government is doing.

The technology is moving forward, but the Federal Government is falling behind.

Agencies operate on old systems, often with multiple programs that cannot speak to each other, and with outdated, obsolete technologies.

We also need to make sure that money is well spent. The Federal Government spends $80 billion a year on information technology (IT) investments—every year—to operate outmoded systems agencies currently rely on and develop new ones. But $80 billion a year, and we know there is waste and duplication.

We need to get the most out of every dollar. And too often, we don't.

The Federal Government's IT Dashboard identifies 201 major IT investments totaling more than $12 billion, with significant concerns that need management attention.

Let me repeat that: 201 Federal IT investments. $12 billion in question marks. That is not acceptable to any of us.

There are numerous examples of expensive multiyear projects over budget and delayed, of investments that ultimately failed, wasting taxpayer money and crippling the Government's ability to do its job.

At a time of tight budgets, we cannot afford to waste funds. We should not be paying more and getting less. Agencies need IT investments that are efficient and effective, that help them complete their missions.

Agencies have identified savings from duplication and waste within IT portfolios totaling over $2.5 billion in the next 3 years. The Government Accountability Office (GAO) has identified additional savings by consolidating data centers. There are many opportunities to improve the way the Federal Government spends money on IT. We need to make the most of them.

At the same time, we need well-trained experts to do the work. For these investments to succeed, there are some existing and new tools being used by Federal agencies, but there may be more that can be done to train, recruit, and retain qualified IT specialists.

I want to make sure that citizens can depend on the Web to interact with their Government. IT is not a luxury. It is essential for individuals and for businesses. Small companies from places like Albuquerque and Las Cruces should be able to go online and find what Federal Government opportunities exist, and to be able to submit bids to compete for those opportunities.

American taxpayers should be confident that their money is being spent wisely and efficiently.

I look forward to hearing testimony today on how the fiscal year 2015 budget will advance oversight of IT investments and what more could be done. I am hoping that this hearing will help to guide this subcommittee's efforts as we evaluate the President's budget request and craft our appropriations bill.

I am also pleased to be working with my subcommittee colleagues, Ranking Member Johanns and Senator Moran, on bipartisan legislation to empower Federal agency chief information offi-

cers to drive more effective IT investments with more flexibility, transparency, and accountability.

And so with that, I turn to my ranking member, Senator Johanns, for any remarks he would like to make.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Thank you, Mr. Chairman. I want to say how much I appreciate you holding this important hearing today. As members of this committee, we, of course, have a responsibility to conduct oversight to ensure that hard-earned tax dollars of millions of Americans are spent appropriately, thoughtfully, wisely.

One area in need of this oversight is the $82 billion the Federal Government will spend on IT in the fiscal year 2014. Given the resources at stake and the importance of the projects, it is imperative that the Office of Management and Budget (OMB) and other Federal agencies appropriately manage these acquisitions and improve transparency and efficiency.

We can all name the project that ended with failure or with serious problems. I can name healthcare.gov.

While a crisis makes news, also troubling are the accounts that simply don't grab headlines. They don't have the high profile, like projects with ongoing costs that grow year after year.

Long-term investments must represent good value. We must be able to assure our citizens that it is good value. So we have to have safeguards in place to ensure that oversight of these projects is consistent; that problems are anticipated, ideally before they occur; and, most importantly, that someone is accountable, someone is responsible.

Often, large, complex information technology projects drag on. Sometimes they outlast the administration that initiated them, and the employees responsible for managing them.

In our Financial Services and General Government bill alone, billions have been spent over the years on trying to modernize tax systems at the Internal Revenue Service (IRS). That work has just gone on and on and on. While these projects appear to be back on track now, past problems generated millions in costs and years of delay.

As recent press reports have reminded us, the Office of Personnel Management (OPM) has a long history of unsuccessful retirement modernization initiatives.

Recognizing the need to modernize its retirement processing in the late 1980s, OPM began initiatives aimed at automating its antiquated paper-based processes. However, following attempts over more than 2 decades, the agency has not yet been successful in achieving the modernized retirement system envisioned.

These results, or lack thereof, are the type that anger our constituents who see hard-earned tax dollars being squandered on seemingly endless failed initiatives, and they have a right to be concerned.

According to the Government Accountability Office (GAO), across the Government, IT projects too often go over budget, fall behind schedule, and don't deliver sufficient value. Responsibility for oversight of information technology projects is oftentimes fragmented throughout the specific agency owning the project, and the projects

and spending receive insufficient oversight, maybe from Congress, but also from the Office of Management and Budget.

Unfortunately, when it comes to IT spending, it appears there is not a lot of management or effective budgeting going on at OMB.

Whether issues relate to program requirements, performance, spending, security, there are lots of people involved, but oftentimes no clear lines of accountability.

So, Mr. Chairman, I think this hearing is enormously important. I look forward to the testimony of the witnesses.

We welcome you here. We hope you can enlighten us today with your testimony. I look forward to the opportunity to ask questions.

Thank you, Mr. Chairman.

Senator UDALL. Thank you very much, Senator Johanns.

And we are delighted today to be joined by our chairwoman of the Appropriations Committee, Senator Mikulski.

Senator Mikulski, if you would like to do an opening statement, we would be ready for that at this point.

STATEMENT OF SENATOR BARBARA A. MIKULSKI

Senator MIKULSKI. Mr. Chairman, I know we want to get on with our hearing, so I am going to welcome the witnesses, but I am going to thank you and Senator Johanns for convening this hearing.

For some time, both in my role as chair of the subcommittee on Commerce, Justice, Science, to now my chair of the full committee, I have become increasingly concerned about what I call techno-boondoggles.

Part of the job of the Appropriations Committee is to be a quiet guardian of the purse. Well, I intend to be a not-so-quiet guardian of the purse. And what I worry about is that we spend billions and zillions on technology projects that are often ineffective or lacking in utility to, often, dysfunction.

Just two examples, as the chair of the Commerce, Justice, we had a tremendous fiasco over the funding of the census, so much so that Secretary Gutierrez, who I have great admiration for as CEO of a major corporation, called me aghast, and we went back, taking the census by hand after billions.

We had a Federal Bureau of Investigation (FBI) project in which all the computers were supposed to talk, connect the dots. Again, a boondoggle. Had to go back and do it again.

And yet, I fear one of the greatest boondoggles could be now with our Veterans Administration, in which so many agencies have to talk to each other in order to get to where our veterans do not stand in line, disability claims, something I know you are both interested in.

So we have to get a handle on what is happening on these, and in these financial services with the particular people here to testify. The Federal Government has spent more than $600 billion on IT investments over the last decade. And often, we end up doing it again and then again and then again. And I think it is time we get our arms around this.

PREPARED STATEMENT

The Appropriations Committee has to do it because we see everything and we fund everything. So let's get on with it. But I want you to know, working with Senator Shelby, we want to have a smart Government and a frugal Government, and IT could be one of our biggest challenges here. So thank you.

[The statement follows:]

PREPARED STATEMENT OF SENATOR BARBARA A. MIKULSKI

Thank you to Senators Udall and Johanns for convening this hearing. The American people are shocked—and so am I—every time it is discovered that billions of dollars have been wasted on what I call techno boondoggles.

These techno boondoggles are technology projects that should in theory make the Government more effective and efficient in providing services, but instead turn out to be complete flops.

The result of these flops is a lot of wasted time and taxpayer money. When things go wrong, we always see the 3 Bs—Big money, Big projects and Big failures.

This Committee has a responsibility to provide oversight of the funding for these projects to ensure that we get the most bang for our buck.

According to the General Accounting Office, the Federal Government has spent more than $600 billion on technology or information technology (IT) investments over the last decade. Unfortunately, I don't think we have gotten a good return on this investment.

We have spent billions of dollars on projects that have languished for years, only to be canceled or replaced with something else. This is inexcusable!

One of the best examples of this type of techno boondoggle comes from the Air Force, which tried to replace 240 outdated computer networks with one system. In theory, that sounds like a great idea. But in reality, the agency spent $1 billion and wasted 5 years before eventually terminating the project altogether in 2012.

Senator McCain described it as "one of the most egregious examples of mismanagement" he had ever seen.

Another example comes from the Department of Homeland Security attempt to create a new passenger screening system for people traveling by plane.

After spending $42 million and 8 years, they scrapped the whole project and replaced it with a different new screening system.

Those are just two examples—sadly, I could cite dozens of others.

Today I would like to hear how we can stop this kind of unnecessary spending. As Chairwoman of the Appropriations Committee, I'm committed to providing significant oversight of these projects and I believe this hearing is a good first step.

Last week, I convened a hearing on the importance of innovation and research. Those investments save lives, improve national security and create jobs. Innovation can also improve the performance of Federal agencies and help the Government better serve our constituents.

When a techno boondoggle occurs, we not only waste tax dollars, but we hamper the delivery of services to the American public that depends on them.

For example, the Department of Veterans Affairs processes and distributes disability payments to millions of veterans across the country. The Social Security Administration provides disability payments to millions of Americans, while the Office of Personnel Management manages Federal employee retirement benefits for millions of people, including many of my constituents.

My staffers who handle casework for these three agencies are some of the busiest people I know because of the ongoing backlogs. These backlogs weren't created by failed IT systems, but they were certainly made worse.

At a time of smaller budgets and difficult spending decisions, we have to make sure every dollar is spent wisely. When the Federal Government signs an IT contract, we are not only signing a contract with a company to build a program or implement a system. We are signing a contract with the American people that promises their tax dollars will be spent wisely and in a way that advances the mission of the agency.

I take this responsibility very seriously and look forward to hearing from our witnesses.

Senator UDALL. Thank you, Madam Chairwoman. We really appreciate your involvement in this. I know that this is something you have cared about passionately for a long time.

Mr. VanRoekel, I would like you to present your remarks on behalf of the Office of Management and Budget.

STATEMENT OF HON. STEVEN VanROEKEL, CHIEF INFORMATION OFFICER, OFFICE OF MANAGEMENT AND BUDGET

Mr. VANROEKEL. Thank you, sir. Chairman Udall, Ranking Member Johanns, and Chairwoman Mikulski, thank you for the opportunity to testify on the President's fiscal year 2015 budget request for the improvement of Federal information technology investments and oversight.

It is important to consider this request in the context of the President's overall fiscal year 2015 budget request for the Office of Management and Budget, which is $93.5 million and 480 full-time equivalent employees.

This request would enable OMB to address the growing workload while more effectively overseeing program management and funding across more than 100 Federal agencies and departments. This is a critical investment with returns in the form of improved program management, budgetary savings, and smarter regulations, some of the many critical outcomes that the administration, Congress, and the American people look to OMB to help ensure.

The Office of E-Government and Information Technology's work is core to achieving each of those aims. I would like to take a minute to discuss what our work has achieved to date and what our focus will be moving forward.

Every day during my nearly 20 years in the private sector, I focused on improving and expanding core services and customer value while also cutting costs. When I joined the administration in 2009, I found willing partners in this mission and have spent the past 3 years in OMB focused on maximizing the return on investments in Federal information technology, driving innovation to meet customer needs, and establishing a foundation for securing and protecting our information systems.

In the decade prior to this administration, the Federal IT budget increased at the compound annual growth rate of 7.1 percent a year. If spending had increased at the same rate during this administration, our current budget IT request would total $117 billion, not the roughly $80 billion that is being requested for information technology across the Federal Government in fiscal year 2015.

Throughout the President's first term and into today, we have focused on establishing mechanisms to stop this growth in IT spending. We have flatlined IT spending, and since 2012, our PortfolioStat data-driven accountability sessions have resulted in over $2.5 billion in identified cost savings and $1.9 billion in realized savings, showcasing the results of the administration's Governmentwide policies to drive this efficiency.

With these efficiency efforts firmly underway in fiscal year 2014 and fiscal year 2015, the administration is increasing its efforts to deliver smarter, more effective applications of technology. This work, which the President's fiscal year 2015 budget supports as

part of the President's management agenda, focuses on ensuring the Federal Government has three things: one, the best talent working inside Government; two, the best companies working with Government; and three, the best processes in place to make sure everyone involved can do their best work and, more importantly, be held accountable for delivering excellent results to the American people.

To support this work, the fiscal year 2015 budget requests $20 million for the Information Technology Oversight and Reform Fund. This fund will use data, analytics, and digital services to improve the efficiency, effectiveness, and security of Government operations and programs. This funding will also allow OMB to continue the work of PortfolioStat, enhance cybersecurity capabilities, and create the Digital Service, a centralized, world-class team made up of our country's brightest digital talent. These people will be charged with removing barriers to exceptional Government service delivery and remaking the digital experiences that citizens and businesses have with their Government.

The Digital Service, in close partnership with the General Services Administration's (GSA's) 18F delivery team, will establish standards to bring the Government's digital services in line with the best private sector service experiences, to identify gaps in their service capability, and to provide oversight and accountability to ensure we see results.

It will work side-by-side with agencies to ensure they have the resources and talent needed to deliver great services on time, on spec, on budget, and with optimal user functionality.

This capability, which will drive effectiveness across key citizen-facing services, is being incubated now under my office in OMB in fiscal year 2014 and, if funded, will expand in fiscal year 2015.

The fiscal year 2015 Information Technology Oversight and Reform (ITOR) request, this fund, represents a modest investment in comparison to the total Federal IT spending of approximately $80 billion annually. And through the ITOR fund, and the help of this subcommittee in both the Senate and the House, we have delivered tangible results in Government technology efficiency. And we look forward to accelerating this return on investment as we apply these efforts to effectiveness of technology in 2015.

In conclusion, it is apparent, in today's world, we can no longer separate the outcomes of our Federal programs from the smart use of technology. By increasing emphasis on customer needs and making it faster and easier for individuals and businesses to complete transactions with their Government, online or off-line, we can deliver the world-class services that they expect.

PREPARED STATEMENT

I am excited to continue working with this subcommittee on our shared goals and look forward to our conversation and questions. Thank you.

[The statement follows:]

PREPARED STATEMENT OF HON. STEVEN VANROEKEL

Chairman Udall, Ranking Member Johanns, and members of the subcommittee, thank you for the opportunity to testify on the President's fiscal year 2015 request for the improvement of Federal information technology (IT) investments.

During my 20 years in the private sector, I woke up every day focused on improving and expanding core services and customer value while also cutting costs. I brought this focus with me to the Federal Government. When I joined the administration in 2009, and the Office of Management and Budget (OMB) in 2011, I found willing partners in this mission and have spent the past 3 years at OMB focused on driving innovation to meet customer needs, maximizing our return on investments in Federal information technology, and establishing a trusted foundation for securing and protecting our information systems.

Before discussing the administration's fiscal year 2015 request for the Information Technology Oversight and Reform (ITOR) fund and Office of E-Government, I want to raise OMB's overall fiscal year 2015 budget request. The President's fiscal year 2015 budget for OMB requests $93.5 million and 480 full-time equivalents (FTEs) to address growing workloads while making targeted investments to enable OMB to more effectively oversee program management and funding across more than 100 agencies and departments throughout the Federal Government. The budget request would bring OMB back up to a staffing level comparable to 2009, though well below 2010, and support our expanded role in a number of key priority areas for this subcommittee. This is a critical investment with large returns in the form of improved program management, budgetary savings, and smarter regulations—some of the many critical outcomes that the administration, Congress, and the American people look to OMB to help ensure. While OMB has taken on a number of new functions and responsibilities in recent years, our funding and staffing levels have been significantly constrained and have not kept pace with our counterparts at the Congressional Budget Office. Today, OMB is 11 percent smaller than as recent as fiscal year 2010, with a fiscal year 2014 estimated FTE level of 470. As a result of sequestration, OMB employees were required to take 8 furlough days last year—the most of any agency in the Federal Government. While the funding restored in fiscal year 2014 appropriations was a step in the right direction, and we thank the subcommittee for its support, there is still work to be done. The requested funding will allow OMB to continue to play a central role in supporting the development and execution of a wide range of crucial programs and policies and managing critical Government functions. Today more than ever, OMB has a central role to play in our efforts to move our economy forward by creating jobs, growing the economy, and promoting opportunity for all.

FOCUS ON EFFICIENCY

Constantly improving the state of Federal technology is a priority for this administration and is a mission that OMB takes seriously. In these times of fiscal constraint, this means we must drive innovation while controlling spending—by maximizing effectiveness and efficiency in everything we do. The administration's first term efforts largely focused on establishing mechanisms to stop out of control IT spending, promoting new technologies such as cloud computing and mobile, opening up Federal Government data for private sector use, enhancing cyber capabilities, and deploying Federal technology as a tool to increase efficiency to allow Government to do more with less.

In the decade prior to this administration, the Federal IT budget increased at the compound annual growth rate of 7.1 percent. If spending increased at the same rate during this administration, our current IT budget request would total $117 billion. However, through PortfolioStat data-driven accountability sessions, and with the help of this subcommittee, Federal agencies enhanced analytical approaches to more effectively manage Federal IT portfolios and improve IT cost oversight. The Office of E-Government established a rigorous, continuous process for agencies to drive and measure information technology savings through the consolidation of duplicative services and other tactics to fund investment in innovation.

The result is over $2.5 billion of identified cost savings and $1.9 billion of realized savings through the PortfolioStat process and a consolidation of commodity IT. During this administration, we flatlined Federal IT spending, driving efficiencies and fueling innovation across the Federal technology portfolio, through initiatives like data center consolidation, cloud computing and the administration's Digital Government strategy, all the while working to keep Federal data safe and secure. Through these efforts and others, Federal agencies began to seize upon productivity gains seen in the private sector and apply technology to improve efficiency of our Government.

FOCUS ON EFFECTIVENESS

With our actions to drive efficiency across IT portfolios firmly underway, the administration is also increasing its efforts to deliver smarter, more effective applications of technology to improve the delivery of Federal services, information, and benefits. In doing so, we are applying the same rigor and data-driven analytical capabilities we used to drive efficiency across Federal IT to ensure agencies use IT effectively to deliver on their core missions.

To deliver citizens the services they expect from their Government, we must shift the focus of Federal Government IT projects from compliance and process to meeting user needs. We must be intensely user-centered and agile, involve top talent from the private sector in Government IT projects, and ensure agency leadership is actively engaged and accountable to the public for the success of the digital services of their agency. To support this effort, the administration's Smarter IT Delivery Agenda seeks to improve the value we deliver to citizens through Federal IT, and the speed and cost-effectiveness with which it is delivered.

The work of the Smarter IT Delivery Agenda builds upon the progress of reshaping the delivery of information technology already underway, as well as introduces new approaches and tools to transform the Government IT landscape. To do this, we are focused on a three-part agenda focused on ensuring the Federal Government has: (1) the best talent working inside Government; (2) the best companies working with Government; and, (3) the best processes in place to make sure everyone involved can do their best work and be held accountable for delivering excellent results for our customers, the American people.

The Smarter IT Delivery Agenda aims to increase customer satisfaction with top Government digital services; decrease the percentage of Government IT projects that are delayed or over budget; and increase the speed with which we hire and deploy qualified talent to work on Government IT projects.

There are several key projects already underway, and we will undertake additional projects in the coming months as the agenda continues to evolve.

FOCUS AREA 1: GET THE RIGHT TALENT WORKING INSIDE GOVERNMENT

IT excellence starts with having the best people executing IT in Government. While there are many talented IT professionals across Government, it is clear that we need to broaden and deepen this talent pool to meet present and future needs.

We must also work to solve the current challenges facing Government when it comes to quickly hiring qualified technical talent. IT is already one of the most competitive job markets in our economy, but Government hiring processes make competing for that talent even more challenging. Today, the average hiring cycle for IT specialists in the Federal Government is over 100 days. The norm for leading private sector companies is 7–14 days. Given the competitive markets for technical talent, Government is often unable to acquire top candidates given the current hiring process.

The Digital Service

To accelerate the pace of change, we are standing up a Digital Service—a centralized, world-class capability that is part of the Federal Chief Information Officer (CIO) Team made up of our country's brightest digital talent, which we will pilot with existing funds in 2014, and scale in 2015 according to the President's fiscal year 2015 budget. The team will be charged with removing barriers to exceptional Government service delivery and remaking the digital experiences that citizens and businesses have with their Government.

Through a modest team of people housed within the E-Government office at OMB, the Digital Service will establish standards to bring the Government's digital services in line with the best private sector service experiences, define common platforms for re-use that will provide a consistent user experience, collaborate with agencies to identify gaps in their delivery capacity to design, develop, and deploy excellent citizen-facing services, and provide oversight and accountability to ensure we see results. The Digital Service is a close partnership with the 18F delivery team at the U.S. General Services Administration (GSA), and will work side-by-side with agencies to ensure they have the resources and talent needed to deliver great services on time, on spec, on budget, and with optimal user functionality.

Flexible Hiring Authority Options for IT Talent

Building on the success of the Presidential Innovation Fellows program—a program that is delivering low cost, innovative solutions like RFP–EZ, advancing open data initiatives at agencies and more—the administration is pursuing flexible hiring authority options for IT talent, reducing barriers to the hiring of key digital experts

in Government. The program is being developed in partnership with the Office of Personnel Management, and would be phased in with agencies such as GSA.

FOCUS AREA 2: GET THE BEST COMPANIES WORKING WITH GOVERNMENT

The administration is also taking steps to reduce barriers and burdens in Federal procurement and increase the ability for innovative and non-traditional companies to work with the Federal Government with FBOpen—a new platform that allows easier access to Federal opportunities. In addition, OMB recently worked with GSA and procurement experts across Government on an open dialogue[1] to reduce barriers and burdens in Federal procurement.

Open Dialogue

The open dialogue was a joint effort between the Chief Acquisition Officers Council, OMB, GSA, and the Chief Information Officers Council to engage all stakeholders in the acquisition community to better understand the opportunities and challenges they face when doing business with the Federal Government. The focus of the dialogue was to generate solutions in three areas: streamlining reporting and compliance requirements, identifying industry best practices, and increasing participation by qualified non-traditional Government contractors. We anticipate that we will have recommendations for actions emerging from this work, and are eager to work with Congress on developing a whole-of-Government approach to improving Federal acquisitions.

FOCUS AREA 3: PUT THE RIGHT PROCESSES AND PRACTICES IN PLACE TO DRIVE OUTCOMES AND ACCOUNTABILITY

Complicated Federal IT projects often face similar challenges: (1) they lack visibility and real-time communication among the technical or IT staff, the mission or business owner, and the executive team; (2) they use the outdated waterfall approach to technology development, which includes long lead requirements setting rather than the agile approaches—where products are developed in rapid, iterative cycles—that have made the consumer Internet so successful; and (3) there is responsibility and accountability regarding compliance issues, but not enough end-to-end responsibility for the project actually working for its intended users at targeted investment levels. Taken together, these qualities can result in sub-optimal outcomes and high costs.

To address these issues, the administration will focus its efforts on driving accountability for customer service, mission results and cost; sharing best practices; and guiding agencies and contractors in delivering great digital services.

Tech FAR Guide

The administration will develop a compilation of the 21st century, agile aspects of the Federal Acquisition Regulation (FAR) that will guide agencies in soliciting services in new ways—ways that more closely match techniques used by the private sector—such as using challenges and crowdsourcing approaches to involve citizens, writing requirements that allow for more flexible execution, or a pay-for-service model. In particular, the guide will include FAR-allowed processes used by agencies that have successfully implemented IT projects, many of which are currently underutilized.

Digital Service Playbook

The administration will develop a Digital Service Playbook to share best practices for effective IT service delivery in Government. This playbook will build on successes both within and outside Government and will guide both technical and business owners within agencies. It will include best practices for building modern solutions across the implementation of the technology, how to measure customer input and manage customer expectations, and how to share solutions across Government.

PortfolioStat 2014

This spring, the administration is implementing PortfolioStat 2014, the third year of this successful program. PortfolioStat 2014 will not only continue the rigorous data-driven focus on finding efficiencies in agencies that has resulted in $1.9 billion in savings since 2012, but also adds a new focus on accountability around service delivery to ensure agencies are accountable for delivering on their highest impact IT investments. As I have testified previously, the PortfolioStat process brings together technology experts with the agency's senior accountable officials and Deputy

[1] http://www.gpo.gov/fdsys/pkg/FR-2014-04-23/pdf/2014-09129.pdf.

Secretary to evaluate agency performance against measured outcomes and increase accountability and responsibility within agencies.

THE INFORMATION TECHNOLOGY OVERSIGHT AND REFORM FUND AND ENHANCED CYBERSECURITY

To support this work, the fiscal year 2015 budget requests $20 million for the Information Technology Oversight and Reform (ITOR) fund. This fund, previously known as the Integrated, Efficient, and Effective Uses of Information Technology (IEEUIT), will use data, analytics and digital services to improve the efficiency, effectiveness and security of Government operations and programs.

With the funding requested for fiscal year 2015, OMB would continue the work of PortfolioStat and enhance cybersecurity capabilities that will ensure we can protect our country's national digital assets. The additional funding represented in ITOR will enable OMB to better leverage analytics and industry expertise to conduct targeted, risk-based oversight reviews of agencies' cybersecurity activities. The result of these efforts will inform future Federal information security policies, metrics, and Cross Agency Priority (CAP) goals, and will ensure successful implementation of important policy work underway with continuous diagnostics, anti-phishing, and identity management initiatives. The fiscal year 2015 ITOR request represents a modest investment in comparison to the total Federal IT spending of approximately $80 billion annually. Through the ITOR fund and the help of the subcommittee, we have delivered tangible results in Government technology efficiency. We look forward to delivering the same return on investment from these funds as we apply them to effectiveness of technology in fiscal year 2015.

CONCLUSION

In conclusion, it is apparent that in today's world we can no longer separate the effectiveness of our Federal programs from the smart use of IT. By increasing emphasis on customer needs and making it faster and easier for individuals and businesses to complete transactions with the Government—online or offline—we can deliver the world-class services that citizens expect. To do this it is imperative that we get the best talent working inside Government, the best companies working with Government, and the best processes in place to deliver results for our customers, the American people.

Mr. Chairman and members of the subcommittee, thank you for holding this hearing and inviting me to speak today. I appreciate this subcommittee's interest and ongoing support and I am excited to continue working with the subcommittee on our shared goal of improving the efficiency and effectiveness of our Government. I would be pleased to answer any questions you may have at this time.

Senator UDALL. Thank you very much, Mr. VanRoekel.

Administrator Tangherlini, I invite you now to present your remarks on behalf of the General Services Administration.

STATEMENT OF HON. DAN TANGHERLINI, ADMINISTRATOR, GENERAL SERVICES ADMINISTRATION

Mr. TANGHERLINI. Thank you very much and good afternoon, Chairman Udall, Ranking Member Johanns, full committee Chair Mikulski, members and staff of the committee. My name is Dan Tangherlini, and I am the administrator of the U.S. General Services Administration, or GSA.

Before focusing on the topic of today's hearing, I would like to do two things, first, introduce our new deputy administrator, Denise Roth, who as chief operating officer will focus, among other duties, on internal GSA information technology. And next, I would like to thank the chairman, the ranking member, committee members, and staff for your hard work on the fiscal year 2014 Consolidated Appropriations Act, especially in the current funding environment.

This legislation represented a positive step forward for our Nation and for our economy. Among its many provisions, the act made available more than $9.3 billion in funding for GSA to invest in our Nation's public building infrastructure, pay rent for our leased

buildings, consolidate offices to save money, and upgrade land ports of entry to secure our borders.

GSA's fiscal year 2015 budget request looks to continue these efforts. And I want to sustain our partnership to make sure this is not an isolated investment, but a foundation for a long-term, sound management of our Government's real property infrastructure.

The challenges of technology procurement and delivery facing the Government have been a focus for better management and oversight throughout this administration. Given GSA's mission to deliver the best value in real estate acquisition and technology services to the Government and the American people, we believe we are uniquely positioned to help make a difference in these efforts.

Through better management of our own IT investments, as well as offerings GSA provides Governmentwide, GSA can support the administration's efforts to better manage IT.

Since my arrival at GSA, we have been focused on consolidating and streamlining major functions within the agency to eliminate redundancy, improve oversight, and increase accountability. As part of GSA's top-to-bottom review, GSA brought together all IT functions, budgets, and authorities from across the agency under an accountable, empowered GSA Chief Information Officer (CIO) in line with the best practices followed by most modern organizations today.

GSA now has one enterprise-wide process for making IT investments, which ensures that investments are geared toward the highest priorities in support of agencies' strategic goals.

We set internal goals to reduce ongoing operating costs to allow the organization to make better long-term investments using our enterprise-wide, data-driven IT budget process.

Consolidation also provides an opportunity to adopt the best forward-leaning practices in supporting investments. In recognition of the need to modernize not just applications, but how we support IT, and consistent with broader Federal efforts, GSA instituted a cloud-first policy that prompts all application development initiatives to look first to the GSA cloud platforms before considering legacy platforms with higher operational costs.

The focus of our transition has not been limited to what we build, but also how we build. Our move to an agile development shop has resulted in a significant increase in our ability to rapidly deploy and scale.

Consolidated IT governance is also helping GSA realize a high-performing IT environment as effectively and efficiently as possible while also providing a level of transparency and accountability that will lead to continuous, ongoing improvement.

GSA also looks for opportunities to help agencies adopt new technologies and take advantage of digital services that improve mission delivery and enhance their interactions with the public.

For example, we recently announced the creation of 18F, the digital delivery team within GSA that aims to make the Government's digital and Web services simple, effective, and easier to use for the American people.

By using lessons from our Nation's top technology startups, these public service innovators are looking to provide support for our

Federal partners in delivering better digital services at reduced time and cost, and making us a better consumer of IT.

GSA's internal IT reforms, acquisition solutions, and digital services are in keeping with our mission to deliver the best value in information technology solutions to Government and the American people.

PREPARED STATEMENT

GSA still has a lot of work ahead of us, and I am grateful for the subcommittee's support for our reform efforts. I appreciate the opportunity to appear before you today, and I am happy to answer any questions that you have. Thank you.

[The statement follows:]

PREPARED STATEMENT OF HON. DAN TANGHERLINI

Good afternoon, Chairman Udall, Ranking Member Johanns, and members of the subcommittee. My name is Dan Tangherlini, and I am the Administrator of the U.S. General Services Administration (GSA).

The challenges of technology procurement and delivery facing the Government have been a focus for better management and oversight throughout this administration. They present an opportunity to deliver better outcomes for the American people in a more efficient manner. Given the U.S. General Services Administration's mission to deliver the best value in real estate, acquisition, and technology services to the Government and the American people, we believe we are uniquely positioned to help make a difference in these efforts. Through better management of our own information technology (IT) investments, as well as offerings GSA provides Governmentwide, GSA can support the administration's efforts to better manage IT and help to continue improving some of these longstanding challenges.

GSA INFORMATION TECHNOLOGY

Empowering the Chief Information Officer

Since my arrival at GSA, we have been focused on consolidating and streamlining major functions within the agency to eliminate redundancy, improve oversight, and increase accountability. Consistent with the administration's push to strengthen Chief Information Officer (CIO) authorities, GSA brought together all IT functions, budgets, and authorities from across the agency under an accountable, empowered GSA CIO, in line with the best practices followed by most modern organizations today. GSA has moved from 17 different regional and bureau CIOs to one enterprise CIO office. To improve management and accountability, GSA established the Investment Review Board co-chaired by the GSA CIO and Chief Financial Officer (CFO) with oversight and authority over all GSA IT spending. Prior to this consolidation, GSA's business lines and often the regions had separate IT systems and budgets, providing limited visibility and oversight into proposed investments and creating significant redundancy and inefficiency.

Enterprise Planning

GSA now has one enterprisewide process for making IT investments, which ensures that investments are geared toward the highest priorities in support of the agency's strategic goals. We are now able to more comprehensively look at the portion of spending that is focused on operating and maintaining existing systems. We have set internal goals to reduce ongoing operating costs to allow the organization to make better long-term investments using our enterprisewide, data driven zero-based IT budgeting process.

Zero-based IT Budgeting

GSA is beginning to leverage an internal zero-based IT budgeting (ZBB) process to develop the IT budget. ZBB is a budgeting method that requires justification for all expenses in each new fiscal period. This method will ensure budgeting processes align to the organization's strategy by tying budget line items to specific strategic goals and initiatives. For instance, GSA used to maintain multiple systems to track engagements with partner Federal agencies. Through these changes, GSA's major business lines will share these tools, facilitating a two-fold win. From an IT perspective, we eliminated the cost of maintaining redundant systems, resulting in lower

operations and maintenance costs. From the mission execution side, we improved engagement with partner Federal agencies by putting a more complete picture of who we work with in the hands of our staff.

Enhanced Use of Cloud Computing and Consolidation of Data Centers

Consolidation also provides an opportunity to adopt the best forward-leaning practices not just in where and what IT investments are made, but also how we support these investments. In recognition of the need to modernize not just applications but how we support IT, and consistent with broader Federal efforts, GSA instituted a "cloud first" policy that prompts all application development initiatives to look first to the GSA cloud platforms available as technology solutions before evaluating legacy platforms with higher operational costs. In doing this, GSA has saved money not only in the areas of reduced infrastructure costs, but also through the reuse of previously developed functionality. This initiative in part has also allowed us to consolidate 1,700 legacy applications into fewer than 100 cloud-based applications between 2011 and 2013. GSA's use of cloud services has saved $15 million[1] over the past 5 years. GSA has also been aggressive in shutting down unneeded data centers as part of the Federal Data Center Consolidation Initiative. In fiscal year 2013, GSA shut down 37 data centers, meeting our goal, and we intend to shut down an additional 24 this fiscal year.

Agile Development

The focus of our transition has not been limited to what we build, but also how we build. GSA IT has moved away from the world of waterfall application development methodologies that have historically led to higher costs and poor product quality, to an agile methodology which allows us to work better, faster, and leaner than we ever have before. Our move to an agile development shop has resulted in a significant increase in our ability to rapidly deploy and scale. As a result, beginning in 2013, GSA's development cycle time has been reduced to 6 to 8 weeks from 8 to 12 months.

These IT reform initiatives have resulted in more efficient allocation of IT resources. In fiscal year 2013, GSA spent $698 million in IT spending. In fiscal year 2015, GSA requested $572 million, a reduction of nearly 18 percent. We have cut 45 full time equivalent positions in the IT area and identified several duplicative systems in the regions and between various offices that are now being consolidated. In addition, GSA's strategic hiring plan is focused on obtaining IT skills through Government hires to allow us to decrease the reliance on contractors in some areas.

Consolidated IT governance helps GSA realize a high performing IT environment as effectively and efficiently as possible. Enterprise IT governance will ensure GSA is investing in the right initiatives at the right time, allow greater oversight of key IT investments, and promote interoperability and transparency through the GSA enterprise. It also allows a level of transparency and accountability that will lead to continuous ongoing improvement.

IT ACQUISITION SOLUTIONS

In addition to our efforts to better manage internal GSA IT investments and policies, we also offer acquisition solutions to agencies that deliver savings and enable them to focus more on core mission activities.

GSA aggregates and leverages the Federal Government's buying power to obtain a wide range of information technology and telecommunications products and services in support of agency missions across Government through contract vehicles like Schedule 70 and Networx. Schedule 70 is an indefinite delivery/indefinite quantity (IDIQ) multiple award schedule that provides direct access to products, services, and solutions from more than 5,000 certified industry partners. Networx provides cost-effective solutions for partner agencies' communications infrastructure and service needs. Through better pricing of these and other similar acquisitions, GSA helped agencies save more than $1 billion in fiscal year 2013, and will help them save an additional $1 billion in fiscal year 2014 on these acquisitions.[2]

Additionally, GSA is currently developing the Prices Paid Portal. This proof of concept tool is intended to provide greater visibility into the prices paid by Government agencies for commonly purchased goods and services. Currently, the system is being populated with initial data on simple commodities such as office supplies, with data on more complex items to follow. Allowing the Federal acquisition community to see and analyze the cost of these goods and services is intended to drive bet-

[1] Savings resulting from use of cloud services, such as Salesforce Platform as a Service, and E-mail as a Service.

[2] Compared to commercial pricing for comparable services and terms and conditions.

ter pricing for all future Federal procurements. Our hope is to replicate our purchasing experience as individuals where comparative market pricing information is widely available, such as many e-commerce, travel and secondary market portals.

INNOVATIVE TECHNOLOGIES AND DIGITAL SERVICES

GSA also looks for opportunities to help agencies adopt new technologies and take advantage of digital services that improve mission delivery, and enhance their interactions with the public. For example, the Federal Risk and Authorization Management Program (FedRAMP) is a Governmentwide program that accelerates adoption of cloud computing across Government by providing a standardized approach to security assessment, authorization, and continuous monitoring for cloud products and services. This mandatory approach, which uses a "do once, use many times" framework, is saving cost, time, and staff required to conduct redundant agency security assessments.

GSA helps to ensure that we have tools that allow the Government to access the ingenuity of the American people to help solve Government's challenges. GSA manages Challenge.gov, an award winning platform to promote and conduct challenge and prize competitions Governmentwide. Challenge.gov seeks to involve more Americans in the work of Government. Eighty contests were hosted in fiscal year 2013, covering a wide range of technical and creative challenges. For instance, the Federal Trade Commission (FTC) hosted a robocall challenge, which asked innovators to create solutions to block illegal robocalls on landline or mobile phones. The FTC received nearly 800 entries and selected two winners in a tie for the best overall solution. One winning solution, Nomorobo, went to market on September 30, 2013, and has blocked nearly 1.3 million calls for consumers.

GSA also is leading efforts to open Government data to entrepreneurs and other innovators to fuel development of products and services that drive economic growth. GSA operates Data.gov, the flagship open Government portal, which enables easy access to and use of more than 90,000 data collections from over 180 Government agencies. By facilitating information transparency and access, GSA allows anyone, whether an individual or a business, to take public information and apply it in new and useful ways. A snapshot of the power of open data can be seen on Data.gov/Impact, which provides a list of companies leveraging open Government data to power the economy.

GSA is also committed to helping agencies through smarter delivery of IT projects. In collaboration with White House Office of Science and Technology Policy, GSA manages the Presidential Innovation Fellows (PIF) program. The PIF program recruits and sources some of our Nation's brightest individuals to specific agencies and challenges them to implement solutions that save money and make the Federal Government work better for the American people. The program is set up to deliver results in months, not years, and has already demonstrated its value through solutions like the United States Agency for International Development's (USAID's) Better Than Cash and the Department of Veterans Affairs' (VA's) Blue Button.

Building on this approach, and in coordination with the Digital Service at the Office of Management and Budget (OMB), GSA recently announced the creation of 18F— a digital delivery team within GSA that aims to make the Government's digital and Web services simple, effective, and easier to use for the American people. By using lessons from our Nation's top technology startups, these public service innovators are looking to provide support for our Federal partners in delivering better digital services at reduced time and cost. 18F is structured to develop in an agile manner, building prototypes rapidly and putting them in the hands of users for feedback; measure success not in terms of completion of a system, but through customer use; build core capacity so that the Government can build and deliver technology solutions; and scale what works iteratively.

18F is already engaged in various initiatives to improve services GSA provides to our constituents. As an example, the 18F team helped develop a new, innovative tool called FBOpen (fbopen.gsa.gov) that allows small and innovative businesses to quickly access Federal contracting and grant opportunities by using simple search queries. This open source search tool makes it easier for small businesses and less traditional Federal contractors to better find and bid on Government opportunities, while increasing competition and delivering a simpler way to find all of the opportunities the Federal Government makes available. By pairing innovative technologists with agency procurement experts and reaching out to small businesses to understand their needs, GSA was able to successfully test (and deploy) a viable product in less than 6 months. FBOpen is just one example of how use of smarter IT practices can shorten the time to value, whether work is performed by Federal employees, contractors, or both.

CONCLUSION

GSA's internal IT reforms, acquisition solutions, and digital services are in keeping with our mission to deliver the best value in information technology solutions to Government and the American people. GSA still has a lot of work ahead of us, and I appreciate the subcommittee's support of our reform efforts.

I appreciate the opportunity to appear before you today and I am happy to answer any questions you have. Thank you.

Senator UDALL. Thank you for your testimony.

And now, Director Archuleta, I would like you to present your remarks on the half of the Office of Personnel Management.

STATEMENT OF HON. KATHERINE ARCHULETA, DIRECTOR, OFFICE OF PERSONNEL MANAGEMENT

Ms. ARCHULETA. Thank you, Chairman Udall, Ranking Member Johanns, and Chairwoman Mikulski for inviting me to participate in today's hearing on the oversight of the information technology investments and to testify on the issues facing the Federal IT workforce.

As director of the Office of Personnel Management, one of my goals is to build an engaged, inclusive, diverse, and well-trained workforce, not only for today's needs, but also for the future.

In order to meet their missions, Federal agencies must have the tools to attract, develop, and keep top talent from all segments of society. To accomplish this, the Office of Personnel Management (OPM) is partnering with agencies to help address Governmentwide and agency-specific recruitment, training, and retention needs in areas where skills are in high demand.

The development and proper deployment of IT will require fast thinking and intelligent minds at the helm in order to tap into the vast potential for the skillful harnessing of cyber's possibilities.

The demand for cyber skills is real. The Bureau of Labor Statistics has projected that computer occupations will grow by 18 percent from 2012 to 2022, while all other occupations will grow by 11 percent.

This is why OPM supports the Governmentwide development of qualified Federal cyber personnel through workforce planning, recruitment, training and development, and other initiatives.

OPM is the lead agency to meet to the OMB cross-agency priority goal to close critical skills gaps in the Federal workforce. We have partnered with relevant interagency councils and working groups and to design the most effective strategies to address cyber workforce needs.

OPM realizes that agencies may need to take advantage of existing flexibilities to meet their hiring needs. We have collaborated with the CIO Council to ensure a broad understanding of the various hiring and pay authorities available to attract and bring on board needed talent.

OPM has also helped agencies cut down the time it takes to hire, from the posting of a vacancy announcement to bringing employees on board.

OPM is committed to ensuring that agencies are aware of the services we can offer in the crafting of job opportunity announcements in a way that gets them to the best possible candidates. With well-written job opportunity announcements, agencies can

find superior candidates for a position and fill that post as quickly as possible.

Agencies have a number of existing pay and leave flexibilities at their disposal that can be used to recruit and retain cyber personnel. This includes recruitment and retention incentives, enhanced annual leave accrual rates, student loan repayments, as well as general workplace flexibilities.

In addition, OPM is ready to work with agencies to consider providing special rates or critical position pay.

Further, three initiatives have been identified as possible positive courses of forward action. The first is the establishment of a cross-Government talent exchange program called GovConnect. GovConnect will help all agencies test and scale talent exchange programs. It would enable employees to find project-based rotational assignments and enable managers to reach into the broader Federal workforce to fill critical needs.

Second, OPM is working on a learning and development resource exchange called GovU. GovU would be a collaborative model for the sharing of training and development resources across the Federal Government.

Finally, training and development resources are critical tools in employee growth. OPM will continue to work with agencies and other stakeholders to utilize existing recruitment and retention tools, and explore whether additional flexibilities are warranted. These efforts will help ensure that we build and develop a Federal IT workforce that is engaged, inclusive, and high-performing in order to meet the changing challenges of today and tomorrow.

PREPARED STATEMENT

Thank you for inviting me here today, and I am happy to answer any questions you may have.

[The statement follows:]

PREPARED STATEMENT OF HON. KATHERINE ARCHULETA

Thank you for inviting me to participate in today's hearing regarding oversight of information technology (IT) investments, and to testify on issues facing the Federal IT workforce. I am happy to be here with you today.

As Director of the Office of Personnel Management (OPM), one of my goals is to build an engaged, inclusive, diverse, and well-trained workforce, not only for today's needs but also for the future. In order to meet their missions, Federal agencies must have the tools to attract, develop, and keep top talent, from all segments of society. To this end, OPM is partnering with agencies to help address Governmentwide and agency-specific recruitment, training, and retention needs in areas where skills are in high demand.

Anticipating cyber workforce needs and ensuring that the Federal Government is prepared to meet those needs is an important goal for OPM. The development and proper deployment of cyber will require fast-thinking, intelligent minds at the helm in order to tap into the vast potential for the skillful harnessing of cyber's possibilities. The demand for cyber skills is real—the Bureau of Labor Statistics projects that computer occupations will grow by 18 percent between 2012–2022, while all other occupations will grow by 11 percent. This is why OPM supports the Governmentwide development of qualified Federal cyber personnel through workforce planning, recruitment, training and development and other initiatives. This development is informed by routine data analysis that OPM conducts to assess the needs arising out of the Federal cyber workforce, as well as agency progress toward meeting cyber workforce targets. In addition, OPM has launched the first-ever complete inventory of all cyber positions in the Federal Government, to be housed in our Enterprise Human Resources Information (EHRI) system. Agencies are currently working to populate this database with a designation code for all positions that conduct work

related to cybersecurity. Through the EHRI data set, OPM and agencies will have clearer visibility on current and projected cyber workforce needs.

OPM is the lead agency to meet the Office of Management and Budget's (OMB's) Cross Agency Priority Goal to close critical skills gaps in the Federal workforce, and has partnered with relevant interagency councils and working groups to design the most effective strategies to address cyber workforce needs. Further, OPM, in our continued support of the White House's 25 Point Implementation Plan To Reform Federal IT Management, has developed the IT Program Management Career Path Guide and recommended training curriculum for the newly established IT Program Management job title. OPM worked closely with the Chief Information Officers (CIO) Council and OMB on this project. The final product provides guidance to Federal agencies on the creation and improvement of the IT Program Management career path at each agency.

OPM continues to support the National Science Foundation's administration of the CyberCorps Scholarship for Service (SFS) program. The SFS program awards scholarships to students pursuing a degree in cybersecurity. In exchange for the scholarship, students agree to work for the Government in a cybersecurity position. OPM provides program guidance, monitors student progress, hosts virtual career fairs, participates in the planning and execution of live job fairs, and markets the SFS program to students and Federal agencies. In January 2014, the annual job fair attracted more than 400 students, who had the opportunity to network with recruitment representatives from over 40 Federal agencies. Since 2002, more than 1,500 students have graduated and gone to work for over 130 different agencies and subagencies in a variety of occupations such as IT management, computer scientist, and computer engineer.

OPM realizes that agencies may need to take advantage of existing flexibilities to meet their hiring needs. To this end, OPM has partnered with the CIO Council to ensure there is a broad understanding of the various hiring and pay authorities available to attract and hire the talent needed. Over the years, OPM has provided agencies with a number of expedited hiring authorities where suitable justification has been given. This includes Governmentwide Direct-Hire Authority for cybersecurity professionals, at grade 9 and above, in the Information Technology Management series (Information Security). OPM has also helped agencies cut down on the timeline of an average hire from the posting of a vacancy announcement to bringing employees on board. OPM is also committed to ensuring that agencies are aware of the services OPM can offer in crafting job opportunity announcements in a manner that nets them the best possible candidates. OPM, through both our public policy function and our reimbursable services offered via USA Staffing, can help agencies develop and post clear and attractive job opportunity announcements. With well written job opportunity announcements, agencies can both find superior candidates for the job and achieve quick, timely hiring. We recommend that agencies take advantage of OPM's expertise as a resource when beginning their candidate search.

Agencies have a number of existing pay and leave flexibilities at their disposal that can be used to recruit and retain cyber personnel. This includes the ability to set pay above the minimum rate for newly hired cyber employees with superior qualifications or who are filling a special agency need; recruitment and retention incentives; enhanced annual leave accrual rate; student loan repayments; as well as general workplace flexibilities including telework and alternative work schedules. In addition, OPM is ready to work with agencies to consider providing special rates or critical position pay. Special rates are intended to address significant or likely significant agency handicaps in recruiting or retaining qualified employees. Similarly, the critical position pay authority requires individuals to possess an extremely high level of expertise in scientific or technical fields. Agencies must show that a position being considered for higher compensation under critical position pay is critical to the agency's successful accomplishment of an important mission. Further, the critical position pay authority may only be used to the extent necessary to recruit or retain an individual exceptionally well qualified for the position.

Overall, OPM is supporting the development of Governmentwide enterprise training and resource exchanges across agencies as called for in the President's fiscal year 2015 budget. For example, OPM will develop university partnerships that increase access for Federal employees to affordable education and training that is targeted to the Federal Government's priority skills needs, such as science, technology, engineering, and mathematics. These partnerships will enable Federal occupational and human resources leaders to work with post-secondary institutions to target curriculum to emerging skills needs in the Federal Government.

Working with agencies to address their cyber workforce needs requires anticipating workforce challenges and creating a culture of excellence and engagement to

enable higher performance. To this end, three initiatives have been identified as possible positive courses of action. While each of these initiatives can apply outside of the cyber workforce, each can appropriately be used to address agencies' cyber workforce needs. We are still in the vetting stage, but we think these ideas have promise.

The first idea is the establishment of a cross-Government talent exchange program called GovConnect. GovConnect would be designed to help all agencies test and scale talent exchange programs and enable employees to find project-based rotational assignments and enable managers to reach into the broader Federal workforce to fill critical skills needs. GovConnect would seek to create a more mobile and agile workforce through communities of practice that can share ideas and solutions with each other through online networking.

Secondly, OPM is working on a reimbursable learning and development resource exchange called GovU. GovU would be modeled off OPM's Human Resources University (HRU). HRU has, at its core, a collaborative model for the sharing of training and development resources across the Federal Government. OPM hopes to continue in this model with GovU by enabling agencies to share training and development resources to meet common needs. To facilitate this, OPM is collaborating with the Chief Human Capital Officers' Council and the Chief Learning Officers' Council to create an operational project plan.

Finally, training and development resources are critical tools in employee growth, and OPM is reviewing these resources to ensure they are consistently excellent and easily accessible Governmentwide. Further, through increased training and development comes greater accountability from and higher performance expectations for Federal employees. As capabilities and credibility are enhanced, efforts are needed to incorporate continuous improvement in the education opportunities and tools available to Federal employees.

OPM will continue to work with agencies, and with our labor partners, and other stakeholders to utilize existing recruitment and retention tools and to explore whether additional flexibilities are warranted to address IT workforce needs. OPM will continue to help agencies enhance the management and performance of their workforce by sharing best practices and leadership development resources. These efforts will help ensure that we build and develop a Federal IT workforce that is engaged, inclusive, and high performing in order to meet the challenges of both today and tomorrow.

Thank you for inviting me here today, and I am happy to address any questions you may have.

Senator UDALL. Thank you very much for your testimony.

Mr. Powner, I now invite you to present your remarks on behalf of the GAO.

STATEMENT OF HON. DAVID POWNER, DIRECTOR, INFORMATION TECHNOLOGY ISSUES, GOVERNMENT ACCOUNTABILITY OFFICE

Mr. POWNER. Chairman Udall, Ranking Member Johanns, Chairwoman Mikulski, we appreciate the opportunity to testify on how the Federal Government can better manage its annual $80 billion investment in information technology. Of this $80 billion, three-quarters is spent on operational or legacy systems while the remaining goes toward new development. Therefore, it is vitally important that new systems acquisitions are managed and governed effectively, and that the Federal Government finds more efficient ways to deliver existing services.

Over the past 5 years, OMB has initiated excellent efforts to do just that. This morning, I would like to highlight four significant initiatives, the IT Dashboard, TechStat sessions, data center consolidation, and PortfolioStat. For each, I will highlight accomplishments to date, but also what needs to be done to get even more out of these initiatives.

INFORMATION TECHNOLOGY DASHBOARD

Starting with the Dashboard, the IT Dashboard was put in place to highlight the status and CIO assessments of approximately 750 major IT investments across 27 departments. This public dissemination of each project's status is intended to allow OMB and the Congress to hold agencies accountable for results and performance.

The accuracy of the information on the Dashboard has improved over time with certain agencies reporting more accurately than others.

Here is what the Dashboard tells us: As this chart indicates, of the 750 major investments, 560 are in green status, 116 are in yellow, and 40 are in red.

So we have about 200 projects, Mr. Chairman, that you mentioned that total about $12 billion that are at risk and need attention.

Only eight agencies report red or high-risk projects. Nineteen agencies do not have high-risk projects, according to the Dashboard, including the Department of Defense (DOD), the Department of the Treasury, OPM, and GSA.

Senator MIKULSKI. Did you say they don't?

Mr. POWNER. They do not. So if you go to the Dashboard right now, DOD does not have any reds listed.

Mr. Chairman, there are three things that need to happen to make the Dashboard a better accountability mechanism.

One, all major investments need to be listed on the Dashboard. Our work has shown that several investments, like the Department of Energy's (DOE's) supercomputers, are not listed on the Dashboard.

Two, ratings need to be even more accurately reported. There are clearly more than 200 projects that are high- or medium-risk.

And then three, OMB and agencies need to aggressively govern the at-risk investments using TechStat sessions.

OMB TECHSTAT MEETINGS

TechStat sessions are OMB meetings initiated in 2010 to turn around troubled IT investments that were failing or not producing results. OMB held about 80 of these meetings and had great results. That included scaling back projects and even terminating failing projects.

OMB subsequently empowered CIOs to hold their own TechStat sessions within their respective agencies, a move we agree with, but we also strongly think that OMB should hold TechStat sessions on a selective basis for high-risk or troubled projects and for projects that are top national priorities.

OMB recently told us that they held two TechStat sessions in 2013. Clearly, this is not enough.

DATA CENTER CONSOLIDATION

Now turning to how we better manage operational systems, OMB started a data center consolidation effort in 2010 to address the Government's low server utilization rates, estimated between 10 and 15 percent, far from the industry standard of 60 percent.

This effort was also to result in $3 billion in savings across all the departments. Our ongoing work shows that there are currently 7,500 data centers, about 750 of those have been consolidated or closed to date. There are over $1.3 billion in savings that have resulted from this, and agencies estimate another $3 billion in savings in fiscal years 2014 and 2015. Therefore, expected savings through fiscal year 2015 should be around $4.5 billion. Better transparency on the savings is needed, in our opinion.

PORTFOLIOSTAT INITIATIVE

I would like to commend the subcommittee for requiring this quarterly report from OMB on IT reform savings. OMB recently expanded the data center consolidation effort into a larger initiative called PortfolioStat to eliminate additional duplicative spending of administrative and business systems. In its quarterly report to this committee, OMB reports they have achieved $1.9 billion in savings through this initiative through 2013, and that the target is $2.5 billion. The target should be much higher.

Based on our work, there are over 200 PortfolioStat initiatives that agencies are working on to eliminate at least $5.5 billion in duplicative spending. It is critical that these 200 initiatives are driven to closure so that the $5 billion in savings can be achieved.

In summary, Mr. Chairman, the tremendous transparency that the Dashboard provides needs to be even more effectively used to lessen risk and failures on large IT acquisitions, and both the data center consolidation and PortfolioStat processes need to build off their initial successes to achieve savings that collectively tally about $10 billion.

PREPARED STATEMENT

Thank you for your oversight of these important issues, and we look forward to working with you further.

[The statement follows:]

PREPARED STATEMENT OF HON. DAVID POWNER

Chairman Udall, Ranking Member Johanns, and members of the subcommittee, I am pleased to be here today to discuss how best practices and major information technology (IT) reform initiatives can help the Federal Government better acquire and manage IT investments. As reported to the Office of Management and Budget (OMB), Federal agencies plan to spend at least $82 billion on IT in fiscal year 2014. Given the scale of such planned outlays and the criticality of many of these systems to the health, economy, and security of the Nation, it is important that OMB and Federal agencies provide appropriate oversight and transparency into these programs and avoid duplicative investments, whenever possible, to ensure the most efficient use of resources.

However, as we have previously reported and testified, Federal IT projects too frequently fail and incur cost overruns and schedule slippages while contributing little to mission-related outcomes.[1] During the past several years, we have issued multiple reports and testimonies on best practices for major acquisitions and Federal

[1] See, for example, Government Accountability Office (GAO), Information Technology: OMB and Agencies Need To More Effectively Implement Major Initiatives To Save Billions of Dollars, GAO–13–796T (Washington, DC: July 25, 2013); Secure Border Initiative: DHS Needs To Reconsider Its Proposed Investment in Key Technology Program, GAO–10–340 (Washington, DC: May 5, 2010); and Polar-Orbiting Environmental Satellites: With Costs Increasing and Data Continuity at Risk, Improvements Needed in Tri-agency Decision Making, GAO–09–564 (Washington, DC: June 17, 2009).

initiatives to acquire and improve the management of IT investments.[2] In those reports, we made numerous recommendations to Federal agencies and OMB to further enhance the management and oversight of IT programs.

As discussed with subcommittee staff, I am testifying today on the results and recommendations from our selected reports on how best practices and IT reform initiatives can help Federal agencies better manage major acquisitions and legacy investments. All work on which this testimony is based was performed in accordance with generally accepted Government auditing standards or all sections of the Government Accountability Office's (GAO's) Quality Assurance Framework that were relevant to our objectives. Those standards and the framework require that we plan and perform our audits and engagements to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives; the framework also requires that we discuss any limitations in our work. We believe that the information, data, and evidence obtained and the analysis conducted provide a reasonable basis for our findings and conclusions based on our objectives. A more detailed discussion of the objectives, scope, and methodology of this work is included in each of the reports on which this testimony is based.[3]

BACKGROUND

Information technology should enable Government to better serve the American people. However, despite spending hundreds of billions on IT since 2000, the Federal Government has experienced failed IT projects and has achieved little of the productivity improvements that private industry has realized from IT. Too often, Federal IT projects run over budget, behind schedule, or fail to deliver results. In combating this problem, proper oversight is critical.

Both OMB and Federal agencies have key roles and responsibilities for overseeing IT investment management and OMB is responsible for working with agencies to ensure investments are appropriately planned and justified. However, as we have described in numerous reports,[4] although a variety of best practices exist to guide their successful acquisition, Federal IT projects too frequently incur cost overruns and schedule slippages while contributing little to mission-related outcomes.

Agencies have reported that poor-performing projects have often used a "big bang" approach—that is, projects that are broadly scoped and aim to deliver capability several years after initiation. For example, in 2009 the Defense Science Board reported that the Department of Defense's (Defense's) acquisition process for IT sys-

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[2] See, for example, GAO, Information Technology: Leveraging Best Practices To Help Ensure Successful Major Acquisitions, GAO–14–183T (Washington, DC: Nov. 13, 2013); Information Technology: Additional Executive Review Sessions Needed To Address Troubled Projects, GAO–13–524 (Washington, DC: June 13, 2013); Data Center Consolidation: Strengthened Oversight Needed To Achieve Billions of Dollars in Savings, GAO–13–627T (Washington, DC: May 14, 2013); Data Center Consolidation: Strengthened Oversight Needed To Achieve Cost Savings Goal, GAO–13–378 (Washington, DC: Apr. 23, 2013); Information Technology Dashboard: Opportunities Exist To Improve Transparency and Oversight of Investment Risk at Select Agencies, GAO–13–98 (Washington, DC: Oct. 16, 2012); Data Center Consolidation: Agencies Making Progress on Efforts, but Inventories and Plans Need To Be Completed, GAO–12–742 (Washington, DC: July 19, 2012); Information Technology: Critical Factors Underlying Successful Major Acquisitions, GAO–12–7 (Washington, DC: Oct. 21, 2011); Information Technology: Continued Attention Needed To Accurately Report Federal Spending and Improve Management, GAO–11–831T (Washington, DC: July 14, 2011); and Information Technology: Investment Oversight and Management Have Improved but Continued Attention Is Needed, GAO–11–454T (Washington, DC: Mar. 17, 2011).

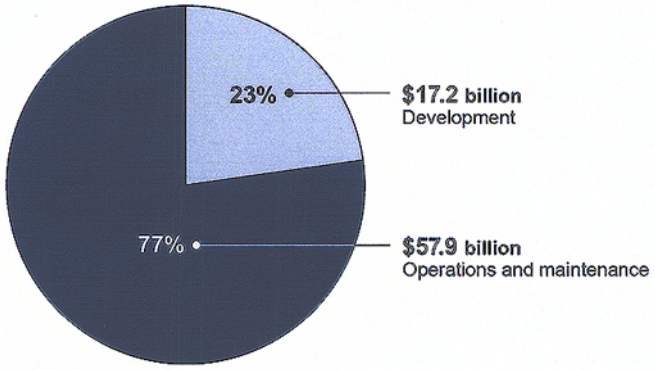
[3] GAO, Information Technology: Additional OMB and Agency Actions are Needed To Achieve Portfolio Savings, GAO–14–65 (Washington, DC: Nov. 6, 2013); IT Dashboard: Agencies Are Managing Investment Risk, but Related Ratings Need To Be More Accurate and Available, GAO–14–64 (Washington, DC: Dec. 12, 2014); GAO–13–524; GAO–13–378; GAO–13–98; GAO–12–742; Information Technology Reform: Progress Made; More Needs To Be Done To Complete Actions and Measure Results, GAO–12–461 (Washington, DC: Apr. 26, 2012); IT Dashboard: Accuracy Has Improved, and Additional Efforts Are Under Way To Better Inform Decision Making, GAO–12–210 (Washington, DC: Nov. 7, 2011); GAO–12–7; Data Center Consolidation: Agencies Need To Complete Inventories and Plans To Achieve Expected Savings, GAO–11–565 (Washington, DC: July 19, 2011); Information Technology: OMB Has Made Improvements to Its Dashboard, but Further Work Is Needed by Agencies and OMB To Ensure Data Accuracy, GAO–11–262 (Washington, DC: Mar. 15, 2011); and Information Technology: OMB's Dashboard Has Increased Transparency and Oversight, but Improvements Needed, GAO–10–701 (Washington, DC: July 16, 2010).

[4] See, for example, GAO, FEMA: Action Needed To Improve Administration of the National Flood Insurance Program, GAO–11–297 (Washington, DC: June 9, 2011); GAO–10–340; Secure Border Initiative: DHS Needs To Address Testing and Performance Limitations That Place Key Technology Program at Risk, GAO–10–158 (Washington, DC: Jan. 29, 2010); and GAO–09–564.

tems was too long, ineffective, and did not accommodate the rapid evolution of IT.[5] The board reported that the average time to deliver an initial program capability for a major IT system acquisition at Defense was over 7 years.

Each year, OMB and Federal agencies work together to determine how much the Government plans to spend on IT projects and how these funds are to be allocated. As reported to OMB, Federal agencies plan to spend more than $82 billion on IT investments in fiscal year 2014, which is the total expended for not only acquiring such investments, but also the funding to operate and maintain them. Of the reported amount, 26 Federal agencies[6] plan to spend about $75 billion, $17 billion on development and acquisition and $58 billion on operations and maintenance (O&M).[7] Figure 1 shows the percentages of total planned spending for 2014 for the $75 million spent on development and O&M.

Figure 1: Percentages of Planned IT Spending for Fiscal Year 2014



Source: GAO analysis of OMB data.

However, this $75 billion does not reflect the spending of the entire Federal Government. We have previously reported that OMB's figure understates the total amount spent in IT investments.[8] Specifically, it does not include IT investments by 58 independent executive branch agencies, including the Central Intelligence Agency, or by the legislative or judicial branches. Further, agencies differed on what they considered an IT investment; for example, some have considered research and development systems as IT investments, while others have not. As a result, not all IT investments are included in the Federal Government's estimate of annual IT spending. OMB provided guidance to agencies on how to report on their IT investments, but this guidance did not ensure complete reporting or facilitate the identification of duplicative investments. Consequently, we recommended, among other things, that OMB improve its guidance to agencies on identifying and categorizing IT investments.

Further, over the past several years, we have reported that overlap and fragmentation among Government programs or activities could be harbingers of unnecessary duplication.[9] Thus, the reduction or elimination of duplication, overlap, or

[5] Defense Science Board, Report of the Defense Science Board Task Force on Department of Defense Policies and Procedures for the Acquisition of Information Technology (Washington, DC: March 2009).

[6] The 26 agencies are the Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, Homeland Security, Housing and Urban Development, Interior, Justice, Labor, State, Transportation, the Treasury, and Veterans Affairs; Environmental Protection Agency, General Services Administration, National Aeronautics and Space Administration, National Archives and Records Administration, National Science Foundation, Nuclear Regulatory Commission, Office of Personnel Management, Small Business Administration, Smithsonian Institution, Social Security Administration, and U.S. Agency for International Development.

[7] According to the analytical perspectives associated with the President's fiscal year 2014 budget, the remainder is comprised of classified Department of Defense (DOD) IT investments.

[8] GAO, Information Technology: OMB Needs To Improve Its Guidance on IT Investments, GAO–11–826 (Washington, DC: Sept. 29, 2011).

[9] GAO, 2013 Annual Report: Actions Needed To Reduce Fragmentation, Overlap, and Duplication and Achieve Other Financial Benefits, GAO–13–279SP (Washington, DC: Apr. 9, 2013); 2012 Annual Report: Opportunities To Reduce Duplication, Overlap and Fragmentation, Achieve

Continued

fragmentation could potentially save billions of tax dollars annually and help agencies provide more efficient and effective services.

OMB HAS LAUNCHED MAJOR INITIATIVES FOR OVERSEEING INVESTMENTS

OMB has implemented a series of initiatives to improve the oversight of underperforming investments, more effectively manage IT, and address duplicative investments. These efforts include the following:

—*IT Dashboard*.—Given the importance of transparency, oversight, and management of the Government's IT investments, in June 2009, OMB established a public Web site, referred to as the IT Dashboard, that provides detailed information on 760 major IT investments at 27 Federal agencies, including ratings of their performance against cost and schedule targets. The public dissemination of this information is intended to allow OMB; other oversight bodies, including Congress; and the general public to hold agencies accountable for results and performance. Among other things, agencies are to submit Chief Information Officer (CIO) ratings, which, according to OMB's instructions, should reflect the level of risk facing an investment on a scale from 1 (high risk) to 5 (low risk) relative to that investment's ability to accomplish its goals. Ultimately, CIO ratings are assigned colors for presentation on the Dashboard, according to the five-point rating scale, as illustrated in table 1.

TABLE 1—IT DASHBOARD CIO RATING COLORS, BASED ON A FIVE-POINT SCALE FOR CIO RATINGS

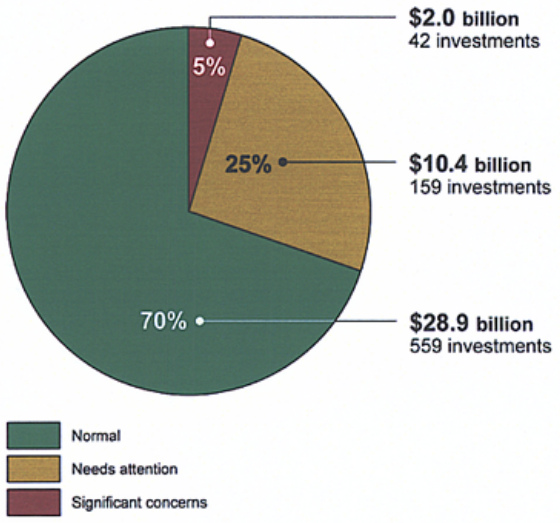
Rating (by agency CIO)	Color
1—High risk	Red
2—Moderately high risk	Red
3—Medium risk	Yellow
4—Moderately low risk	Green
5—Low risk	Green

Source: OMB's IT Dashboard.

As of April 2014, according to the IT Dashboard, 201 of the Federal Government's 760 major IT investments—totaling $12.4 billion—were in need of management attention (rated "yellow" to indicate the need for attention or "red" to indicate significant concerns). (See figure 2.)

Savings, and Enhance Revenue, GAO–12–342SP (Washington, DC: Feb. 28, 2012); and Opportunities To Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue, GAO–11–318SP (Washington, DC: Mar. 1, 2011).

Figure 2: Overall Performance Ratings of Major Investments on the IT Dashboard, as of April 2014



Source: OMB's IT Dashboard.

—*TechStat Reviews*.—In January 2010, the Federal CIO began leading TechStat sessions—face-to-face meetings to terminate or turnaround IT investments that are failing or are not producing results. These meetings involve OMB and agency leadership and are intended to increase accountability and transparency and improve performance. Subsequently, OMB empowered agency CIOs to hold their own TechStat sessions within their respective agencies. According to the former Federal CIO, the efforts of OMB and Federal agencies to improve management and oversight of IT investments have resulted in almost $4 billion in savings.

—*Federal Data Center Consolidation Initiative*.—Concerned about the growing number of Federal data centers, in February 2010 the Federal CIO established the Federal Data Center Consolidation Initiative. This initiative's four high-level goals are to promote the use of "green IT"[10] by reducing the overall energy and real estate footprint of Government data centers; reduce the cost of data center hardware, software, and operations; increase the overall IT security posture of the Government; and shift IT investments to more efficient computing platforms and technologies. OMB believes that this initiative has the potential to provide about $3 billion in savings by the end of 2015.

—*PortfolioStat*.—In order to eliminate duplication, move to shared services, and improve portfolio management processes, in March 2012, OMB launched the PortfolioStat initiative. Specifically, PortfolioStat requires agencies to conduct an annual agency-wide IT portfolio review to, among other things, reduce commodity IT[11] spending and demonstrate how their IT investments align with the agency's mission and business functions.[12] PortfolioStat is designed to assist agencies in assessing the current maturity of their IT investment management process, making decisions on eliminating duplicative investments, and moving to shared solutions in order to maximize the return on IT investments across

[10] "Green IT" refers to environmentally sound computing practices that can include a variety of efforts, such as using energy efficient data centers, purchasing computers that meet certain environmental standards, and recycling obsolete electronics.

[11] According to OMB, commodity IT includes services such as enterprise IT systems (e-mail; identity and access management; IT security; Web hosting, infrastructure, and content; and collaboration tools); IT infrastructure (desktop systems, mainframes and servers, mobile devices, and telecommunications); and business systems (financial management, grants-related Federal financial assistance, grants-related transfer to State and local governments, and human resources management systems).

[12] OMB, Implementing PortfolioStat, Memorandum, M–12–10 (Washington DC: Mar. 30, 2012).

the portfolio. OMB believes that the PortfolioStat effort has the potential to save the Government $2.5 billion over the next 3 years by, for example, consolidating duplicative systems.

OPPORTUNITIES EXIST TO IMPROVE ACQUISITION AND MANAGEMENT OF IT INVESTMENTS

Given the magnitude of the Federal Government's annual IT budget, which is expected to be more than $82 billion in fiscal year 2014, it is important that agencies leverage all available opportunities to ensure that their IT investments are acquired in the most effective manner possible. To do so, agencies can rely on IT acquisition best practices and initiatives such as OMB's IT Dashboard, and OMB-mandated TechStat sessions. Additionally, agencies can save billions of dollars by continuing to consolidate Federal data centers and by eliminating duplicative investments through OMB's PortfolioStat initiative.

Best Practices Are Intended To Help Ensure Successful Major Acquisitions

In 2011, we identified seven successful acquisitions and nine common factors critical to their success, and noted that the factors support OMB's objective of improving the management of (1) large-scale IT acquisitions across the Federal Government, and (2) wide dissemination of these factors could complement OMB's efforts.[13] Specifically, we reported that Federal agency officials identified seven successful acquisitions, in that they best achieved their respective cost, schedule, scope, and performance goals.[14] Notably, all of these were smaller increments, phases, or releases of larger projects. The common factors critical to the success of three or more of the seven acquisitions are generally consistent with those developed by private industry and are identified in the following list of common critical success factors:

—Program officials were actively engaged with stakeholders.
—Program staff had the necessary knowledge and skills.
—Senior department and agency executives supported the programs.
—End users and stakeholders were involved in the development of requirements.
—End users participated in testing of system functionality prior to formal end user acceptance testing.
—Government and contractor staff were consistent and stable.
—Program staff prioritized requirements.
—Program officials maintained regular communication with the prime contractor.
—Programs received sufficient funding.
(Source: GAO analysis of agency data.)

These critical factors support OMB's objective of improving the management of large-scale IT acquisitions across the Federal Government; wide dissemination of these factors could complement OMB's efforts.

IT Dashboard Can Improve the Transparency into and Oversight of Major IT Investments

The IT Dashboard serves an important role in allowing OMB and other oversight bodies to hold agencies accountable for results and performance. However, we have issued a series of reports highlighting deficiencies with the accuracy and reliability of the data reported on the Dashboard.[15] For example, we reported in October 2012 that Defense had not rated any of its investments as either high or moderately high risk and that in selected cases, these ratings did not appropriately reflect significant cost, schedule, and performance issues reported by GAO and others. We recommended that Defense ensure that its CIO ratings reflect available investment performance assessments and its risk management guidance. Defense concurred and has revised its process to address these concerns.

Further, while we reported in 2011 that the accuracy of Dashboard cost and schedule data had improved over time,[16] more recently, in December 2013 we found that agencies had removed investments from the Dashboard by reclassifying their investments—representing a troubling trend toward decreased transparency and accountability.[17] Specifically, the Department of Energy reclassified several of its

[13] GAO–12–7.
[14] The seven investments were (1) the Department of Commerce's Decennial Response Integration System, (2) Defense's Defense Global Combat Support System-Joint (Increment 7), (3) the Department of Energy's Manufacturing Operations Management Project, (4) the Department of Homeland Security's Western Hemisphere Travel Initiative, (5) the Department of Transportation's Integrated Terminal Weather System, (6) the Internal Revenue Service's Customer Account Data Engine 2, and (7) the Veterans Affairs Occupational Health Recordkeeping System.
[15] GAO–14–64; GAO–13–98; GAO–12–210; GAO–11–262; and GAO–10–701.
[16] GAO–12–210.
[17] GAO–14–64.

supercomputer investments from IT to facilities and the Department of Commerce decided to reclassify its satellite ground system investments. Additionally, as of December 2013, the public version of the Dashboard was not updated for 15 of the previous 24 months because OMB does not revise it as the President's budget request is being created.

We also found that, while agencies experienced several issues with reporting the risk of their investments, such as technical problems and delayed updates to the Dashboard, the CIO ratings were mostly or completely consistent with investment risk at seven of the eight selected agencies.[18] Additionally, the agencies had already addressed several of the discrepancies that we identified. The final agency, the Department of Veterans Affairs, did not update 7 of its 10 selected investments because it elected to build, rather than buy, the ability to automatically update the Dashboard, and has now resumed updating all investments. To their credit, agencies' continued attention to reporting the risk of their major IT investments supports the Dashboard's goal of providing transparency and oversight of Federal IT investments.

Nevertheless, the rating issues that we identified with performance reporting and annual baselining,[19] some of which are now corrected, serve to highlight the need for agencies' continued attention to the timeliness and accuracy of submitted information, in order to allow the Dashboard to continue to fulfill its stated purpose. We recommended that agencies appropriately categorize IT investments and that OMB make Dashboard information available independent of the budget process. OMB neither agreed nor disagreed with these recommendations. Six agencies generally agreed with the report or had no comments and two others did not agree, believing their categorizations were appropriate. We continue to believe that our recommendations are valid.

TechStat Reviews Can Help Highlight and Evaluate Poorly Performing Investments

TechStat reviews were initiated by OMB to enable the Federal Government to turnaround, halt, or terminate IT projects that are failing or are not producing results. In 2013, we reported that OMB and selected agencies had held multiple TechStats, but that additional OMB oversight was needed to ensure that these meetings were having the appropriate impact on underperforming projects and that resulting cost savings were valid.[20] Specifically, we determined that as of April 2013, OMB reported conducting 79 TechStats, which focused on 55 investments at 23 Federal agencies. Further, four selected agencies—the Departments of Agriculture, Commerce, Health and Human Services (HHS), and Homeland Security (DHS)—conducted 37 TechStats covering 28 investments. About 70 percent of the OMB-led and 76 percent of agency-led TechStats on major investments were considered medium to high risk at the time of the TechStat.

However, the number of at-risk TechStats held was relatively small compared to the current number of medium- and high-risk major IT investments. Specifically, the OMB-led TechStats represented roughly 18.5 percent of the investments across the Government that had a medium- or high-risk CIO rating. For the four selected agencies, the number of TechStats represented about 33 percent of the investments that have a medium- or high-risk CIO rating. We concluded that until OMB and agencies develop plans to address these weaknesses, the investments would likely remain at risk.

In addition, we reported that OMB and selected agencies had tracked and reported positive results from TechStats, with most resulting in improved governance. Agencies also reported projects with accelerated delivery, reduced scope, or termination. We also found that OMB reported in 2011 that Federal agencies achieved almost $4 billion in lifecycle cost savings as a result of TechStat sessions. However, we were unable to validate OMB's reported results because OMB did not provide artifacts showing that it ensured the results were valid. Among other things, we recommended that OMB require agencies to report on how they validated the outcomes. OMB generally agreed with this recommendation.

Continued Oversight Needed To Consolidate Federal Data Centers and Achieve Cost Savings

In an effort to consolidate the growing number of Federal data centers, in 2010, OMB launched a consolidation initiative intended to close 40 percent of Government

[18] The Departments of Agriculture, Commerce, Energy, Justice, Transportation, the Treasury, and Veterans Affairs; and the Social Security Administration.

[19] At times, a project's cost, schedule, and performance goals—known as its baseline—are modified to reflect changed development circumstances. These changes—called a rebaseline—can be done for valid reasons, but can also be used to mask cost overruns and schedule delays.

[20] GAO–13–524.

data centers by 2015, and, in doing so, save $3 billion. Since 2011, we have issued a series of reports on the efforts of agencies to consolidate their data centers.[21] For example, in July 2011 and July 2012, we found that agencies had developed plans to consolidate data centers; however, these plans were incomplete and did not include best practices.[22] In addition, although we reported that agencies had made progress on their data center closures, OMB had not determined initiative-wide cost savings, and oversight of the initiative was not being performed in all key areas. Among other things, we recommended that OMB track and report on key performance measures, such as cost savings to date, and improve the execution of important oversight responsibilities, and that agencies complete inventories and plans. OMB agreed with these two recommendations, and most agencies agreed with our recommendations to them.

Additionally, as part of ongoing follow-up work, we have determined that while agencies had closed data centers, the number of Federal data centers was significantly higher than previously estimated by OMB. Specifically, as of May 2013, agencies had reported closing 484 data centers by the end of April 2013, and were planning to close an additional 571 data centers—for a total of 1,055—by September 2014. However, as of July 2013, 22 of the 24 agencies participating in the initiative had collectively reported 6,836 data centers in their inventories—approximately 3,700 data centers more than OMB's previous estimate from December 2011. This dramatic increase in the count of data centers highlights the need for continued oversight of agencies' consolidation efforts.

Agencies' PortfolioStat Efforts Have the Potential To Save Billions of Dollars

OMB launched the PortfolioStat initiative in March 2012, which required 26 executive agencies to, among other things, reduce commodity IT spending and demonstrate how their IT investments align with the agency's mission and business functions.[23] In November 2013, we reported on agencies' efforts to complete key required PortfolioStat actions and make portfolio improvements.[24] We noted that all 26 agencies that were required to implement the PortfolioStat initiative took actions to address OMB's requirements. However, there were shortcomings in their implementation of selected requirements, such as addressing all required elements of an action plan to consolidate commodity IT, and migrating two commodity areas to a shared service by the end of 2012. In addition, several agencies had weaknesses in selected areas such as the CIO's authority to review and approve the entire portfolio, and ensuring a complete baseline of information relative to commodity IT. Further, we observed that OMB's estimate of about 100 consolidation opportunities and a potential $2.5 billion in savings from the PortfolioStat initiative was understated because, among other things, it did not include estimates from Defense and the Department of Justice. Our analysis, which included these estimates, showed that, collectively, the 26 agencies reported about 200 opportunities and at least $5.8 billion in potential savings through fiscal year 2015, at least $3.3 billion more than the number initially reported by OMB.

In March 2013, OMB issued a memorandum commencing the second iteration of its PortfolioStat initiative.[25] This memorandum identified a number of improvements that should help strengthen IT portfolio management and address key issues we have identified. However, we concluded that selected OMB efforts could be strengthened to improve the PortfolioStat initiative and ensure agencies achieve identified cost savings, including addressing issues related to existing CIO authority at Federal agencies, and publicly reporting on agency-provided data. We recommended, among other things, that OMB require agencies to fully disclose limitations with respect to CIO authority. In addition, we made several recommendations to improve agencies' implementation of PortfolioStat requirements. OMB partially agreed with these recommendations, and responses from 20 of the agencies commenting on the report varied.[26]

In summary, OMB's and agencies' recent efforts have resulted in greater transparency and oversight of Federal spending, but continued leadership and attention

[21] GAO–13–378; GAO–12–742; and GAO–11–565.

[22] GAO–12–742 and GAO–11–565.

[23] OMB, Implementing PortfolioStat, Memorandum M–12–10 (Washington, DC: Mar. 30, 2012).

[24] GAO–14–65.

[25] OMB, Memorandum for the Heads of Executive Departments and Agencies: Fiscal Year 2013 PortfolioStat Guidance: Strengthening Federal IT Portfolio Management, M–13–09 (Washington, DC: Mar. 27, 2013).

[26] Of the 20 agencies commenting on the report, 12 agreed with our recommendations directed to them, 4 disagreed or partially disagreed with our recommendations directed to them, and 4 provided additional clarifying information.

are necessary to build on the progress that has been made. The expanded use of the common factors critical to the successful management of large-scale IT acquisitions should result in more effective delivery of mission-critical systems. Additionally, Federal agencies need to continue to improve the accuracy and availability of information on the Dashboard to provide greater transparency and even more attention to the billions of dollars invested in troubled projects. Further, agencies should conduct additional TechStat reviews to focus management attention on troubled projects and establish clear action items to turn the projects around or terminate them.

The Federal Government can also build on the progress of agencies' data center closures and reduction in commodity IT. With the possibility of over $5.8 billion in savings from the data center consolidation and PortfolioStat initiatives, agencies should continue to identify consolidation opportunities in both data centers and commodity IT. In addition, better support for the estimates of cost savings associated with the opportunities identified would increase the likelihood that these savings will be achieved.

Chairman Udall, Ranking Member Johanns, and members of the subcommittee, this completes my prepared statement. I would be pleased to respond to any questions that you may have at this time.

ATTACHMENT, HIGHLIGHTS OF GAO–14–568T

LEVERAGING BEST PRACTICES AND REFORM INITIATIVES CAN HELP AGENCIES BETTER MANAGE INVESTMENTS

Why GAO Did This Study

The Federal Government reportedly plans to spend at least $82 billion on IT in fiscal year 2014. Given the scale of such planned outlays and the criticality of many of these systems to the health, economy, and security of the Nation, it is important that OMB and Federal agencies provide appropriate oversight and transparency into these programs and avoid duplicative investments, whenever possible, to ensure the most efficient use of resources.

GAO has previously reported and testified that Federal IT projects too frequently fail and incur cost overruns and schedule slippages while contributing little to mission-related outcomes. Numerous best practices and administration initiatives are available for agencies that can help them improve the oversight and management of IT acquisitions.

GAO is testifying today on the results and recommendations from selected reports that focused on how best practices and IT reform initiatives can help Federal agencies better manage major acquisitions and legacy investments.

What GAO Recommends

GAO has previously made numerous recommendations to OMB and Federal agencies on key aspects of IT acquisition management, as well as the oversight and management of these investments. In particular, GAO has made recommendations regarding the IT Dashboard, efforts to consolidate Federal data centers, and PortfolioStat.

What GAO Found

Information technology (IT) acquisition best practices have been developed by both industry and the Federal Government to help guide the successful acquisition of investments. For example, GAO recently reported on nine critical factors underlying successful major IT acquisitions. Factors cited included (1) program officials were actively engaged with stakeholders and (2) prioritized requirements.

One key IT reform initiative undertaken by the Office of Management and Budget (OMB) to improve transparency is a public Web site, referred to as the IT Dashboard, which provides information on 760 major investments at 27 Federal agencies, totaling almost $41 billion. The Dashboard also includes ratings of investments risk on a scale from 1 (high risk) to 5 (low risk). As of April 2014, according to the Dashboard, 559 investments were low or moderately low risk (green), 159 were medium risk (yellow), and 42 were moderately high or high risk (red).

GAO has issued a series of reports on Dashboard accuracy and, in 2011, found that while there were continued issues with the accuracy and reliability of cost and schedule data, the accuracy of these data had improved over time. Further, a recent GAO report found that selected agencies' ratings were mostly or completely consistent with investment risk. However, this report also noted that agencies had removed major investments from the IT Dashboard, representing a troubling trend toward decreased transparency and accountability. Additionally, GAO reported that as of December 2013, the public version of the Dashboard was not updated for 15 of

the previous 24 months because OMB did not revise it as the President's budget request was being created. Consequently, GAO made recommendations to improve the Dashboard's accuracy, ensure that it includes all major IT investments, and increase its availability. Agencies generally agreed with the report or had no comments.

In an effort to consolidate the growing number of Federal data centers, OMB launched a consolidation initiative intended to close 40 percent of Government data centers by 2015, and in doing so, save $3 billion. GAO reported that agencies planned to close 1,055 data centers by the end of fiscal year 2014, but also highlighted the need for continued oversight of these efforts. Among other things, GAO recommended that OMB improve the execution of important oversight responsibilities, with which OMB agreed.

To better manage the Government's existing IT systems, OMB launched the PortfolioStat initiative, which, among other things, requires agencies to conduct annual reviews of their IT investments and make decisions on eliminating duplication. GAO reported that agencies continued to identify duplicative spending as part of PortfolioStat and that this initiative has the potential to save at least $5.8 billion by fiscal year 2015, but that weaknesses existed in agencies' implementation of the initiative's requirements. Among other things, GAO made several recommendations to improve agencies' implementation of PortfolioStat requirements. OMB partially agreed with these recommendations, and most of the other 20 agencies commenting on the report also agreed.

IT MANAGEMENT MODEL

Senator UDALL. Thank you very much, Mr. Powner, for your testimony.

Let me begin with the questioning here. GSA and OPM have either, and this is indicated in the testimony, moved or are moving to an IT management model that includes a more robust role for their agency CIOs. And the GAO has previously reported on ways the chief Federal information officers are impeded in their ability to manage or even monitor IT spending within their agencies.

And so I am very interested, since you are all moving down this road, how far have you gotten? What percentage of this have you done on consolidation? Are your CIOs empowered to drive down costs, which seems to be something the GAO has talked about over and over again? And are they enabled and empowered to create savings within the agencies? And where are they right now on this?

Mr. TANGHERLINI. I appreciate the question. And GSA, I would say that we are 90 percent down the road of consolidation, 100 percent down the road on the policy of consolidation around the CIO.

But I think that that is an approach that works particularly well for GSA, given our size and the nature of our mission.

As a result of integrating around a single CIO, we have been able to focus very intensely on finding the enterprise opportunities in each of our investments, and the numbers speak for themselves. In the fiscal year 2015 President's budget request, we are requesting an 18 percent lower budget than just 2 years before.

Again, though, I would say that that has been particularly appropriate and effective for GSA because of how we are sized. It may or may not be a model useful for other agencies, depending on how interrelated their functions are, are there similarities between what they do, and how do they deliver services.

Senator UDALL. And you have seen significant savings as a result of this, that you can identify?

Mr. TANGHERLINI. We think the savings comes from a number of areas. One, our cloud first policy, which is really focused around building off of a policy set by OMB, and Steve's leadership has

been incredibly important and helpful, has reduced the long-term cost of operating of other systems. Our data center consolidation efforts, again, led by OMB, supported by the great work of David Powner and the GAO, has also reduced our long-term operating costs.

For us, though, the next step in that evolution was really getting an enterprise sense of what our IT strategy and architecture is. And within GSA, we needed to have a single, accountable leader to deliver that.

Senator UDALL. Thank you.

IT STRATEGY

Director Archuleta, the same questions to you. Where are you at? What successes have you had? Have you seen concrete savings?

Ms. ARCHULETA. One of the first things I did, Senator, when I came into the position of director of OPM in November was in December to hire Donna Seymour as my CIO and to appoint a chief technology officer (CTO) for OPM.

Like Dan's description of what he has been able to accomplish at GSA, we may not be as far along, but I think we are on the right path.

We have completed in the first 100 days of my tenure an IT strategic plan that lays out six very important pillars that match very much what the CIO Council and the leadership, like Steve VanRoekel, have given to us.

First and foremost I put in place IT leadership and IT governance to determine how and where the decisions will be made for the IT infrastructure investments we will make.

All projects must meet the standards that both the leadership and the governance team have set forth, and they are all reviewed by the entire team.

Like Dan and other agencies throughout Government, we are looking at enterprise architecture, and realizing that the investments that we make throughout the enterprise have to take into consideration not only what the needs are, but the limited resources we have available.

For that reason, Donna and her team are not only focused on our immediate needs, but looking into the future, how we can make the right investments with the money that is available to us.

I am proud to say that she has taken important steps in leading this agency that did not have the leadership that it needed in IT. It was an issue during my confirmation, and I am pleased to report that we are making headway.

Senator UDALL. Great.

CIO BUDGET AUTHORITY

Mr. Powner, do you believe this concept of giving CIOs additional authority over their agency IT spending would improve oversight and achieve savings? And do you have any response to what the two witnesses have said?

Mr. POWNER. I think, clearly, the CIO authority is a big issue in the Federal Government. We saw, Steve and I have talked about this, even with the commodity IT. Many CIOs don't have authority

over all the commodity IT or the business and administrative systems.

Giving them certain budget authority sure would be a game changer, no doubt. That would clearly help. It probably would help attract a completely different type of CIO to the Federal Government, too. So clearly, budget authorities would help.

But we also, too, see certain agencies that have been very successful without budget authorities by establishing the right governance processes, in the organization that Dan was referring to, where we do see some appropriate governance in pockets in the Government.

I think IRS was mentioned earlier. They were the poster child for years, but this committee did a lot with spend plan reviews. You got the right people in there. They got the right governance. They turned it around. They are one of the better IT shops in the Government today.

Senator UDALL. Senator Johanns, would you like to proceed at this point?

Senator JOHANNS. Thank you, Mr. Chairman.

Thank you all for being here and your efforts.

IT DASHBOARD

Let me start out with the Dashboard, if I could. If I were to just look at that, I would say there are 70 percent of the projects that are just proceeding along normally. There are 25 percent of the projects that need some degree of attention. Certainly, not major or it would be in the 5 percent category. And only 5 percent of the projects out there are concerning.

Now you also said, Mr. Powner, that there are certain projects that are not included in that, so that is kind of a deficiency in what we are trying to accomplish here.

But how do you explain a situation like healthcare.gov, which I think everybody would acknowledge was a bust. Now, I appreciate they brought in a bunch of people and fine-tuned it or whatever, and saved the day or did their best to save the day. In 1 month, it was listed on the Dashboard under red during its entire development.

So I am sitting here with that knowledge saying to myself, not only is that Dashboard deficient, because you have a whole bunch of stuff going on in the Federal Government that doesn't make its way to the Dashboard, but I am also going to tell you, and I hope you challenge me on this, I am also going to tell you that what finds its way onto Dashboard is jaded. It is not accurate. It is being finessed, because either somebody totally blew it, and they thought this was normal development, or in the alternative, they didn't want anybody to know this thing was in crisis through its development.

Now, I don't care what side of the political spectrum you are on, Democrat or Republican, this is embarrassing.

IT DASHBOARD ACCURACY

So, Mr. Powner, explain that to us. How could healthcare.gov go through this development, tens of billions of dollars spent on it, and 1 month it has a red listing on the Dashboard?

Mr. POWNER. I would say this with the Dashboard, so there are clearly 200 projects that deserve attention. We can't argue that. Our comment is that the work we have done, we looked at the accuracy of the Dashboard, some agencies do a much better job than others. And it is contingent on strong CIOs having review sessions to make sure that what is up here is right. And there are pockets of success.

So what happened with healthcare.gov—and I will say this, sometimes bad data is actually good data, from an oversight perspective, because it was green, green, green, green. It went down March 2013 to red and then right back up to green.

Well, I can tell you, something goes from green to red often, okay, but doesn't go back to green in a month from red. That typically hardly ever happens.

So questions should have been asked there, from a Dashboard perspective. I don't think it was green. But again, even the bad data there told a story, okay? It is really up to the internal processes of those agencies to get this right.

And what we see are some agencies taking it very seriously, and other agencies that aren't.

And I know, Steve, I probably sound like a broken record, but DOD was reporting no red for the last 18 months. That is not true. They have many red projects at DOD.

So there was a recent hearing in front of the Senate Armed Services Committee, where DOD not only are they committed now to coming up with a Dashboard assessment every 6 months, they actually went from 93 investments to 118. They found 25 more major investments at DOD to report on the Dashboard.

So I actually think that is progress. Now, we need to get that right. But we are all over the board on this, but we are encouraged. Before the Dashboard, we didn't have any of this. We didn't have any of this.

EXPEDITIONARY COMBAT SUPPORT SYSTEM

And I will say, the Expeditionary Combat Support System (ECSS) project that failed in the Air Force, Chairwoman Mikulski, and you mentioned some of the big failures, Steve VanRoekel and OMB, they TechStat'ed ECSS three times, so they knew something was wrong with ECSS. And it eventually led to failure.

We can't prove that it was TechStat that did it, but the Dashboard and the TechStat process that was going on at OMB probably saved—$1 billion was wasted on that. But it probably saved a lot more money that could have been wasted on ECSS in the Air Force.

DEPARTMENT OF HEALTH AND HUMAN SERVICES

Senator JOHANNS. I appreciate that explanation, but I am still going to get back to what happened at the Department of Health and Human Services (HHS), because I think this is a worrisome problem for what you are trying to do here.

To me, it seems like somebody was pressuring somebody to report all was fine. If you are going to make an honest assessment of this, you would have thought that you would have had red all

over the place and people saying, "Whoa, time out. When this thing lights up, it may go down."

I mean, think of how poorly this thing worked on the day it was supposed to light up, and people couldn't get on it. I will never forget that very embarrassing scene for the Secretary of Health and Human Services. She is at some event. She has this thing lit up, and this notice comes on that it has crashed. It just was crazy.

In 1 month, it has a red rating. That tells me I can't trust what you were doing here.

And so, where is the pressure coming from? Is it the CIO in Health and Human Services that is collapsing to the pressure? Is the administration saying, "Look, we can't report that. This thing has to roll."

And how do you know that when you get to a point that it is release date, this thing is ready to go, that it just doesn't implode on you, and, therefore, you should not be trying to release something that is not ready for prime time?

Mr. POWNER. Well, Senator Johanns, I don't know what exactly happened there and who did what when with that. But I will say you are absolutely right, when you look at the complexity involved, the compressed schedules, the compressed testing, it should have been red. You are absolutely right. It should have been red.

Senator JOHANNS. I appreciate your candor, because I think everybody knows that is the obvious answer.

So I have kind of run out of time here. There will probably be another round.

So thank you, Mr. Chairman.

Senator UDALL. There will be another round.

Chairwoman Mikulski.

Senator MIKULSKI. Mr. Chairman and ranking member, thank you very much for holding this hearing.

This is an excellent panel because, first of all, we have GAO, who has continually sounded the alarm on these projects, and we are very grateful for the reports.

Many of us actually read these reports. I know the Washington Post says we don't always read them. But I think the appropriators really love GAO and inspector general reports, so thank you.

And at this table here, I think we have the right people who have the spirit of reform and transformation. So my questions will go not so much to fingerpoint, but to pinpoint how we can move ahead to clean up any mess that we have and to prevent any future messes from happening.

So let me join some of my colleagues on our skepticism because when I hear that DOD, Treasury, and OPM have nothing on the Dashboard, when my own constituent service says, particularly with DOD and OPM, my dashboard lights up. I know these issues here come from two sources. One is we look at budgetary constraints, and project after project, big idea, big project, big failure, big bucks. And canceled, terminated, delayed.

BACKLOGS

But I also have a whole other source of information, people who call Senator Barb dot-gov and say I need help. Where are my backlogs?

My caseload in Maryland is exploding on three backlogs: the Veterans Affairs (VA) disability backlog, the Social Security disability backlog, and the OPM retirement backlog. And then when we go to look at these, we find that their roots and origin lie in technology.

So you see where I am coming from. I want to save money, and I also want to respond to the mission. So this then takes me to—let's go to the veterans backlog.

You, the VA Committee that is trying to meet this, and they work on a bipartisan basis, Senator Johnson, Senator Kirk. Then I held a hearing and had General Shinseki, Mr. Hagel, Ms. Colvin, and so on. Well, first we found that they weren't reporting. And then we find now that DOD and VA have computers that don't talk to each other.

VA and DOD have electronic health records that can't talk. In 2008, Congress ordered them to create an interoperable system. In 2013, Hagel and Shinseki say they are abandoning the effort. The agencies spent $1 billion in 5 years and have nothing to show for it.

And now we hear that the agencies are developing two separate systems that aren't sure that they are going to merge and talk with each other. And in the meantime, the number of Iraq and Afghan vets who are applying for benefits is increasing.

They shouldn't have to stand in line because we can't go digital at the VA and have these interoperable systems.

This is to me a cameo of what is wrong. And I could go to OPM. I know you are trying and you have, actually, an excellent reform framework here, and I compliment you on it. But your records are in a cave in Pennsylvania. Your records are in a cave nine stories down in Pennsylvania with a dated, dysfunctional system. That is not an accusation. It is not a fault. It is a fact.

And when they try to pull these records up, you know what happens. They don't work. They get inaccurate assessments.

I can tell my colleagues, we have a substantial number of Federal retirees in Maryland, because we have the great Federal labs, et cetera. So the miscalculations, et cetera. So I can come back to you but you are not even on the Dashboard, but you are on my dashboard.

So let's go to the VA.

Mr. VanRoekel, you are Mr. OMB. You say that OMB needs more help because the workload is expanding. I acknowledge that. I have talked extensively with Ms. Burwell.

But tell me, what is the role of OMB, number one, in being aware of the problem; number two, correcting the problem? How much muscle do you have? How much clout do you have? And how could we correct that problem and use that as an example, because many of these cut across agency lines?

Mr. VANROEKEL. Thank you, ma'am.

PREVENTING MAJOR IT SYSTEM FAILURES

I think when you mentioned techno-boondoggles earlier, I think they have some defining characteristics that we have seen time and time again. The private sector has gone through a big transition in the last 15 years on its view of technology, really going from a very

discretionary thing—it was the ability to send an e-mail or print a document or call the help desk—to this very strategic thing. It is the way you market your products. It is the way you control supply and demand and inventory and quality, and connect with your customers in special ways.

I contend that the Government is going through that transition now, that we are in the midst of that inflection point. And the hangover of not being to the other end of that inflection is really kind of defined by the boondogglish characteristics, which are when faced with a problem, we see a single big procurement go out to a typically single, big monolithic vendor with a multiyear specification that runs out to an end. That tends to lead to a very large failure at the end of that, where in year 1, you may have a great idea. In year 2, you have no results to show that justifies getting funding in out-years.

And the pace of change of technology, the turnover of people in the Government, all these things contribute to not leading you to the end result that you want to see.

And so our first order of business is really thinking about how we change that big, monolithic approach into what modern Internet companies do today, which is delivering results very, very quickly. If you use Facebook, and you go up on Facebook, there is probably a new version of Facebook that comes out every month or so. They turn over all the time. You just don't know it, because you just get to take advantage of that.

And so bringing that into Government and setting Governmentwide policy are core to my direction.

The second part of this is deeper engagement with agencies. The Federal enterprise, a lot of people misconceive that my organization is the IT shop on the sixth floor of the building and we roll up our sleeves and we sort of dive in. The Federal enterprise is practically a sector of the economy. It is so large. And the ability for a very modest group at OMB, in small double digits on my team, doesn't have the ability to dive in and write code and develop solutions.

What I propose in the 2015 budget is really about how do we create a mechanism, instead of reactively when things are going wrong, proactively go in and engage with agencies to help them right the ship.

Senator MIKULSKI. Do you have the authority, the clout, and resources to go across the agencies or to pick out something that you know that is heading toward a disaster?

Mr. VANROEKEL. I believe I do, yes. I have the authority to work with the OMB director and the agencies on formulating the President's budget. I have Governmentwide policy authority through my role in OMB, and that authority gives me the ability to go in and stop projects.

And as Mr. Powner mentioned, we have done that in agencies through the TechStat process.

But going in reactively is often too late. I think we need to go in on these projects like VA——

Senator MIKULSKI. Do you have the authority, clout, and resources to go in early?

Mr. VANROEKEL.Yes, ma'am.

VA DISABILITY CLAIMS BACKLOG

Senator MIKULSKI. So what can we do to clean up the VA? Not the VA. It goes beyond the VA.

With the indulgence of my colleagues, because I know how passionately you feel about this problem, this veterans' disability long line and also the inability of VA to seem to go digital.

I have walked into the Baltimore office, the third worst field office in the Nation, trying to correct it. If you look at the records of a single event, I am 4'11" on a good day. Some of those records are almost as high as I am. And you have dedicated staff foraging through records trying to pluck a piece of paper to really be able to process the claim.

So what can you do about it? And what will you do about it? And can I have your word that when you leave here, it will be your top priority?

Mr. VANROEKEL. I have a personal interest in the VA. My father is probably watching the Webcast right now. He had his knee replaced at a Veterans hospital in Sioux Falls, South Dakota, a Vietnam vet.

And I have actually been working with the Department of Veterans Affairs on helping shape the direction to take.

I think it speaks to the chairman's earlier comment around CIO authorities. And I think the key thing to consider there is that a lot of these programs that are happening in Government are not just an IT problem. It is not the CIO. And just giving the CIO authority, you are not going to get to where you need to go.

It really takes a collective effort across how we are thinking about——

Senator MIKULSKI. I need to have three to five concrete steps that, Memorial Day, when I go out and talk to my veterans, I want to be able to tell them, in addition to the bipartisan commitment on spending financial resources to do it, that it is going to happen. And you cannot leave this to Shinseki and Hagel. And I am not knocking those men, whatsoever.

We have to solve the problem. And if there is one thing the Congress of the United States agrees on, on both sides of the aisle, on both sides of the dome, no veteran should stand in line to have their disability benefit processed.

So how can we do this? And what would you tell me to tell those veterans that we are going to do to do that?

Mr. VANROEKEL. I would say, that, one, I am the Federal CIO and committed to working on this, and I welcome working with you and your staff and the committee and the larger Congress on driving this forward, as well as working with my counterparts across Government who play an important role in this, and with the Department of Veterans Affairs, the Deputy Secretary of the VA. I have had many conversations around the work to be done here and thinking about, really, the smart application of technology.

And I think they are making good strides on the veterans benefit management system. I think it is a good application of process. We need to really deeply look at process. We have been working with the department on really rethinking some core processes in light of technology.

And third, it is working with the veteran service organization. They are really the frontline, really, of a lot of this.

Senator MIKULSKI. Right.

Mr. VANROEKEL. And we need a closer working relationship with them to encourage all of them to really submit fully developed veterans claims electronically, which we have the capability to receive from them, but we predominantly still get paper through that pipeline. So we inherently create a problem by the veteran service organizations, sort of the lack of electronic——

CIO AUTHORITIES

Senator MIKULSKI. Well, I appreciate everything you said. My time is up. And in fact, the Chair has been most indulgent with my time. And this goes to everybody.

So all of you and the recommendations of GAO, first of all, that is not an accurate number. It doesn't include independent agencies. It doesn't include the legislative branch and the judicial branch, which in and of itself is something.

So that is one thing. The underestimation of the problem, I think, exists.

Number two, what I would like to suggest, Mr. Chairman, is that we survey the subcommittee chairs and get from the subcommittee chairs what they consider the top three issues in technology from healthcare.gov, which was brought up, what we have in CJS, Veterans, and then do it, and then OPM and your situation.

We have to do this, and I am going to ask you to not put us in a priority, but show you the way as we fund this year's appropriation, we cannot have waste. And if this were fraud, we would say one corrupt contractor. But this is dysfunction. This isn't corruption.

So we need a sense of urgency, which I believe you have. And you have people in place now, I believe, that are present, so that we can move on this.

But we cannot tolerate this in this committee. We have to get value for the dollar, be accountable to the taxpayers, and fulfill the missions of our agencies.

So let's go forward together.

Senator UDALL. Chairwoman Mikulski, thank you very much. I think that is an excellent suggestion, working with our subcommittee chairs to try to get that information.

I couldn't echo more what she said in terms of the vets. I mean, this is something that is completely bipartisan up here. We had an excellent meeting. We brought them into appropriations. She was chairing the hearing. We said what do you need to do it? I think we gave them some dollars, but I don't think it is proceeding in the way that is getting the job done.

So that is something you could really help us with, Mr. VanRoekel.

Senator Johanns—or, Senator Moran, your turn to——

Senator MORAN. People often get Kansas and Nebraska confused, but rarely Senators Johanns and Moran.

Mr. Chairman, thank you very much. You and Senator Johanns have been, in my view, greatly interested in a topic that matters significantly to us as taxpayers and people who care about the effi-

ciency and effectiveness of Government. I look forward to us pursuing policies and encouraging agencies to develop plans that alter the landscape significantly in efficiency and effectiveness and timeliness of the way we deliver services to Americans.

And in my view, this is exactly the kind of hearing that the Appropriations Committee ought to be having. We ought to do this more often. It is the reason I was interested and willing to be a member of the Senate Appropriations Committee, because of the opportunity we have for oversight. And I am grateful to my two colleagues here for pursuing this line of questioning.

Let me start with the GAO, and I think part of this was covered, as I understand, before I arrived in regard to healthcare.gov. So I want to focus not on healthcare.gov, but on the IT Dashboard.

REPORTING ACCURACY

And my question is, GAO has issued a report on improving the Dashboard as a transparency tool. Which agencies are reporting accurately? Which agencies are not? And what can we do to make this tool more helpful for oversight purposes?

Mr. POWNER. We do a lot of work checking certain agencies, but there are a handful of agencies that we believe are reporting quite accurately, the Department of Agriculture (Ag), Commerce, Education, Homeland Security (DHS), the Department of the Interior (DOI), and VA are reporting accurately.

If you go to the Dashboard now, you will see reds, yellows, greens for all those agencies. It looks appropriate, given the complexity of some of these IT projects.

If you look at DOD, the Department of Justice, the State Department, Department of Transportation, and Treasury, there is probably more risk than what they are reporting at those five agencies.

Senator MORAN. Thank you. What is the difference between the agencies that are reporting accurately and those that are not? What would you call the characteristic difference between what is happening in one, as compared to the other? What is missing?

Mr. POWNER. I would say, these are CIO ratings, so it is clearly driven by the CIO. I think CIO involvement, and we hear certain CIOs, when they get ratings that funnel up to them to post on the Dashboard, and certain CIOs push back and say, "No, I think there is more risk than what we are reporting." We like to hear that. I mean, that is how you effectively manage these programs, by acknowledging the risk and then tackling the risk going forward. So I think it is up to those strong CIOs to really question to make sure we have accurate status.

We only have 760 of these. Most agencies have no more than 50. It is not asking that much of any agency to get an accurate assessment when many are spending between $2 billion and $6 billion within their agencies on these major investments.

Senator MORAN. Are you telling me that it is the attitude, approach, the effectiveness, the leadership skills of the CIO that determines whether or not you get the accurate outcome?

Mr. POWNER. It is all that, and we talked a little bit, too, prior about CIO authorities. Some agencies have authorities where they are deeply involved with certain of these projects, and some aren't, to be realistic. And the authorities are kind of all over the board.

Senator MORAN. Does that corollary apply to those who are doing it the best and those who are doing it less well so? Is there an authority issue, in, again, those two categories? Can we tie them together?

Mr. POWNER. You would tie them together, but I also have seen some CIOs who are very effective at using this mechanism without having the authorities still getting accurate ratings.

And those are just good leaders within certain agencies.

Senator MORAN. Thank you very much.

SYSTEM FOR AWARD MANAGEMENT

Let me turn to the GSA, SAM.gov. Since the Government switched from the Central Contractor Registration (CCR) to SAM.gov, as I understand it, there has been a drop in the number of new businesses competing for Government contracts. The number of new registrations per month has dropped over 35 percent, and I have heard from some small businesses interested in contracting with the Government, the Federal Government, about the difficulty of navigating the process.

Here are my questions: Can you explain the drop in registration in switching from CCR to SAM.gov? Should we expect the same drop with regard to other systems as they are integrated into SAM.gov? Is there a backlog to certify those news registrants? And if so, how do we reduce it? And what is GSA doing to improve the system that burdens new entrants into this process?

Mr. TANGHERLINI. I think in many ways SAM.gov, as part of the integrated acquisition environment, actually represents some of the less than best practices of how Government goes and buys technology.

And when I came to GSA, I inherited this program, which was heading toward failure. We worked very closely with OMB. We were able to turn it around so that we could deliver this vital mission.

But if I could go back in time, I would have worked closely with our CIO, who was not integrated in the project initially, which right there suggests that there is going to be an opportunity for failure, and we would have built it in a very different way than the way we are building it now.

Now what we found with SAM.gov is that actually we pushed up, dramatically pushed up, people's compliance with certain types of reporting. And that was the goal, to get people more compliant with required reporting in order to be an approved and certified Federal vendor.

But that means that more people are having trouble getting through the compliance hurdle. So while we have seen a drop in the number of people applying, we have dramatically seen an increase in the overall compliance of the people who are, in fact, certified.

So now we are going back and asking, are there ways that we can actually make it easier for people to get on to SAM. Can we make SAM much more user-friendly? Can we make it much more effective, because as a primary buyer of services for the Federal Government, we want as many competitors as possible bidding on

Federal contracts. We don't want to reduce the number of people competing.

We don't have a backlog right now, but we do have a system that, because of its very high compliance hurdles, actually makes it harder for people to get all the way through. When they are through, they are compliant. We feel that is a better certified vendor that we are offering the Federal community. But we have to figure out ways to make it easier.

Senator MORAN. Those two things, in my view, should not be mutually exclusive.

Mr. TANGHERLINI. I agree. I completely agree.

Senator MORAN. Thank you, Mr. Chairman.

Senator UDALL. Thank you, Senator Moran.

CIO SPENDING AUTHORITY

Mr. VanRoekel, in 2011, OMB issued a memo outlining that CIOs, and this is a quote from that memo, "should drive down costs and improve service for commodity IT."

Yet, few Federal CIOs seem to have authority over community IT purchases, including their agencies. And you heard the testimony earlier, I was kind of laying the groundwork for the question I am asking you here.

Doesn't it make sense to you that this might be an area that is ripe for a legislative solution or legislative enactment? The three of us are on a piece of legislation that gives specifically that authority to the CIOs that was in your memo. And so will you work with members of this subcommittee to ensure CIOs have the ability to oversee IT spending within their agencies?

Mr. VANROEKEL. Thank you. I consider this a very important issue. That memo is actually the first memo issued by my office in my tenure as Federal CIO, so I weigh it very heavily as very important.

The role of the CIO has continued to evolve over time. If you looked at CIOs, even in the private sector, even what we now consider cutting edge private sector companies, 10 or 15 years ago, you would have seen a much different set of characteristics than you see today.

Today, the CIO is a cyber warrior. They stay on top of cyber-type aspects. They are a business owner, and they manage, in the private sector, profit and loss (P&L) statements. In the public sector, they manage these very large budgets. They are an executive from a team, a multilayered team aspect.

What we have inspired to do in my tenure is not only, one, lay the groundwork to say that our first stage of getting costs under control was really to make sure that we had a view into this commodity spend. It is unthinkable in the private sector for an agency of Government to run more than one e-mail system.

When we came to Government in 2009, the Department of Agriculture was running 21 e-mail systems. And so our first foray here was let's get our arms around this commodity stuff. This is the lowest of the low-hanging fruit to drive cost savings.

The Department of Agriculture, I am happy to report now, as Mr. Powner said, they are one of the great reporting agencies. They are running one e-mail system. It is cloud-based. They have one way

of buying mobile devices. They have one way of buying computers across that very large enterprise, and they have done a great job driving this stuff forward.

So as we evolve, as we take this journey through really moving from discretionary to strategic, I think the role of the CIO will continue to evolve. And I think there is room for policy and discussions around what that role entails.

What I would caution is that that role, I believe, truly believe, is going to continue to evolve and will be set up in a way that we should have fruitful discussions to talk about what that is going to look like for now and into the future for success.

Senator UDALL. Mr. Powner, could you comment on that, specifically on the authority of the CIO? Do you believe it would be helpful to identify specifically that they have the authority to make commodity IT purchases, and those kind of things, throughout the agencies?

Mr. POWNER. Yes, I think if you start with the authority issue on commodity IT, there is no reason why CIOs in the Federal Government should not have authority over commodity IT.

And I think the PortfolioStat initiative, we have 200 initiatives that total $5.8 billion. If we do it right, we could save money. That includes some data center consolidation. It includes going to the cloud. It includes eliminating a lot of duplication.

And there is always this big debate, are CIOs responsible for mission-critical applications and systems? Frankly, they should be. But let's start with commodity IT. Start with commodity IT, get the authorities right there, and then we can grow the CIO authorities, as Mr. VanRoekel referred to. I think that is the appropriate way to go.

Senator UDALL. Thank you.

Senators Johanns.

Senator JOHANNS. Thank you, Mr. Chairman.

RETIREMENT PROCESSING

If I could go to Director Archuleta with a question or two about the retirement system, it seems to me that when you are dealing with the body of people from the Federal system who are qualified for retirement or are on a retirement program, that you are dealing with a pretty defined universe, compared to rolling out an IT system for the entire United States and everybody who might access it.

This would seem, by comparison, relatively straightforward. But we have all read that article about the cave. I can't imagine working under those conditions, to be honest with you. But people go back to the stacks and stacks of paper files. And literally, they are figuring out retirement with a pencil and piece of paper and a calculator.

I mean, I was amazed. Is that truly what is happening? When somebody reaches retirement age, they decide to retire, how do you make sure—walk us through the steps where they go from the decision to retire and retirement day to actually being on the system?

Ms. ARCHULETA. I would be glad to, Senator.

First, let me say, especially as we honor employees this week, that employees at Boyers are a terrific group of individuals who are

very dedicated to making sure that our annuitants are served in the best way possible.

If they are not able to meet some of our expectations, it is not because they are not trying. It is because we have not given them the tools they need to implement the work that is so important.

When you think about the number of people that Retirement Services deals with on a daily basis at any given time, the general group of people are over 2 million retirees and their families who are customers of Retirement Services. And, as you know, we have about 1.9 million people in the Federal Government right now. On any particular month, anywhere from 9,000 to 10,000 of those individuals retire.

In 2010, there was a decision to shut down an IT system that had been piloted. It didn't work. And the result of which is that we had to go back to the drawing board. What the employees did was to use very effectively what has been characterized as paper and pencil, but, I will tell you, a lot of dedication as well.

They have managed to reduce the backlog. Today, just a few days ago, we reported to you that there were approximately 15,000 backlogged cases. That still is too many.

So as a result of my commitment to reduce the backlog that I made during my confirmation hearing, and with the help of our new CIO and the dedicated staff at Retirement Services (RS), we are focused on three priorities for reducing the backlog and moving forward into the future on how we deal with Retirement Services.

The first one, and you will recognize all of these, sir, because your constituents talk about them, is that we are going to look at customer service first, and what is the response time that it takes for any annuitant to hear about whether he or she is eligible for the retirement contributions that they have put away in their retirement fund.

Usually, if I were to retire tomorrow, I would work with my Human Resources (HR) manager in the Department of Labor, and I would let her know that I was retiring. The HR manager would then gather my papers and inform our Retirement Services that Katherine Archuleta is about ready to retire.

The gathering of those papers on the day that I do retire, if there are no outstanding issues around my retirement, what will happen is that first, I retire on May 1. About May 15 or so, I will get my first check, which is the accumulation of my leave pay. On about June 1, I will get my first retirement check, and that will be 80 percent of what I am entitled to. The last 20 percent will come in the final adjudication of my file, and usually that happens within another 30 to 45 days. That is a normal case.

But sometimes not everybody is as easy as Katherine Archuleta. There are other times when there are other issues that employees encounter, such as court cases or other liabilities that they encounter, which we must investigate.

If all of that information is in our hands, that same timeline will apply. However, if there are things that are not available, if we don't have the paperwork, if the court is involved, it takes a lot more investigation by these individuals.

So that customer service is really important to us, that we are communicating. So we are focusing on that.

The second thing, sir, that I would tell you we are doing is focusing on case management, how do we get those files as quickly as we can? The investment, the appropriation that you provided to us at $2.6 million will enable us to develop the case management system. We have asked for another $2.4 million in 2015. That will allow us to complete that. And by the end of fiscal year 2015, we should have a case management system online.

Finally, we are going to work on the post-adjudicative workload. Those are individuals who in fact have already retired and changes in their lives have made further work with them necessary. That might be a death of the annuitant. It might be a divorce of the annuitant. There might be new child custody issues. All of those things come into play as their annuities are calculated.

It is a complicated process. It is in paper and pencil right now. But I will tell you that there is a dedicated staff, including the people in Boyers, many of whom have worked there for over 20 years, who are working very hard to solve these problems.

Senator JOHANNS. You know, nobody here is picking on the employees.

Ms. ARCHULETA. No, I know that, sir. Yes.

Senator JOHANNS. We are happy that there is somebody who wants to do the work and is dedicated and forcefully trying to get it done.

But I do think this is an example of where we have spent money, really, to no avail. You have the employees out there holding things together, but when you say we haven't given them the resources, I think we have given them the resources. We just haven't deployed the resources appropriately, and it has not been effectively utilized.

Ms. ARCHULETA. And I could add to that the resources have worked. So it is my commitment to you, sir, to keep you up-to-date on where we are at in this process. As I said, I have employed a new CIO. It is at the top of her list of things that we are going to accomplish.

And I will be sure to keep you and this committee up to date on our progress.

Senator JOHANNS. Thank you, Mr. Chairman.

Senator UDALL. Senator Moran.

Senator MORAN. Thank you again.

FEDERAL RISK AND AUTHORIZATION MANAGEMENT PROGRAM CERTIFICATION

Let me go back to OMB. I want to talk about the Federal Risk and Authorization Management Program (FedRAMP). Your memorandum requires that all cloud service providers (CSPs) must be FedRAMP-certified by June 4, 2014, and that if they are, that makes them eligible to partake in future Federal cloud service procurement opportunities.

June 4 is not very far away, and FedRAMP certification seems to me to be pretty important. And I think there is some concern that we may not be prepared by June 4. And so my questions are, what measures will be taken to ensure that agencies enforce the FedRAMP deadline on CSPs seeking Government acquisition June 4 and beyond?

Mr. VANROEKEL. The FedRAMP, just to catch people up, FedRAMP is called the Federal Risk Authorization and Management Program. Agencies of Government were going under our cloud-first policy to cloud vendors and basically asking for very specific and unique requirements for each agency. What was happening was, two things are really happening. One was that they were driving all the cost savings out of it by asking for unique solutions to be produced by the private sector, to send them back these solutions. And two, it was creating all this variability in the marketplace, where cloud vendors didn't know how to sell to Government. They didn't know how to provide.

So I launched FedRAMP to basically build a consistent way of doing cybersecurity around these cloud providers, effectively shaping cloud computing as we know it in the United States.

Now if you go to Amazon or Microsoft or any of these large cloud vendors and you talk to them, even about their corporate strategy, they are using FedRAMP as the way of defining consistent cybersecurity capabilities to sell into the private sector. We are even seeing other foreign governments pick up FedRAMP as now their model of operating, because the United States owns about 80 percent of cloud computing capabilities for the world. And so we are making good progress.

On FedRAMP adoption inside the Government, we have over, I believe, a dozen or so vendors that have now reached the FedRAMP certification that can now sell into Government. And agencies also are then required, because I didn't want people to get out and fail, and, "If I don't go to the cloud, then I can just use my own stuff inside my own data center." Part of what you are seeing in the June deadline is getting Federal agencies to say, if they are going to provide their own capabilities, we are going to require that they meet those same guidelines for cybersecurity. And I believe we are making great progress.

Senator MORAN. If you have to meet the same requirements, what would be the incentive to stay in-house?

Mr. VANROEKEL. That is a great question. It was actually part of the incentive structure we put in place to try to get people to go to the private sector, because we think that is a better, long-term motion.

Senator MORAN. Is it better because of cost savings? Better because you think the security would ultimately be better?

Mr. VANROEKEL. I think it is better for a couple reasons. One is, it goes from a very capital-intensive model to an OpEx model where instead of upgrading your data center and coming to committees like this and asking for money every 3 years to buy new servers and things, you just pay one price over the course of time. And two is the capability. You get the benefit of upgrades and things that the vendor is doing at scale with other customers.

When you go to Amazon.com, you don't think to yourself, do I have the latest version of Amazon.com installed? You just use it, and it is just available to you. That is kind of the beauty of cloud and where this goes, is that we can reap the benefits of large-scale, and get the benefits of the upgrades and the technology shifting over time without us having to drive it ourselves.

Senator MORAN. You mentioned the number 12. Is that a good number? Is that a sufficient number?

Mr. VANROEKEL. I was looking. These move all the time, so I was trying to pull to the page. I believe that is very close, but I would be happy to get back to you.

[The information follows:]

As of June 2014:

22 cloud services have received FedRAMP authorizations:

—12 companies and 13 cloud services have received Joint Authorization Board (JAB) issued Provisional Authorizations To Operate (P–ATO).

—2 companies and 3 cloud services have received agency issued Authorizations To Operate (A–ATO).

—5 private cloud services have been authorized by the Department of Homeland Security (DHS).

—1 Government agency (U.S. Department of Agriculture) has one cloud service that meets FedRAMP requirements.

—There are 13 cloud service providers (CSPs) with 13 cloud services in-process for Joint Authorization Board authorization.

The authorized cloud services range across Infrastructure as a Service (IaaS), Platform as a Service (PaaS), and Software as Service (SaaS) offerings. At any given time, there are also upwards of a dozen systems being actively reviewed by the JAB for FedRAMP authorization, and many more in the pipeline.

Senator MORAN. Just in general, is that the number of vendors that you would want to be certified? Or is the audience much larger, the opportunity much larger?

Mr. VANROEKEL. The key to that is, many of the very large vendors out there are represented in that 12. The bulk of the large vendors, like the Microsofts and Amazons of the world, are represented in that number.

We have a very rich pipeline, and I think the vibrancy in this cloud marketplace continues to evolve and expand. And it is a place that really speaks to kind of American exceptionalism in technology.

Senator MORAN. Very good.

BROADBAND ACCESS

Another question, Mr. Chairman, talk about broadband access with the GSA. The Middle Class Tax Relief and Job Creation Act of 2012 directed GSA to develop a master contract to govern the placement of wireless service antennas on buildings and other property owned by the Federal Government. This makes some sense to me, but I also understand that not much has happened, and that GSA is significantly behind the deadline. I think President Obama has directed this to happen. It hasn't happened following his Executive order. It is a congressionally mandated program.

Would you bring me up-to-date on where we are and maybe my understanding of the timeframe? As I understand, you are a couple years behind?

Mr. TANGHERLINI. I will actually have to follow up with you and the subcommittee to give you a better update on where we stand with that particular initiative related to the Recovery Act.

[NOTE: *See* in the "Additional Committee Questions" at the end of the hearing the General Services Administration's response to Senator Moran's question above.]

Senator MORAN. I think there is merit to achieving this goal. I think it enhances the wireless industry's ability to deliver. I pay at-

tention to these issues, in part because of the rural nature of where I come from. And it also is trying to create revenue for the Treasury. So I would be glad to have your follow up.

Mr. TANGHERLINI. We support all of those things. We would like to help out.

Senator MORAN. Okay, thank you very much.

Senator UDALL. Thank you, Senator Moran.

DIGITAL SERVICES

OMB's fiscal year 2015 budget request includes a new Digital Service team of 25 staff to identify major IT problems across agencies. GSA's new 18F team will include talented, private, and nonprofit sector technology experts to help resolve IT issues at the agencies.

I want to ask Mr. VanRoekel and Mr. Tangherlini, can you explain how these teams will work together to prevent major IT system failures and improve citizen services? What types of problems do you expect these groups to solve? How is this effort different from the Presidential Innovation Fellows? And are you concerned that the agencies may be reluctant to request help from GSA's 18F team?

Mr. VANROEKEL. Great, so I think I will go first. The key thing to think about as far as I think a lot of what you have heard today is a lot of our engagement on Federal IT on programs that aren't going so well is very reactive. We go in when indicators are showing us things aren't going well, or other notable examples where we go when in, in a reactive way.

The intention of this budget request is to really shift from reactive to more proactive, where we are starting to identify what are the key investments that agencies are doing, and then how do we get a team of people in that you would really, as American taxpayers, would want in looking at these investments in a nonbiased way to understand what are the gaps that need to be filled.

Current staff within OMB, our time is primarily comprised of our statutory duties that do the budget formulation, reporting to Congress, and other things. Our GAO engagement work, which is, amazingly, up to about 40 percent of our time, is spent working on GAO inquiries.

HIRING EXPERTISE

And then through the great work of this committee, we stood up a couple years ago the IT Oversight and Reform Group, which is a small group that has been really focused on Government efficiency. It is what has driven those billions of dollars in savings we talked about. It is what drives the report that you get on a quarterly basis that has line item savings identified inside agencies. And it has driven the PortfolioStat process.

This additional capacity that we are talking about in the 2015 budget is really about bringing people in. Think of the Facebook engineer out there, the usability person at Google, or the person who can take a rotation in Government, work within Government, where we go in and having identified important projects within Government, come into those Government agencies and provide expert consulting, look at and spend time with agency.

And I am saying, by "spend time," not a 3-hour PowerPoint session, but spend 1 or 2 or 3 weeks or more with the agency really getting behind the scenes on what is going on inside this agency, what are commonsense, 21st century ways that we need to address the issues at hand, and then work with agency on coming up with a plan on how to address those.

So really think of our group as the group that does the consultancy upfront, identifies gaps, comes up with a plan to address those gaps. And then the way that the agencies would address those gaps I anticipate would be one of three ways.

One is they would find or hire someone into their own organization to address those. We actually have been working with Director Archuleta on looking at flexibility in technical hiring and other things to help fill that sort of gap.

Two is looking at the vendor community and understanding can these vendors who are working on these projects subprime in small innovative companies? Can they work in a different way? Can they bring talent in? We have seen that work effectively in Government.

Or third is potentially working with GSA's 18F team, where they are building delivery capacity, people who would actually sit with agency and write code or work on these projects in a small way.

And what we have seen time and time again, from me going into an agency and helping them on a project to other efforts, a very small number of people who have a notion of how to deliver things, in modern technology terms, can really change the game, and change the dynamic in a way.

It doesn't take an army of new people coming in. You can actually just inject a few well-meaning people in to really change the outcomes today.

18F

Senator UDALL. Dan, on the 18F.

Mr. TANGHERLINI. I would just add to that. What we are trying to do is build an additional level of capacity beyond our existing capacity, which is to provide agencies with contract solutions. So that rather than agencies trying to figure out every component of how you would solve a problem, we can help agencies through having internal capacity, programming capacity, better understanding of how you build IT systems, help them experiment with solutions, so that when we go back into the marketplace for the bigger buy, we are actually a more knowledgeable consumer of IT services.

We think that working more closely with the capacity that Steve is developing means that we are going to have an opportunity to have a feedback mechanism, figure out what is working, frankly, what isn't working, and make sure that we carry that message from agency to agency, so that these mistakes don't get repeated over and over again.

The other exciting aspect of this is that 18F is going to be the resident home for the Presidential Innovation Fellows. So those are folks who the agencies have personally selected to come work on problems that they have identified. And from that, we are going to have a better way of understanding the challenges within those agencies. We are going to use some of the experiences that the Presidential Innovation Fellows bring back, share with the other

fellows, to understand how we should be targeting our efforts to serve agencies.

We also think that the Presidential Innovation Fellows will be a fantastic recruiting tool both for our internal capacity that we are developing at GSA, external capacity that is being developed in the other agencies, and maybe even Steve's office, too.

Senator UDALL. Thank you.

IT INITIATIVES

You have commented on this area, previously, so I am wondering, do you believe these new proposals would address some of your concerns in terms of providing more guidance and oversight to IT initiatives, which I think you have mentioned in the past?

Mr. TANGHERLINI. I think these are good ideas to be proactive and to be innovative and to get in on the front end. That is definitely needed. So these initiatives are great.

But we have 760 investments up here that are in flight; 275, roughly, of the 760 are acquisitions that need some basic blocking and tackling to get them done. And then we also have most of this as legacy spend, data center consolidation and PortfolioStat.

So I think these are great ideas, but we can't lose sight of this, because we are spending a lot of money and we need help with some of this.

Senator UDALL. Thank you very much.

Senator Johanns.

Senator JOHANNS. I am very mindful of the fact that we are going to get called to a couple votes, I think in about 10 or 15 minutes, so if I could just ask a couple quick questions, just a follow-up on healthcare.gov.

HEALTHCARE.GOV

Mr. VanRoekel, were you a part of the oversight team? Or was there an oversight team, as healthcare.gov was being built and working its way toward implementation?

Mr. VANROEKEL. My role was very in line with the mission and role that OMB plays, in that I assembled team across the Federal agencies that related to the Affordable Care Act. It was something that we call the IT steering committee.

And the primary output of this team was the data services hub capability of the Affordable Care Act implementation. It is somewhat of a natural act for agencies to work within their own agencies. It is not as natural in the model that is Government for these agencies to work across their borders. So we brought together the teams of technical people to work with each other to solve the opportunity for these transactions to be routed between the agencies.

Senator JOHANNS. Okay. Did you have any concerns when healthcare.gov was not reporting red? I mean, they did 1 month and then popped right back to green. Did that raise any red flags for you and your office? Or did anyone come to you and say, "You know, I just wonder if we can rely upon the information that we have been given by HHS."

IT DASHBOARD

Mr. VANROEKEL. The IT Dashboard, it is probably important to note as a kind of pretense to this, primarily tracks cost and schedule variance. Cost and schedule variance wasn't something that the Government was tracking, writ large, before my office created the IT Dashboard. And the IT Dashboard was sort of an important first step in getting agencies not only to report this, but, more importantly, letting agency CIOs have visibility into the corners of their agencies on what all the investments were and what were the cost and schedule variance of those investments. We now have that as a cost and schedule variance to track. And that is what IT Dashboard does.

I agree with Mr. Powner. We hold a lot of potential to enrich the way we are looking into these investments and our fiscal year 2015 budget request really starts to get at the capacity to be able to that.

Senator JOHANNS. So at that time and at this time today, if I am a Secretary, and we report that we are on budget, number one, and number two, that we are meeting the schedule for whatever rollout day is, then I get a green on the performance Dashboard is what you are saying?

Mr. VANROEKEL. I have added another feature to the Dashboard that is something I call rebaselining. So if an agency goes in and has set an initial cost schedule and time schedule to their investment, we could not tell, in the first versions of IT Dashboard, if an agency is going in and changing their targets, they were moving the schedule, moving the costs.

In late 2011, early 2012, we added the functionality, so we could see if someone was rebaselining their investment, meaning they were moving the goal line on cost or schedule. That gives us a key indicator to look at as well.

Senator JOHANNS. You can kind of see the point I am getting to. I think that is good information to have. But I could be a Cabinet member and my team could be coming to me and saying, "We are on budget. We are on schedule. We are not moving the goalposts," and I would report green. And then the fourth thing they could be reporting to me, "We don't think this has a prayer of working."

And yet, I would be in compliance with the Dashboard, right?

Mr. VANROEKEL. I think, to Senator Mikulski's point earlier on kind of these large monolithic projects, one of the primary problems we have is we don't know the health of the project until the end, until we get to the delivery. We have seen this in many examples across the Federal Government.

AGILE DEVELOPMENT

The key is, as I mentioned earlier, to think in a more modular way. How am I delivering something I can actually see and touch and feel in 60 days or 90 days, and limit those deliveries to that time?

Part of our broader policy work, and the capacity that we are putting into the 2015 budget, is working more side-by-side with agencies to drive this as the new normal.

You wouldn't walk into a private sector company today and see them spec'ing a 3-year project that is $100 million and things like that. Just as a society, you don't deliver solutions that way.

Our aspiration with this work is to get Government to really think about how am I doing things in a more agile way that delivers customer value very soon.

In the cases where I work with agencies, or we get people who were bringing this to agencies, we see great results.

IT DASHBOARD RATINGS

Senator JOHANNS. What you are telling me, you answered that in a finessed sort of way, what you are telling me is the answer to my question is yes, you could report you were on time, you are on budget, you are not rebaselining, but my team could be telling me that it looks like this thing will fail, and I would still be in compliance with the Dashboard.

Mr. VANROEKEL. The green, yellow, and red are self-assessments. They are independent of the metrics we see under the Dashboard. We do track those metrics, independent of green, yellow, red. We actually don't use green, yellow, red as the key indicator.

Senator JOHANNS. David, I saw you nodding.

Mr. POWNER. Well, I will give you a good example. I think DOD has turned a corner. They now have 118 investments reported, up from 93. They have agreed to provide an assessment every 6 months, not monthly, like other agencies.

But in their new guidance, what they said, and they have had so many failures with enterprise resource planning (ERP) systems, and the Air Force ECSS is the recent example. They are going to list every ERP system they are doing as red, because of their past history. I actually think that is appropriate, so it gets the right attention.

So they could be perfect on cost and schedule, but they may call it, if it is ERP, and the complexities they have had and all the past failures, it is going to be red.

We like that. So I like where there is flexibility, because it is okay if we have more reds. We want this managed more effectively, so we are not wasting taxpayer money.

Senator JOHANNS. And, again, not to get into a partisan debate about whether we like the healthcare bill or not—we could have that debate, and we have had—I think the managers, right up to the gentleman in the Oval Office, deserve to know if this thing isn't coming together.

As a former Cabinet member myself, I would want to know that. And if I did know that, I would be telling somebody, my committee of jurisdiction, the President himself, "There is a very serious problem here."

And that is what I am trying to get to. I just want to make sure that whatever processes we have in place are catching what we think they are catching. And I just worry that today we are not there yet.

Now I compliment you. I do think knowing about price or whether you are on budget, et cetera, is good information to have. But

at the end of the day, we also want to know that when we spend that money, we are going to get something that actually works.

And that is where the Federal Government, I think, gets so much criticism. We spend all this money, and at the end of the day, it doesn't work, and we are all kind of going, "Wow, that was a surprise," when, quite honestly, somebody had to know that as this was being put together, it wasn't coming together. That is what I am trying to achieve here, how do we get to that?

And that is a question for another day, but a question we are going to continue to press on. And I thank you for your indulgence, Mr. Chairman.

Senator UDALL. Senator Moran.

Senator MORAN. Mr. Chairman, no questions.

Senator UDALL. Okay, let me see here, first of all, let me thank all of you for participating and being here today. You can see there is a real passion up here for the work that you do, and saving real dollars, and focusing on this. We really appreciate the top officials and experts in IT here, and your ideas for improvement. I think you gave us some very good suggestions.

Today's discussion, I think, has been very helpful, and it will be instructive as we move forward.

The hearing record will remain open until next Wednesday, May 14, at noon, for subcommittee members to submit statements and questions to be submitted to the witnesses for the record.

[The following questions were not asked at the hearing, but were submitted to the agencies for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO HON. STEVEN VANROEKEL

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

TECHSTAT AND FAILING IT PROJECTS

Question. The Government Accountability Office (GAO) has noted that the Office of Management and Budget (OMB) has transferred responsibility of TechStat reviews to agencies, and conducts many fewer TechStat sessions itself. Much of the success of previous TechStat sessions has been attributed to the fact that they were attended by high-level managers from the agency and OMB.

—Do you believe that TechStat reviews are as effective when conducted by agencies as when conducted by OMB?

—What tools do agencies have to terminate information technology (IT) investments that are critically over budget, over schedule, or failing to meet performance goals?

—Similarly, what tools do agencies have to replace these terminated investments with new commercial IT solutions?

—What authority does OMB have to intervene into agency IT projects that are at risk or failing and cancel them?

—What will OMB do to provide more guidance and oversight of the Federal Government's most at-risk IT projects?

Answer. OMB works on a continual basis with agencies to conduct TechStats, be they led by the agency or by OMB itself. As part of the 25 Point Plan to Reform Federal IT Management, OMB worked with agencies to develop a TechStat toolkit, which was based on the rigorous processes OMB used to develop the TechStat model. The Toolkit provides templates, guides and other tools for an agency to successfully execute a TechStat. OMB believes that TechStats can be more effective as a tool, when managed and applied by agencies. This is because agencies are closer to the programs and are able to recognize the triggers and risk factors that an investment may be heading off course more quickly than OMB can. As a result, the agency can assemble a multidisciplinary team to review the investment and implement corrections.

Agencies have broad latitude to cancel failing investments. In fact, in many instances they are able to marshal administrative remedies faster than OMB. Agen-

cies can terminate contracts and assign personnel to meet revised agency priorities. These types of changes are implemented very quickly. In addition, on at least an annual basis agencies convene investment review boards (IRBs) to review the IT investments of their respective institutions to ensure that they are delivering on the vision and consistent with the agreed upon strategy.

Additionally, as part of the Smarter IT Delivery Initiative, OMB is reshaping the delivery of information technology already underway and introducing new approaches/tools to transform the Government IT landscape. To do this, OMB is focused on a three-part agenda that will provide the Federal Government with: (1) the best talent (2) the best companies; and, (3) the best processes to drive outcomes and accountability.

As part of this effort, in August 2014, the Administration began piloting the U.S. Digital Service. This small team of America's best digital experts will work in collaboration with other Government agencies to identify and fix problems, to help upgrade the Government's technology infrastructure, and to make Web sites more consumer friendly. The team has one core mission: to improve and simplify the digital experience that people and businesses have with the U.S. Government by:

—Establishing standards to bring the Government's digital services in line with the best private sector services;
—Identifying common technology patterns that will help us scale services effectively;
—Collaborating with agencies to identify and address gaps in their capacity to design, develop, deploy and operate excellent citizen-facing services; and
—Providing accountability to ensure agencies see results.

The Administration also released for public comment two crucial components in its growing IT toolkit that will enable agencies to do their best work—the Digital Services Playbook and the TechFAR Handbook.

The Digital Services Playbook lays out best practices for effective digital service delivery and will serve as a guide for agencies across Government. To increase the success of Government digital service projects, this playbook outlines 13 key "plays" drawn from private and public-sector best practices that, if followed together, will help Federal agencies deliver services that work well for users and require less time and money to develop and operate.

To ensure Government has the right tech tools to do its job, and can be more agile and flexible to meet rapidly changing needs, the dministration also launched the TechFAR Handbook. The TechFAR Handbook is a guide that explains how agencies can execute key plays in the Playbook in ways consistent with the Federal Acquisition Regulation (FAR). This document will help agencies take advantage of existing authorities to procure development services in new ways that more closely match the modern software development techniques used in the private sector.

With regard to OMB, it has authority as described in the E-Government Act of 2002 (Public Law 107–347) to oversee implementation of:

—Capital planning and investment control for information technology;
—The development of enterprise architectures;
—Information security;
—Privacy;
—Access to, dissemination of, and preservation of Government information;
—Accessibility of information technology for persons with disabilities; and
—Other areas of electronic Government.

OMB's Office of E-Government and Information Technology will continue to publish new and/or updated guidance to support agencies in their development and management of IT investments. This includes revising the capital planning guidance that is used to help agencies manage IT investments. The revisions are intended to provide the right level of visibility into the investments so that agencies, OMB, Congress and the public can see that the Government is making smart investments in IT.

SPECIAL HIRE AND PAY AUTHORITIES

Question. Both GSA's 18F and OMB's Digital Service are using Schedule A hiring authority. Direct Hire Authority is available for Information Technology Management (Information Security) (GSA–2210, GS–9 and above, Governmentwide and nationwide), but not all IT positions.

—Given the high demand and competition for IT-related positions, and because the private sector can often pay higher salaries for such positions, what increased hire and pay authorities are under consideration for IT positions that don't currently have any, and what types of positions would these be?

—What other types of hiring and pay incentives beyond those now available to Government employees and agencies should be contemplated for recruitment and retention of IT specialists?

—Do you believe that OMB needs additional authority to expand the use of Schedule A hiring authority for the Digital Service?

Answer. OMB, the U.S. Department of Veterans Affairs (VA) and the General Services Administration (GSA) recently received authority from the Office of Personnel Management (OPM) to hire a small number of Schedule A, Digital Services Experts to support the Smarter IT Delivery Initiative. We believe that hiring flexibilities like this will better allow agencies to compete with private sector hiring standards for elite IT talent. Currently, we are planning research and evaluation methods which would help the Government determine if this Schedule A authority should be scaled Governmentwide. In the meantime, the Administration continues to explore other flexible hiring options that agencies can utilize such as term appointments. The Administration also encourages agencies to utilize the direct hire authority for cybersecurity professionals where applicable.

DATA CENTER CONSOLIDATION UPDATE

Question. Since agencies began executing their data center consolidation plans in 2011, more than 700 Federal data centers have been closed. This has led to $3 billion in reported savings through PortfolioStat, but more progress can be made. GAO's testimony notes that as of last July, Federal agencies reported having nearly 7,000 data centers. Measuring average server utilization is one way to evaluate how effectively the Federal Government is using its remaining data centers. While the industry standard for average server utilization is 60 percent, the Federal Government's standard is roughly 10 percent.

—How many Federal data centers existed at the start of this initiative and how many are there now?

—What is the current average server utilization rate at Federal data centers?

—What is your target utilization rate for Federal servers?

—How is OMB providing oversight of this initiative and coordinating agency efforts to consolidate data centers?

Answer. In October 2010, based on agency submissions after the launch of the Federal Data Center Consolidation Initiative (FDCCI), OMB reported 2,094 data centers. As of July 2014, agencies have identified 9,540 data centers, of all types and sizes. This increase, explained in further detail below, is a result of a change in definition of a data center, and is not a result of construction of new data centers. The 9,540 is categorized into two populations, core (275 data centers) and non-core (9,265), further defined below.

It is important to note that since the FDCCI was launched there have been several important policy shifts within the data center space which provide some context for the increased 9,540 figure. First, in March 2012, based on a recommendation from the FDCCI Task Force (a CIO Council body), OMB changed the definition of a data center and removed all square footage and tiering requirements (the original definition required 500 square feet and meeting strict criteria from the Uptime Institute). Subsequently, this caused a dramatic increase in the number of data centers that agencies reported. As mentioned above, the jump was not due to construction of new data centers, as the Government maintains a net zero growth policy dating back to the summer of 2010. Further, the definitional change has provided additional transparency and insight into the Federal Government's actual data center footprint. The majority of the Government's data centers are smaller rooms and closets (less than 1,000 square feet), rather than large, stand-alone facilities, that one envisions when he/she considers what a Google, Facebook or Microsoft may employ.

Second, in March 2013, the FDCCI was integrated into PortfolioStat, the Government's IT portfolio management initiative. As these efforts converged, OMB instructed agencies to focus on optimizing those data centers that are pivotal to delivering taxpayer services, while closing duplicative and inefficient data centers. As a result, agency progress under the FDCCI is no longer solely measured by closures. Instead the FDDCI Task Force categorized agency data center populations into two categories: core and non-core. While the Government will continue to target the initial goal of closing 40 percent of agency-identified, non-core data centers, agencies will also be measured by the extent to which their core data centers are optimized for total cost of ownership. To enable this, the Task Force developed energy, facility, labor, storage, virtualization and cost per operating system metrics.

Instead of focusing on one metric, for example, server utilization, OMB worked with the FDCCI Task Force to develop total cost of ownership metrics, which measure performance against all the cost areas of data centers, rather than just one di-

mension (utilization) of one piece of data center equipment (servers). These metrics, which were published as part of the fiscal year 2014 PortfolioStat guidance, cover hardware, software, energy, human capital and facilities density. OMB and the 24 participating Federal agencies believe that working to meet the targets for these metrics puts the Government in a better position to address emerging taxpayer needs than just focusing on server utilization.

To date, agencies have closed 976 data centers with 3,665 planned for closure by the end of fiscal year 2015. This information is updated on a quarterly basis on Data.gov. OMB provides oversight through its PortfolioStat process, monthly FDCCI Task Force meetings, continuous budget development and execution discussions, and if necessary, other avenues.

IMPROVING THE IT DASHBOARD—TIMELINESS

Question. The IT Dashboard has been an important tool for improving transparency and accountability in Federal IT spending. However, GAO has made several recommendations to OMB for improving the IT Dashboard which have not yet been implemented. For example, the public version of the IT Dashboard is not updated during preparation of the President's budget request, which takes roughly 6 months. GAO also noted that the IT Dashboard was not updated for 15 months out of a recent 24-month period. This transparency tool should be kept accurate and up to date.

—Will you make sure that the IT Dashboard is updated throughout the year, including during budget deliberations, as GAO recommends?

Answer. Agencies have the ability to update and view the IT Dashboard on a continuous basis throughout the year. The IT Dashboard is also available for public viewing year round. However, agency data submissions to OMB during the budget-development period include both factual information as well as pre-decisional deliberative materials. It is important that OMB preserve the confidentiality of the deliberations that are at the core of the budget development process, which involves the identification, evaluation, and consideration of budgetary alternatives, as well as sensitive procurement data. The manner in which agencies submit this data makes it difficult, as a practical matter, to separate the factual information from the pre-decisional deliberative materials during this period. Given the existing data model and application design, OMB is currently not in a position to release, for example, CIO ratings and other "regularly-updated portions" during the budget development period without, at the same time, releasing pre-decisional deliberative materials.

IMPROVING THE IT DASHBOARD—ACCURACY

Question. Currently, the Dashboard posts data on whether major IT projects are on schedule and on budget. This information is useful to understanding the status of IT projects, but it does not fully represent the risk of major projects.

—How could OMB improve the IT Dashboard to provide more accurate and meaningful data on the status and risk of failure for major IT projects?

Answer. Agencies are required, at least monthly, to submit cost and schedule data on IT investments to the IT Dashboard. This information is useful to understanding the status of IT projects. Over the last few years, these submissions, along with related calculations, have been updated to provide more transparency. For example, cost and schedule performance was previously tracked via individual milestones within a major investment, which did not have the ability to link related activities together. With the introduction of projects and activities in fiscal year 2013, the IT Dashboard now reports cost and schedule performance at a more granular level, using parent-child activity groupings to reflect the work breakdown structure (WBS) used by agencies to manage the projects within their investments. Further, each year OMB provides feedback to agencies regarding their preliminary IT budget materials along with data quality related feedback. Since 2011, the IT Dashboard has included a data quality report for each investment and OMB reminds and encourages agencies to review this report regularly.

While OMB works with agencies directly to correct and resolve data issues when it finds missing data submissions or erroneous data, it also continuously looks for ways to further improve the data quality. For example, in the fiscal year 2016 capital planning guidance, OMB has initiated a new requirement that agencies identify at least three open risks for all active projects and submit the same to the IT Dashboard along with risk assessment and risk mitigation plan.

Further, risk management is the identification, assessment, and prioritization of risks (followed by coordinated and execution of resources to minimize, monitor, and control the probability and/or impact of these risks or to maximize the realization of opportunities). Merely identifying the investments risks, as OMB has stressed in

PortfolioStats, TechStats and other means, is not a guarantee that the risks won't be realized. Managing risk is a continual, dedicated, iterative process that is never complete.

IT DASHBOARD—MAJOR INVESTMENTS RECLASSIFIED

Question. GAO's testimony notes that major IT investments were removed from the IT Dashboard. The Department of Energy, for example, apparently reclassified several of its supercomputer investments from "information technology" to facilities. A December 2013 GAO report describes such reclassifications as "representing a troubling trend toward decreased transparency and accountability."

—Why were the investments removed from the dashboard?

—What is OMB doing to provide better guidance to agencies for more accurate and consistent reporting?

Answer. Agencies have the responsibility to define the composition of their IT portfolio. As specified in the Clinger Cohen Act, agencies "provide for the selection of information technology investments to be made by the executive agency, the management of such investments, and the evaluation of the results of such investments."

To assist agencies in managing their IT portfolio, OMB provides guidance on information technology definitions. OMB uses the definition of "Information Technology" and "major information system" as defined in 40 U.S.C. 11101 and OMB Circulars A–11 and A–130. While all IT Investments are reported to the Federal IT Dashboard, major information systems have an increased reporting requirement. Each year during the development of the President's budget, OMB and agencies determine which IT systems and investments should be reported as major. Systems and investments that are deemed to no longer meet the definition of a major investment are downgraded to non-major and as such no longer subject to the increased OMB level oversight and reporting. In the example of the U.S. Department of Energy's (DOE) decision to not report supercomputers as a part of their IT Portfolio, OMB responded by explicitly included supercomputing as a policy requirement in the PortfolioStat Integrated Data Collection Common Definitions, which is available to all agencies on max.gov. Please see the policy statement below:

> "This term refers to any equipment or interconnected system or subsystem of equipment that is used in the automatic acquisition, storage, manipulation, management, movement, control, display, switching, interchange, transmission, or reception of data or information by an executive agency. IT is related to the terms capital asset, IT investment, program, project, sub-project, service, and system. It also includes computers, ancillary equipment (including imaging peripherals, input, output, and storage devices necessary for security and surveillance), peripheral equipment designed to be controlled by the central processing unit of a computer, software, firmware and similar procedures, services (including support services), and related resources; but does not include any equipment acquired by a Federal contractor incidental to a Federal contract (40 USC 11101); however OMB policy includes in this supercomputers, software for mission systems, telecommunications, and satellite signal processing."

IT DASHBOARD—MAKING IT A MODEL FOR TRANSPARENCY

Question. The IT Dashboard Web site notes that this tool enables "Federal agencies, industry, the general public and other stakeholders to view details of Federal information technology investments." Yet the IT Dashboard itself is not subject to such transparency.

—How much is spent annually on operation of the dashboard?

—Will you commit to making details of the funding and delivery of the IT Dashboard completely transparent?

Answer. The IT Dashboard is an investment listed on the IT Dashboard, just like any other IT investment. The URL is: https://www.itdashboard.gov/investment?buscid=622. At $450,000, it would not qualify as a "major" investment at most agencies. However, due to its high profile role in transparency, OMB keeps visibility into the performance of this investment at that level. Each year, OMB considers and evaluates whether additional investments to provide more timely information and capabilities to agencies, Congress and the public would yield the proper return on investment. OMB looks forward to working with Congress to understand what capabilities would improve transparency.

INCREMENTAL DEVELOPMENT

Question. GAO and IT project management experts stress the importance of using incremental, modular development strategies when building major IT systems. Delivering small increments over time leads to greater success. Far too often, big complicated procurements lead to a failure that comes after years of cost overruns and delays. Current OMB policy calls for 6 month deliveries.

—What percentage of major Federal IT acquisitions are currently developed incrementally?

—What barriers exist that prevent all IT investments from being immediately restructured to an incremental development model?

—How can OMB further reduce risk of IT project failures by encouraging more incremental and modular procurement strategies?

Answer. As of July 2014, the Governmentwide average planned duration for delivering key IT functionality was 156 days. However, 12 agencies report average planned durations above this average and DOD reports an average of 456 days,[1] demonstrating that OMB and agencies need to continue to address this critical policy area.

To help all agencies meet this goal and move toward iterative IT development, OMB released Contracting Guidance to Support Modular Development in 2012. This guide assists agencies in implementing contracts that support modular development approaches.

To further this work, the Administration also released a Digital Services Playbook (please see response to question #1), which will help agencies deliver effective digital services in a flexible and iterative fashion. One of the "plays" in the playbook is around agile and incremental development. Play #4 states, "[w]e should use an incremental, fast-paced style of software development to reduce the risk of failure by getting working software into users' hands quickly, and by providing frequent opportunities for the delivery team members to adjust requirements and development plans based on watching people use prototypes and real software. A critical capability is being able to automatically test and deploy the service so that new features can be added often and easily put into production. Following agile methodologies is a proven best practice for building digital services, and will increase our ability to build services that effectively meet user needs."

However, there continue to be obstacles impeding agency adoption of proven methodologies, such as agile. These include determining the proper acquisition vehicle to use to perform agile, optimal ways to consider delivery metrics within agile contracting, and how agencies determine success or what a minimal viable product should be. That is why the Administration also released the TechFAR (please see response to question #1), which provides agencies tools and examples of how to use agile development methodologies with the current language of the FAR.

As needed, OMB will continue to work with agencies to develop and promulgate tools and guidance to aid in the use of these commercially-proven best practices.

CIO AUTHORITY OVER IT SPENDING

Question.

—How much of the Administration's total fiscal year 2015 budget request for IT is directly controlled or overseen by the CIO at each agency?

—What is OMB doing to increase CIO authority over IT spending?

—How is OMB working with agencies to ensure that Federal CIOs are truly empowered to drive the types IT efficiencies and savings discussed during this hearing?

Answer. While OMB believes that current statutes provide agency CIOs with the proper authorities to ensure that IT is used as a strategic asset to improve service delivery, it's clear these authorities have not been implemented in a consistent and effective manner across agencies. Direct CIO control over IT budget ranges from less than 1 percent to as high as 97 percent, with an overall average of around 25 percent.

To strengthen CIO authorities, OMB issued memorandum M–11–29, emphasizing the role that CIOs are required to have in the areas of governance, commodity IT, program management and information security. Additionally, OMB has made CIO authorities an integral part of PortfolioStat. As part of PortfolioStat sessions, OMB discusses with agencies their progress implementing CIO authorities. Additionally, OMB has and is committing to continuing a robust dialogue with Congress on whether legislation is required to fully implement CIO Authorities.

[1] Planned duration is taken from the Federal IT Dashboard Activities Data Feed, available to the public.

25 POINT IMPLEMENTATION PLAN TO REFORM FEDERAL INFORMATION TECHNOLOGY MANAGEMENT

Question. In 2010, OMB issued the 25 Point Implementation Plan to Reform Federal Information Technology Management, which detailed action items for OMB and other agencies in order to deliver more value to the American taxpayer. Please provide an update on the current status of 19 action items assigned to OMB, the Federal CIO, and Federal CIO Council.

Answer. The status of each of the 19 action items assigned to OMB, the Federal CIO and the CIO Council are detailed below:

1. Complete detailed implementation plans to consolidate data centers by 2015.

In accordance with the IT Reform Plan, all agencies published their updated Data Center consolidation plans in 2011 and links to the plans were posted on CIO.gov. As part of PortfolioStat in 2013 and outlined in M–13–09 the Federal Data Center Consolidation Initiative (FDCCI) was integrated into PortfolioStat and agencies are no longer required to do separate implementation plans.

As outlined in M–13–09, dated March 27, 2013, to improve the outcomes of PortfolioStat and to advance agency IT portfolio management, OMB consolidated previously collected IT plans, reports and data calls into three primary collection channels:

—*IRM Strategic Plans.* According to Circular A–130, "Information Resources Management (IRM) Strategic Plans should support the agency Strategic Plan required in OMB Circular A–11, and provide a description of how information resources management activities help accomplish agency missions, and ensure that information resource management decisions are integrated with organizational planning, budget, procurement, financial management, human resources management, and program decisions." In addition to requirements established in OMB Circular A–130, IRM Strategic Plans must now be signed by the Agency COO and agencies will be required to address the specific requirements that are defined in Appendix A of this memorandum;

—*Enterprise Roadmap.* In alignment with the IRM Strategic Plan, the Enterprise Roadmap documents an agency's current and future views of its business and technology environment from an architecture perspective. It does so by reflecting the implementation of new or updated business capabilities and enabling technologies that support the agency's strategic goals and initiatives. It also contains a transition plan to show the sequence of actions needed to implement the IRM Strategic plan. Moreover, it focuses on increasing shared approaches to IT service delivery across mission, support, and commodity areas; and

—*Integrated Data Collection (IDC).* OMB has established an Integrated Data Collection channel for agencies to report structured information. Agencies will use this channel to report agency progress in meeting IT strategic goals, objectives and metrics as well as cost savings and avoidances resulting from IT management actions.

The IDC will draw on information previously reported under PortfolioStat, the FDCCI, the Federal Digital Government Strategy, quarterly Federal Information Security Management Act (FISMA) metrics, the Federal IT Dashboard, and selected human resource, financial management, and procurement information requested by OMB.

For additional context, please see response to Question #3.

2. Create a Governmentwide marketplace for data center availability.

The Governmentwide marketplace was established in June 2012, as referenced in the GAO Report from July 2012 on Data Center Consolidation, found at http://gao.gov/assets/600/592696.pdf.

3. Shift to a "Cloud First" policy.

In December 2010, the Administration instituted a "cloud first" policy, which states that if a secure, reliable, and cost effective cloud solution exists, agencies are required to implement that solution. To drive this effort, the Administration published the Federal Cloud Computing Strategy in February 2011. This strategy articulates the benefits, considerations, and trade-offs of cloud computing, provides a decision framework and case examples to support agencies in migrating towards cloud computing, highlights cloud computing implementation resources, and identifies Federal Government activities, roles, and responsibilities for catalyzing cloud adoption.

Under this initiative, cloud computing has now become an accepted and integral part of the Federal IT environment. Agencies no longer question the utility and feasibility of cloud computing; but instead are seeking out opportunities to use cloud

computing to reshape their IT portfolios to drive innovation, maximize return on investment, and improve cybersecurity. To track implementation of the policy, OMB requires agencies to report their cloud computing spending as part of the development of the budget. These figures can be found on the Federal IT Dashboard.

4. Develop a strategy for shared services.

The Administration released the Federal IT Shared Services Strategy on May 2, 2012. It provides organizations in the Executive Branch of the United States Federal Government (Federal Agencies) with policy guidance on the full range and lifecycle of intra- and inter-agency information technology (IT) shared services, which enable mission, administrative, and infrastructure-related IT functions.

5. Design a formal IT program management career path.

OPM and OMB launched the IT Program Manager Career Path in May 2011. This effort included the creation of a new basic title and definition for Information Technology Program Manager under the Technology Management Series, GS–2210 and the release of the IT Program Management Career Path Guide, which provides guidance to Federal agencies on the creation and improvement of the IT Program Management career path at each agency.

6. Require Integrated Program Teams.

Since fiscal year 2013 agencies have been required to provide the names and contact information for Integrated Program Teams members for all major IT investments as part of OMB's annual capital planning guidance Circular A–11 Exhibit 300.

7. Launch a best practices collaboration platform.

In March 2011, the CIO Council developed a Web-based best practices collaboration platform, originally located at cio.gov/bestpractices. Since then, the CIO Council has updated the platform and moved it to MAX.gov, an executive branch collaboration platform. This portal allows program managers to share and aggregate best practices, case studies, lessons learned, and other tools and resources that increase information sharing and enhance collaborative problem-solving and innovation.

8. Launch technology fellows program.

In 2011, OMB and OPM launched the Presidential Management Fellows Technology Fellows Program—a 2-year, rotational, paid fellowship. This fellowship program helped lay the groundwork for the Presidential Innovation Fellows (PIF) program, launched in 2012.

9. Enable IT program manager mobility across Government and industry.

The CIO Council, OMB and OPM launched the pilot IT Program Manager Mobility Program in April 2012 to encourage the movement of program managers across Government and industry. Although six agencies (the Department of the Navy, Department of Defense, Department of Homeland Security, Defense Information Security Agency, General Services Administration and the Department of Veterans Affairs) participated, interagency rotations were never completed. OMB will continue to look for ways to leverage the knowledge and expertise of Federal IT program managers.

10. Design and develop cadre of specialized IT acquisition professionals.

In 2011, the Office of Federal Procurement Policy (OFPP) issued guidance to Chief Acquisition Officers (CAOs), senior procurement executives (SPEs) and Chief Information Officers (CIOs) that provides guidance on designing and developing specialized IT acquisition cadres and developing IT best acquisition practices. The guidance describes how agencies can design and organize a cadre of contracting professionals, Program Managers (PMs), and Contracting Officer's Representatives (CORs) to ensure these functions work closely throughout the process to achieve program goals and strengthen the skills and capabilities of this specialized acquisition cadre to improve outcomes.

11. Identify IT acquisition best practices and adopt Governmentwide.

This requirement was accommodated under the memo, Guidance for Specialized Information Technology Acquisition Cadres, detailed above.

12. Issue contracting guidance and templates to support modular development.

On June 14, 2012, OMB issued Contracting Guidance to Support Modular Development to assist agencies in implementing modular development approaches.

13. Reduce barriers to entry for small innovative technology companies.

Under the Presidential Innovation Fellows program, the Small Business Administration (SBA) launched RFP–EZ as a pilot program on December 28, 2012. RFP–EZ is a Web-based application that is comprised of five different systems, all meant to make it easier for small businesses to sell their services to Government buyers, and enables agencies' contracting officers to quickly source low-cost, high-impact information technology solutions

14. Work with Congress to create IT budget models that align with modular development.

OMB Guidance on Exhibits 53 and 300 Information Technology and E-Government require that projects for major Government IT investments should aim to deliver functionality within 6 months. In addition, the guidance requires agencies to indicate whether the completion of an activity provides a key deliverable or usable functionality and OMB asks agencies to report on whether modular development principles are applied in their acquisition planning. Efforts under this area have been subsumed by larger efforts underway to strengthen CIO authorities through proposed legislation, for example, the Federal Information Technology Acquisition Reform Act (FITARA) and the Federal Information Technology (FITSATA). OMB will continue working through its Information Technology Oversight & Reform appropriation to further examine how budgeting models could be updated, given the fluidity of technological change.

15. Develop supporting materials and guidance for flexible IT budget models.

On June 9, 2012, the CIO Council Best Practices Committee developed Summary Report on IT Budget and Funding Flexibilities. This report is available to agency CIOs across the Federal Government through the CIOC knowledge portal on Max.gov. Additional guidance on flexible budging has been incorporated into yearly budget guidance (see Fiscal Year 2013 Guidance on Exhibit 300—Planning, Budgeting, Acquisition, and Management of Information Technology Capital Assets pages 8 and 18, Fiscal Year 2014 Guidance on Exhibit 53 and 300—Information Technology and E-Government pages 28, 38, and 41 and Fiscal Year 2015 Guidance on Exhibit 53 and 300—Information Technology and E-Government pages 27, 39 and 42).

16. Work with Congress to scale flexible IT budget models more broadly.

To shift agencies toward IT budget models that align with modular development, OMB has integrated modular development in Guidance on Exhibits 53 and 300 Information Technology and E-Government. This includes requiring targets for projects to aim to deliver functionality within 6 months, having acquisition planning with modular development principles, and having innovative investments consistent with policy initiatives such as modular development. For example, the President's fiscal year 2014 budget requested that a new IT Modernization account be created at the Department of Labor to drive improved IT efficiency and effectiveness. This was subsequently enacted by Congress. .

17. Work with Congress to consolidate Commodity IT spending under Agency CIO.

OMB M–11–29, Chief Information Officer Authorities clarified the primary responsibilities and authorities of Agency CIOs across several key areas, including Commodity IT. The memo states that, "Agency CIOs must focus on eliminating duplication and rationalize their agency's IT investments . . . the CIO shall pool their agency's purchasing power across their organization to drive down costs and improve service for commodity IT." OMB has held numerous discussions with Members of Congress on implementing M–11–29 and how those authorities should be codified in statute. Larger efforts to strengthen CIO authorities have been subsumed under several proposed bills, for example, The Federal Information Technology Acquisition Reform Act (FITARA) and the Federal Information Technology Savings, Accountability, and Transparency Act (FITSATA).

18. Reform and strengthen Investment Review Boards.

OMB has worked to reform and strengthen Investment Review Boards by revamping IT budget submissions and assisting agencies in standing up the TechStat model at the Department level.

Beginning with fiscal year 2013 budget submissions OMB developed a new framework for reporting IT investments. This new framework and guidance was designed to increase the relevance of IT investment data, better align budget with management processes, improve data accuracy, and reduce the reporting burden on agencies by establishing a separate Exhibit 300B (see Guidance on Exhibit 300—Planning, Budgeting, Acquisition, and Management of Information Technology Capital Assets).

To assist agencies with oversight, OMB developed the TechStat Toolkit. The Toolkit provides a comprehensive guide for agencies to quickly implement TechStat, from templates for briefing staff and executives on the TechStat model to templates for documenting a detailed action plan for correcting problems. To date, thousands of agency employees have been trained through this toolkit on how to plan, structure and conduct TechStat sessions.

19. Redefine role of Agency CIOs and Federal CIO Council.

While current statutes provide Agency CIOs with the proper authorities to ensure that IT is used as a strategic asset to improve service delivery, these authorities have not been implemented in a consistent and effective manner across agencies. To address this, OMB issued memorandum M–11–29 emphasizing the role that CIOs are required to have governance, commodity IT, program management and information security. Additionally, OMB has made CIO Authorities an integral part of PortfolioStat. As part of PortfolioStat sessions, OMB discusses with agencies progress implementing CIO authorities.

In addition, M–11–29 required Agency CIOs to play a cross-agency portfolio management role through the Federal CIO Council. The CIO Council is the body for CIOs from across the Government to come together to share best practices and recommend changes to existing, or put forward idea for, new policy. Larger efforts are underway within Congress to strengthen CIO authorities and create more flexible funding models under FITARA and FITSATA.

PORTFOLIOSTAT AND COST ESTIMATES FOR MAJOR IT INVESTMENTS

Question. In OMB's PortfolioStat discussions with CIOs, how does OMB verify estimates for savings? What data on costs or source of cost estimates do you use to assess the validity of a budget request for a major program? Is there a formal or independent cost analysis, such as the Defense Department uses?

Answer. Savings reported during the PortfolioStat process are submitted by agencies to OMB's Integrated Data Collection (IDC) with a description of the activity that led to the savings, the amount saved, and the fiscal year associated with the saving. OMB then performs a qualitative review of the data submitted by agencies. During this process, OMB may follow up with agencies to request additional information regarding savings descriptions. The descriptions are then included in the Information Technology Oversight and Reform (ITOR) Quarterly Report to Congress. The report undergoes a multi-step review process where agency officials must confirm the accuracy of the data reported to OMB and Congress.

Furthermore, to validate costs regarding major programs, OMB may request and review a number of documents before approving such requests. For example, OMB may request to review an agency's formal business case for an investment, to include the project plan, program management plan, program performance metrics, and/or analysis of alternatives, to name a few. Additionally, OMB uses the annual budget process to assess the quality and performance of major programs each year.

OMB TECH FAR GUIDE

Question. Mr. VanRoekel, your testimony describes OMB's "Tech FAR" guide to highlight often underutilized ways that agencies can solicit IT tools and services.

—How will this new approach alter the acquisition process for IT projects?

—What metrics, such as quicker competitions of faster delivery times, could help evaluate if Tech FAR is working?

—Why is a separate FAR needed for IT projects? Should the FAR be updated and streamlined for all Federal acquisitions to avoid a proliferation of FAR guides for each type of acquisition?

Answer. To ensure Government has the right tech tools to do its job, and can be more agile and flexible to meet rapidly changing needs, the Administration launched the TechFAR Handbook, a guide that explains how agencies can execute key plays in the Playbook in ways consistent with the Federal Acquisition Regulation (FAR). This document will help agencies take advantage of existing authorities to procure development services in new ways that more closely match the modern software development techniques used in the private sector.

It is important to note that the TechFAR is not a separate FAR, but rather a guide that highlights the flexibilities in the FAR that can help agencies implement the best practices included in the Digital Services Playbook that would be accomplished with acquisition support. The TechFAR handbook is also not intended to usurp existing laws, regulations, or Agency policy.

The TechFAR Handbook states that it is "aligned with the Digital Services Playbook's guidance to use contractors to support an iterative development process fo-

cuses on how to use contractors to support an iterative, customer-driven software development process." In addition, the TechFAR "is not designed to be used for commodity IT purchases, especially where commercially available off-the-shelf items can be used as-is at a lower cost and lower risk to the Government."

CLOUD COMPUTING AND UTILITY-BASED PURCHASING OF IT SERVICES

Question. The President's budget notes that it includes investments to transform the Government IT portfolio through cloud computing, giving agencies the ability to purchase IT services in a utility-based model, paying for only the services consumed.

—How are Federal agencies using this utility-based model to both save costs and also provide more agility for Federal agencies?

—How is OMB coordinating this transition to cloud computing across the Federal Government?

Answer. Since OMB released its "Cloud First" policy in 2010, Federal agencies have shown progress in their movement to cloud platforms and in taking advantage of the cost savings, innovation, scalability and agility that cloud computing offers. Total cloud spending is projected to increase by 10 percent from fiscal year 2013 to the fiscal year 2015 budget, to nearly $3 billion, with more cloud expected in the years to come as the cloud industry matures.

OMB has coordinated the migration to cloud solutions by encompassing an all of Government approach. In connection with our Federal Cloud Computing Strategy, the Administration launched FedRAMP—a Governmentwide program that provides a standardized approach to security assessment, authorization, and continuous monitoring for cloud products and services. Our FedRAMP program now has 18 CSP (cloud service providers) systems that have received FedRAMP Provisional ATO (authorization to operate), providing agencies a valuable tool to get them to the cloud quicker. OMB also works with NIST to continuously develop cloud security, interoperability and portability standards, the Department of State to engage international partners on cloud lessons learned, and GSA to stand up cloud computing acquisition vehicles. In addition, OMB's ongoing PortfolioStat efforts with agencies continue to look for opportunities to shift to the cloud, utilize FedRAMP and take advantage of cloud computing to drive data center optimization.

SHARED SERVICES

Question. Shared services among agencies, particularly for "commodity" IT items, can be key to driving efficiencies and savings in IT. Shared Services is included in the President's second term management agenda and is now a Cross-Agency Priority Goal.

—What are the barriers to providing such shared services in the Federal Government and what steps can OMB take to increase their use, especially for IT services?

Answer. Examples of barriers are (1) changing the culture in most agencies from program-silo'ed services to cross-cutting services within the entire agency and with other agencies; (2) agency-only funding models which hamper and handcuff agency flexibility to transfer money to another agency; and (3) procurement strategies that do not allow for other programs/bureaus/agencies to buy services off contracts negotiated by other agencies. The latter would enable the Government to leverage its buying power to negotiate lower costs as the number of agency adopters increases. Other barriers include technical challenges in scaling and/or integrating systems and applications, having authoritative architectures that provide process and technology standards, as well as cybersecurity and data privacy considerations as shared service delivery models are implemented.

Additionally, as part of the Smarter IT Delivery Initiative, OMB is reshaping the delivery of information technology already underway, as well as introducing new approaches and tools to transform the Government IT landscape. For details on work underway as part of this initiative, see answer to Question #1.

PORTFOLIOSTAT AND SOFTWARE LICENSES

Question. The PortfolioStat initiative includes efforts to consolidate so-called "commodity" IT or more basic, commercially available software, hardware, and cloud services.

—What savings have Federal agencies realized to date through consolidating software licenses?

—How many Federal agencies have a current inventory of their software licenses?

—How many Federal agencies do not have a current inventory of their software licenses?

—What should be the target number of Federal agencies that should have a current inventory of their software licenses?

Answer. To date, a little over $500 million of reported PortfolioStat savings have been tied to enterprise software license consolidation efforts. For example, the Department of the Interior has saved $5.8 million through their Enterprise eArchive System (EES), part of their eERDMS system. However, in discussions with agencies, they have indicated that software management savings are also captured in broader savings and consolidation efforts reported by agencies through PortfolioStat, hence the actual figure is higher, although the exact amount is unknown.

A recent GAO report, Federal Software Licenses: Better Management Needed to Achieve Significant Savings Government-Wide reviewed all 24 Chief Financial Officers Act agencies and analyzed their policies for managing software licenses as well as their software inventories. The report found that 20 of the major Federal agencies have developed policies for managing software licenses and have partially implemented inventories. Those policies will include, but certainly not be limited to, modes and mechanisms to ascertain the proper amount of licenses for any given agency.

DATA ACT AND IMPROVING COST ESTIMATES FOR IT INVESTMENTS

Question. How will OMB use data on actual expenditures for like systems collected under the DATA Act to improve cost estimates and assess budget requests on IT programs?

Answer. The DATA Act does not focus on tracking actual expenditures in IT system-by-system. Nor does the DATA Act change the processes by which agencies produce cost estimates and OMB reviews business cases for IT investments. Implementation of the DATA legislation will contribute to improved availability and quality of Federal spending information and increased transparency for IT and other spending.

RISK ASSESSMENTS OF IT INVESTMENTS

Question. What risk assessment criteria are agencies using to evaluate the risk associated with procurements of IT products and services? Do Federal agencies then communicate the assessment criteria or findings to the private companies impacted?

Answer. Risk assessments should include risk information from all stakeholders and should be performed at the initial concept stage and then monitored and controlled throughout the life cycle of the investment. OMB Guidance on Exhibits 53 and 300 Information Technology and E-Government, which is updated annually, for major investments requires agencies to list all significant project-related risks and operational-related risks that are currently open and provide risk assessment information.

For all active projects and components of IT investments that are in Operations a minimum of three open risks must be identified. When reporting these risks, agencies are required to describe the risk, the cause for the risk, identify a mitigation plan for the risk, list the impact (high, medium, low) and provide a mitigation plan.

In addition, agencies must categorize the risk in one of the following categories: (1) Schedule, (2) Initial costs, (3) Life cycle costs, (4) Technical obsolescence, (5) Feasibility, (6) Reliability of systems, (7) Dependencies and interoperability between this investment and others, (8) Surety (asset protection) considerations, (9) Risk of creating a monopoly for future procurements, (10) Capability of agency to manage the investment, (11) Overall risk of investment failure, (12) Organizational and change management, (13) Business (14) Data/info, (15) Technology, (16) Strategic, (17) Security, (18) Privacy, and (19) Project resources.

It is typical that agencies work internally with Federal staff or with contract resources supporting an investment to ensure there is a comprehensive understanding of all risks and the proper actions to remediate, mitigate, and manage that risk in a proactive manner.

PROCUREMENT ISSUES IN IT

Question. This committee heard testimony that agile, more incremental procurement strategies are especially appropriate for IT investments given the pace of technological change and innovation.

—What steps can OMB take, besides issuing the Tech FAR and "myth buster" guides, to help address complaints that IT procurement takes too long? How can Congress help?

Answer. This past spring, the Federal Chief Acquisition Officers Council and the CIO Council sponsored an open online dialogue to solicit input on how to reduce

burdens and improve the efficiency and effectiveness of the Federal procurement process. A number of themes emerged, such as simplifying procedures for the acquisition of commercial items and taking better advantage of technologies to make it easier for small and innovative businesses and buying agencies to find one another, as we are doing with "FBOpen." OMB is carefully reviewing the recommendations made in the dialogue, both for actions that can be taken administratively as well as areas where legislative support may be beneficial.

OMB'S "MYTH BUSTING" MEMO

Question. OMB issued a "myth busting" memo to help improve communication between industry partners and Federal agencies in the acquisition process. Yet my understanding is that Federal agencies are hesitant to talk to contractors.

—How can OMB reinforce the "myth busting" memo to improve appropriate engagement between contractors and Federal agencies?

Answer. The TechFAR encourages vendor engagement early on in the process and urges agencies to utilize tools such as industry days, Requests for Information (RFI), and draft Requests for Proposals (RFPs) or draft Requests for Quotation (RFQ). This type of engagement helps provide an avenue for the vendors to ask questions to ensure that they understand the process and what the Government is trying to procure. Releasing the TechFAR should help agencies move toward more vendor engagement, but we realize continual work is needed to combat cultural reluctance to engage with contractors. As a result, OMB will explore additional ways to improve communication between industry and Federal agencies such as releasing additional guidance and training opportunities.

IT SCHEDULE 70

Question. GSA's IT Schedule 70 is the largest, most widely used acquisition vehicle in the Federal Government.

—How is the IT Schedule 70 helping or hindering the Government's ability to acquire innovative technologies and IT services?

The General Services Administration is best equipped to answer this question.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

ACCURACY OF IT DASHBOARD

Question. One of the important oversight tools to monitor how the Government buys, builds, and manages its major IT projects is the IT Dashboard. Unfortunately, I this tool is not updated accurately and on an ongoing basis. GAO reported that, as of December 2013, the public version of the Dashboard was not updated for 15 of the previous 24 months.

—Will OMB make the Dashboard publicly available year round, even during budget deliberations, as GAO has recommended?

—What is OMB doing to make sure that all major investments, like DOE's supercomputers, are listed as major investments on the Dashboard?

Answer. Agencies have the ability to update and view the IT Dashboard on a continuous basis throughout the year. The IT Dashboard is also available for public viewing year round. However, agency data submissions to OMB during the budget-development period include both factual information as well as pre-decisional deliberative materials, much of which is at the core of the budget development process. This can include the identification, evaluation, and consideration of budgetary alternatives, as well as sensitive procurement data. The manner in which agencies submit this data makes it difficult, as a practical matter, to separate the factual information from the pre-decisional deliberative materials during this period. Given the existing data model and application design, OMB is currently not in a position to release, for example, CIO ratings and other "regularly-updated portions" during the budget development period without, at the same time, releasing pre-decisional deliberative materials.

In the OMB fiscal year 2016 Guidance on Exhibits 53 and 300, OMB also revised the definition of Information Technology to ensure that things like supercomputers were included. This definition is available to all agencies through max.gov and reads as follows:

> "This term refers to any equipment or interconnected system or subsystem of equipment that is used in the automatic acquisition, storage, manipulation, management, movement, control, display, switching, interchange, transmission, or reception of data or information by an executive agency. IT is related to the terms capital asset, IT investment, program, project, sub-project, service, and

system. It also includes computers, ancillary equipment (including imaging peripherals, input, output, and storage devices necessary for security and surveillance), peripheral equipment designed to be controlled by the central processing unit of a computer, software, firmware and similar procedures, services (including support services), and related resources; but does not include any equipment acquired by a Federal contractor incidental to a Federal contract (40 U.S.C. 11101); however OMB policy includes in this 'supercomputers, software for mission systems, telecommunications, and satellite signal processing.'"

EXPLORING EMERGING CONTRACTING MODELS

Question. As this committee seeks to identify ways to decrease agencies' reliance on appropriated funds for IT acquisitions, I am interested to learn about emerging, non-traditional contracting models, such as no-cost models, that agencies should be considering as one way to increase efficiencies and reduce costs. This committee's fiscal year 2014 appropriations explanatory report directed OMB to produce a report on the use of alternative contracting models, including quantifying costs savings achieved through their use.

—Please provide an update on the status of this report.

—Can you offer examples of emerging models that could help?

Answer. OMB is working with agencies to gather information about their consideration of and experience with "no-cost" contracting for IT related-requirements, such as where an agency developing a public database authorizes the contractor to charge user fees to cover the cost and maintenance of the system, and expect to complete our initial analysis shortly. In addition, we are looking at how to promote greater use of performance-based contracting practices where agency solicitations focus on outcomes, rather than "how to" prescriptions, that in turn allow contractors to provide simpler, less costly proposals and more innovative solutions.

We are also encouraged by the Committee's recent support for an "innovation set-aside" pilot that would allow agencies to conduct competitions or make directed awards, where appropriate, to new entrants. Such an authority could make it easier for agencies to reach high-tech companies that may not be expert in the rules for selling to the Government, but can provide cutting-edge lower cost solutions to meet the needs of the taxpayer. We look forward to working with this Committee and other Members of Congress as we consider new and better ways to provide best value to the taxpayer.

TECHSTAT REVIEWS

Question. TechStat Reviews were initiated by OMB to enable the Federal Government to either turnaround or terminate IT projects that are failing or are not producing intended results. According to GAO, 70 percent of OMB-led and 76 percent of agency-led TechStat reviews on major investments were considered medium to high risk at the time of the TechStat. OMB reported in 2011 that Federal agencies achieved almost $4 billion in life-cycle cost savings as a result of TechStat sessions, although GAO has noted they were unable to validate OMB's reported results.

—GAO has indicated OMB held only two TechStat sessions in 2013. Why weren't more held?

—With 42 moderately high or high risk projects, what is the plan moving forward with OMB-led TechStat sessions, which have proven effective?

—What types of resources and personnel are necessary to conduct a TechStat review on high risk projects?

Answer. OMB works on a continual basis with agencies to conduct TechStats, be they led by the agency or by OMB itself. As part of the 25 Point Plan to Reform Federal IT Management, OMB worked with agencies to develop a TechStat toolkit, which was based on the rigorous processes OMB used to develop the TechStat model. The Toolkit provides templates, guides and other tools for an agency to successfully execute a TechStat. OMB believes that TechStats can be more effective as a tool, when managed and applied by agencies. This is because agencies are closer to the programs and are able to recognize the triggers and risk factors that an investment may be heading off course more quickly than OMB can. As a result, the agency can assemble a multidisciplinary team to review the investment and implement corrections.

Agencies have broad latitude to cancel failing investments. In fact, in many instances they are able to marshal administrative remedies faster than OMB. Agencies can terminate contracts and assign personnel to meet revised agency priorities. These types of changes are implemented very quickly. In addition, on at least an annual basis agencies convene investment review boards (IRBs) to review the IT in-

vestments of their respective institutions to ensure that they are delivering on the vision and consistent with the agreed upon strategy.

To conduct a TechStat, agencies and OMB need to dedicate time and resources across every discipline involved, including the program/mission offices, IT, acquisition, general counsel, human capital, performance, risk, and financial management. These can vary depending on the size of the investment, the maturity of the program and the problem(s) which needs to be addressed.

Additionally, as part of the Smarter IT Delivery Initiative, OMB is reshaping the delivery of information technology already underway and introducing new approaches/tools to transform the Government IT landscape. To do this, OMB is focused on a three-part agenda that will provide the Federal Government with: (1) the best talent (2) the best companies; and, (3) the best processes to drive outcomes and accountability.

As part of this effort, in August 2014, the Administration began piloting the U.S. Digital Service. This small team of America's best digital experts will work in collaboration with other Government agencies to identify and fix problems, to help upgrade the Government's technology infrastructure, and to make Web sites more consumer friendly. The team has one core mission: to improve and simplify the digital experience that people and businesses have with the U.S. Government by:

—Establishing standards to bring the Government's digital services in line with the best private sector services;
—Identifying common technology patterns that will help us scale services effectively;
—Collaborating with agencies to identify and address gaps in their capacity to design, develop, deploy and operate excellent citizen-facing services; and
—Providing accountability to ensure agencies see results.

The Administration also released for public comment two crucial components in its growing IT toolkit that will enable agencies to do their best work—the Digital Services Playbook and the TechFAR Handbook.

The Digital Services Playbook lays out best practices for effective digital service delivery and will serve as a guide for agencies across Government. To increase the success of Government digital service projects, this playbook outlines 13 key "plays" drawn from private and public-sector best practices that, if followed together, will help Federal agencies deliver services that work well for users and require less time and money to develop and operate.

To ensure Government has the right tech tools to do its job, and can be more agile and flexible to meet rapidly changing needs, the Administration also launched the TechFAR Handbook. The TechFAR Handbook is a guide that explains how agencies can execute key plays in the Playbook in ways consistent with the Federal Acquisition Regulation (FAR). This document will help agencies take advantage of existing authorities to procure development services in new ways that more closely match the modern software development techniques used in the private sector.

FEDRAMP

Question. On December 8, 2011, the Office of Management and Budget (OMB) issued a memorandum establishing the requirements for executive agencies to implement and use a standardized test and evaluation process to qualify cloud service providers for participation in the $80 billion a year Federal IT marketplace called the Federal Risk and Authorization Management Program or FedRAMP. Industry estimates demonstrate that FedRAMP has saved the Government $52.5 million since the program began operating in 2012. Considering that the Federal Government spent more than $450 million on security authorizations and incurs annual costs in excess of $9 billion to support more than 60,000 full-time employees to handle related security operations, full implementation of FedRAMP could potentially save both the Government and the industry significant dollars and time. The OMB memorandum requires that all Cloud Service Providers must be FedRAMP certified by June 4, 2014 in order to be eligible to partake in future Federal cloud service procurement opportunities or continue providing services in cases of existing providers. However, as the deadline quickly approaches, many have expressed concerns that OMB and GSA may not be prepared to effectively enforce the June 4, 2014 FedRAMP deadline. Failure to implement measures to ensure Federal agencies comply with this deadline would result in the continued acquisition of non-FedRAMP-certified cloud service offerings, which would not only elevate the security risk to Federal IT systems, but also jeopardize the future of the FedRAMP program.

—What measures will be taken to ensure that agencies enforce the FedRAMP deadline on CSPs seeking Government acquisition opportunities after June 4, 2014?

—How will OMB and GSA support the FedRAMP program going forward to ensure this promising cybersecurity initiative is effectively implemented and the broader goals of the President's International Strategy for Cyberspace and Cloud First policy are ultimately achieved?

Answer. To clarify, the June 2014 deadline referenced in the question was not for cloud service providers, but rather for Federal agencies to update, evolve and refine their cloud authorizations, completed on a continuous basis as they implement and comply with the Federal Information Security Management Act (FISMA). To accomplish this goal, agencies would need to work CSPs, but the deadline was specific to Federal agencies, not industry. Moreover, the value proposition behind FedRAMP is the standardization of the assessing and authorizing cloud solutions, saving both the Government and industry time and resources.

OMB continues to work with the FedRAMP Project Management Office at GSA, the FedRAMP Joint Authorization Board (JAB), CSPs, and agencies on improvements that can be made to the FedRAMP process. For example, OMB is working with this community to improve inter and intra-agency trust of FedRAMP authorizations so that agencies do not unnecessarily duplicate the security authorization process. Additionally, OMB is working with this community to determine if there are ways to accelerate the approval process while still meeting the same quality standards that exist today. As further improvements are made to this program, OMB will brief the relevant committees on this progress.

OMB conducts oversight through normal channels, which include PortfolioStat and processes to support the annual FISMA Report, to gauge agency efforts to meet the June 2014 deadline. As necessary, OMB will work with agencies on corrective actions, for example, if the deadline isn't met. FedRAMP itself is one part of a comprehensive approach to accelerate the adoption of cloud computing across the Government to drive innovation, increase collaboration, and create service efficiencies.

FEDERAL DATA CENTER CONSOLIDATION

Question. In 2010, the Federal CIO established the Federal Data Center Consolidation Initiative to achieve a number of goals including reducing energy consumption; shrink the real estate footprint of Government data centers; reduce the cost of data center hardware, software, and operations; and increase IT security. OMB believes this effort will provide about $3 billion in savings by the end of 2015.

—Please provide a status update of this effort.

—How many data centers have been closed to date and how much savings have there been?

—Which agencies are doing a good job with data center consolidation? Which agencies are not?

—What is OMB doing to make data center cost savings more transparent, as GAO has recommended?

Answer. In October 2010, based on agency submissions after the launch of the Federal Data Center Consolidation Initiative (FDCCI), OMB reported 2,094 data centers. As of July 2014, agencies have identified 9,540 data centers, of all types and sizes. This increase, explained in further detail below, is a result of a change in definition of a data center, and is not a result of construction of new data centers. The 9,540 is categorized into two populations, core (275 data centers) and non-core (9,265), further defined below.

It is important to note that since the FDCCI was launched there have been several important policy shifts within the data center space which provide some context for the increased 9,540 figure. First, in March 2012, based on a recommendation from the FDCCI Task Force (a CIO Council body,) OMB changed the definition of a data center and removed all square footage and tiering requirements (the original definition required 500 square feet and meeting strict criteria from the Uptime Institute). Subsequently, this caused a dramatic increase in the number of data centers that agencies reported. As mentioned above, the jump was not due to construction of new data centers, as the Government maintains a net zero growth policy dating back to the summer of 2010. Further, the definitional change has provided additional transparency and insight into the Federal Government's actual data center footprint. The majority of the Government's data centers are smaller rooms and closets (less than 1,000 square feet), rather than large, stand-alone facilities, that one envisions when he/she considers what a Google, Facebook or Microsoft may employ.

Second, in March 2013, the FDCCI was integrated into PortfolioStat, the Government's IT portfolio management initiative. As these efforts converged, OMB instructed agencies to focus on optimizing those data centers that are pivotal to delivering taxpayer services, while closing duplicative and inefficient data centers. As a result, agency progress under the FDCCI is no longer solely measured by closures.

Instead the FDDCI Task Force categorized agency data center populations into two categories: core and non-core. While the Government will continue to target the initial goal of closing 40 percent of agency-identified, non-core data centers, agencies will also be measured by the extent to which their core data centers are optimized for total cost of ownership. To enable this, the Task Force developed energy, facility, labor, storage, virtualization and cost per operating system metrics.

Instead of focusing on one metric, for example, server utilization, OMB worked with the FDCCI Task Force to develop total cost of ownership metrics, which measure performance against all the cost areas of data centers, rather than just one dimension (utilization) of one piece of data center equipment (servers). These metrics, which were published as part of the fiscal year 2014 PortfolioStat guidance, cover hardware, software, energy, human capital and facilities density. OMB and the 24 participating Federal agencies believe that working to meet the targets for these metrics puts the Government in a better position to address emerging taxpayer needs than just focusing on server utilization.

To date, agencies have closed 976 data centers with 3,665 planned for closure by the end of fiscal year 2015. This information is updated on a quarterly basis on Data.gov. OMB provides oversight through its PortfolioStat process, monthly FDCCI Task Force meetings, continuous budget development and execution discussions, and if necessary, other avenues.

With regards to agency efforts and transparency, OMB is currently working with agencies through the Federal CIO Council on publicly releasing the FDCCI core data center optimization metrics and PortfolioStat cost savings (currently reported through the Information Technology Oversight and Reform Quarterly Report to the House and Senate Committees on Appropriations).[2]

When you examine how agencies are doing with the FDCCI, you see examples of successes and failures across the Government. For example, the Census Bureau saved $18 million from fiscal years 2011–2013 by utilizing cloud computing as a means to do data center optimization, DHS saved $136 million in fiscal years 2012–2013 by decommissioning DHS component serves and migrating these services to DHS enterprise data centers, and EPA saved $10 million in fiscal year 2012 by making better use of shared services through infrastructure optimization and consolidation. At the same time, more work remains to be done, including accurately calculating savings from where the costs of operating the facility are owned by multiple entities, and determining the true impact of energy efficiency efforts when there is a lack of metering. OMB will continue to work across the Government, the FDCCI Task Force and external bodies, including advocacy and industry groups to mitigate these challenges as the FDCCI continues.

FEDERAL CIO AUTHORITY

Question. How much of the total fiscal year 2015 budget request for IT is directly controlled or overseen by the Federal CIO at each agency?

Answer. While OMB believes that current statutes provide agency CIOs with the proper authorities to ensure that IT is used as a strategic asset to improve service delivery, it's clear these authorities have not been implemented in a consistent and effective manner across agencies. Direct CIO control over IT budget ranges from less than 1 percent to as high as 97 percent, with an overall average of around 25 percent.

To strengthen CIO authorities, OMB issued memorandum M–11–29, emphasizing the role that CIOs are required to have in the areas of governance, commodity IT, program management and information security. Additionally, OMB has made CIO authorities an integral part of PortfolioStat. As part of PortfolioStat sessions, OMB discusses with agencies their progress implementing CIO authorities. Additionally, OMB has and is committing to continuing a robust dialogue with Congress on whether legislation is required to fully implement CIO Authorities.

HHS CIO CONTROL OF HEALTHCARE.GOV

Question. How much influence did the HHS CIO, Frank Baitman, have over the Healthcare.gov project?

Answer. The Department of Health and Human Services would be best equipped to answer this question.

[2] Information Technology Oversight and Reform (ITOR) Quarterly Report to Congress, previously known as the IEEUIT Report.

QUESTIONS SUBMITTED TO HON. DAN TANGHERLINI

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

18F

Question. How will you ensure that agencies will not be reluctant to request help from the General Services Administration's (GSA's) 18F team?

Answer. The 18F team will create demand through the delivery of successful outcomes. Agencies have a need for this type of work and if the 18F team is successful, it will be seen as an obvious place to go to partner with a talented team using methods that drive down costs and successfully deliver products and services on time.

GSA is actively promoting the work 18F is undertaking to build awareness and interest. The team is discussing its approach and potential projects with any agency or Federal entity that is interested, and is eager to address any questions. Ultimately, it is up to agency and program leadership to make the decision whether to use any service, product, or tool to better manage and build technology solutions.

SPECIAL HIRE AND PAY AUTHORITIES

Question. I am aware that 18F and the Digital Service are using schedule A hiring authority and that direct hire authority is available for Information Technology (IT) Management (Information Security) (GSA–2210, GS–9 and above, Government-wide and nationwide), but not all IT positions.

Given the high demand and competition for IT-related positions, and because the private sector can often pay higher salaries for such positions, do you believe that increased hire and pay authorities should be considered for IT positions that don't currently have any and if so, what types of positions would these be?

Answer. To date, the 18F program has used standard pay schedules and existing hiring authorities to build the team. GSA feels that an attractive mission and work that is highly valued across the organization can be an excellent recruiting tool for talent.

GSA has worked to improve the time to hire for the 18F organization as long hiring times dissuade many highly qualified candidates from taking positions in both the private and public sector. Technical talent does not stay on the market long.

Question. What other types of hiring and pay incentives beyond those now available to Government employees and agencies do you believe should be contemplated for recruitment and retention of IT specialists?

Answer. When hiring in a competitive area, like technology development, different tools may be needed to help hire and retain the most qualified and talented workforce possible. Working with the Office of Personnel Management, Federal agencies can better understand the authorities currently available to them for hiring and pay.

FIXING SAM.GOV WEB SITE FOR FEDERAL PROCUREMENT OPPORTUNITIES

Question. My office frequently receives requests from small New Mexico companies seeking to find and compete for Federal procurement opportunities. I like to point them to online tools such as GSA's System for Award Management or SAM Web site. But I have heard numerous complaints from small business owners about how complicated the SAM registration process is. And worse, one has to register before one can browse what Federal opportunities are even available. One former Presidential Innovation Fellow documented his frustrations with this by showing each step he encountered when trying to register on SAM. He has 77 slides showing the various steps and complications he faced. At one point near the end, his online application was blocked since he did not have a fax number.

I would like to ask three questions I hope you will answer "yes" to. Will you commit to fixing some of the problems with SAM by:

—Simplifying the SAM registration process?

—Allowing anyone to view and bid on Federal opportunities through SAM?

—Requiring companies to register fully once they are closer in the process to receiving a final award rather than at the start?

Answer. Yes, the GSA Integrated Award Environment (IAE) is committed to greater ease of use and has plans for a user-centric design to further modernize the System for Awards Management (SAM) and other IAE systems. It currently takes an average of 3 calendar days to complete registration in SAM, including external Internal Revenue Service and Department of Defense validations. Some companies that experience problems with these tax and Commercial and Government Entity (CAGE) code validations take longer to register.

Currently, everyone already has the ability to view Federal opportunities without registering in SAM. Federal opportunities are posted at www.fbo.gov, and no SAM registration is required to view them. While SAM currently does not show Federal opportunities, GSA plans to incorporate fbo.gov into SAM in future development.

Similarly, it is already the case that companies are not required to register fully in SAM until they are close to award. Under Federal Acquisition Regulation (FAR) 4.1102(a), prospective contractors are only required to be registered in SAM prior to award, but not prior to submitting an offer. If a contractor has not registered in SAM prior to award, FAR 4.1103(a)(1) instructs contracting officers to contact potential awardees and instruct them to register in SAM prior to award.

FEDRAMP

Question. Mr. Tangherlini, can you discuss the current status of the FedRAMP effort and how many cloud service providers have received at least agency-level authority to operate under FedRAMP?

Answer. FedRAMP is fully operational. The status is summarized below.

As of June 9, 2014, 22 cloud services have received FedRAMP authorizations:

—12 companies and 13 cloud services have received Joint Authorization Board (JAB) issued Provisional Authorizations to Operate (P–ATO).

—2 companies and 3 cloud services have received agency issued Authorizations To Operate (A–ATO).

—5 private cloud services have been authorized by the Department of Homeland Security (DHS).

—1 Government agency (U.S. Department of Agriculture) has one cloud service that meets FedRAMP requirements.

—There are 13 Cloud Service Providers (CSPs) with 13 cloud services in-process for Joint Authorization Board authorization.

The authorized cloud services include both large and small businesses, and range across Infrastructure as a Service (IaaS), Platform as a Service (PaaS), and Software as Service (SaaS) offerings. At any given time, there are also upwards of a dozen systems being actively reviewed by the JAB for FedRAMP authorization, and many more in the pipeline. Agencies are also working on their own authorizations with numerous cloud service providers.

EFFECT OF NOT INVESTING IN IT BUDGETS

Question. For the past several years, IT budgets at agencies have been cut. This has affected projects that are designed to save money once implemented.

Can you discuss some of the effects at your agencies of the inability to implement planned projects?

Answer. GSA IT's budget has been decreasing since 2013, and is projected to continue this trend through fiscal year 2016. GSA's agency-wide consolidation of support functions has provided the Chief Information Officer (CIO) with opportunities to streamline the IT environment and reduce duplication, and, as a result, have been able to reduce associated costs. Efficiencies gained from consolidation have enabled the CIO to shift some resources from running legacy applications and infrastructure and invest in efforts to grow and transform GSA's business IT systems. That said, the realities of a constrained budgetary environment mean that the full benefits of initiatives such as cloud storage, virtual desktop integration, and data center consolidation are taking longer to realize.

Full funding of GSA's fiscal year 2015 request will enable us to further develop and operate transformative solutions that will result in long term savings to the agency. A key component in this transformation is the need to divest GSA of costly legacy solutions and environments, through careful and judicious investments in modern technologies, using common tools and platforms to replace duplicative systems, and to continue to invest in collaborative and cloud based technologies to allow GSA's vision of mobility.

Specifically, full funding will allow us to invest in solutions in the following areas:

—Open Data/Open Government initiatives.

—Data analytics platform to support Governmentwide data analytics.

—Ability to transform GSA IT to adopt agile development processes, resulting in more efficient delivery of IT services.

—Increased compliance and adoption of records and electronic document management practices.

—Increase mobility and automation of paper based business processes.

Our experience has shown that investing in such technologies and initiatives can not only greatly reduce overall agency costs, but also improve how GSA delivers on its mission. Our organization will continue to optimize our operations, reduce dupli-

cation of effort and resources, and enable increasingly efficient delivery of IT services.

25 POINT IMPLEMENTATION PLAN TO REFORM FEDERAL INFORMATION TECHNOLOGY MANAGEMENT

Question. In 2010, the Office of Management and Budget (OMB) issued the 25 Point Implementation Plan To Reform Federal Information Technology Management, which detailed action items for GSA and other agencies in order to deliver more value to the American taxpayer. Please provide an update on the current status of those action items assigned to GSA. For those action items not completed, please explain why.

Answer. (1) Stand-up contract vehicles for secure Infrastructure-as-a-Service (IaaS) solutions.

—The GSA Federal Acquisition Service (FAS) has established Blanket Purchase Agreements (BPAs) for Cloud Infrastructure as a Service (IaaS) with 11 industry partners.

—The providers on this Cloud IaaS BPA allow agencies to buy cloud storage, virtual machines, and Web hosting with an Authority to Operate (ATO) at the Federal Information Security Management Act (FISMA) moderate impact level.

—IaaS helps agencies realize cost savings and efficiencies while modernizing and expanding their IT capabilities without spending capital resources on infrastructure. Cloud-based infrastructure is rapidly scalable, secure, and accessible over the Internet—you only pay for what you use.

(2) Stand-up contract vehicles for "commodity" services.

—GSA has established Federal Strategic Sourcing Initiatives, including a Blanket Purchase Agreement for Wireless Service (http://www.gsa.gov/portal/category/100931?utm_source=FAS&utm_medium=print-radio&utm_term=wirelessfssi&utm_campaign=shortcuts).

(3) Reduce barriers to entry for small innovative technology companies.

—GSA established Business Breakthrough, workshops that offered companies up-to-date information on how to successfully navigate Government contracting (http://www.gsa.gov/portal/content/239329?utm_source=OCM&utm_medium=print-radio&utm_term=businessbreakthrough&utm_campaign=shortcuts).

—GSA created FBOpen, which streamlines the process of looking for opportunities with the Federal Government (https://github.com/18F/fbopen).

—GSA established BusinessUSA, a one-stop platform to make it easier for businesses to access services that help them to hire and grow (http://business.usa.gov/).

—GSA created Challenge.gov, allowing agencies to establish technical, scientific, ideation, and creative competitions where the U.S. Government seeks innovative solutions from the public (https://challenge.gov/).

(4) Launch an interactive platform for pre-request for proposal (RFP) agency-industry collaboration—GSA established the Better Buy Projects Pilots Wiki, an online dialogue with the acquisitions community to make Government buying more open and collaborative (http://www.gsa.gov/portal/content/131483).

GSA AND FEDERAL IT PROCUREMENT

Question. What is GSA doing to help Federal agencies procure IT systems and services and how can this be improved?

Answer. FAS' Integrated Technology Service (ITS) is helping Federal agencies procure IT systems and services to meet the Government's missions while saving taxpayer dollars.

In the first 7 months of fiscal year 2014, Federal, State, and local entities spent $13.9 billion through GSA's IT contracts. Documented savings for agencies using certain GSA programs are $607 million between October 2013 and March 2014. We expect by the end of fiscal year 2014, agencies will save a total of $1.3 billion using several of GSA's IT contracts and resources. In addition, agencies using GSA contracts are avoiding the cost, time, and resources spent on setting up redundant contracts throughout Government.

For example, in our Network Services Networx program, ITS helped save Government 30 to 60 percent compared to benchmarked commercial pricing and Government saved, on average, 7.27 percent using GSA's Reverse Auctions, with 87 percent of the awardees being small businesses. In addition, ITS' software acquisition Blanket Purchase Agreements (BPAs)—SmartBUY—saved the Government $776.7 million in fiscal year 2013 by negotiating reductions in software prices.

In addition to providing agencies increased savings, ITS is focused on improved relationships and collaboration with our Government partners, increasing our customer service, and utilizing partnerships with both agencies and industry to find solutions to complex Government problems. For example, ITS has partnered with OMB and other Federal agencies to provide solutions for IT hardware (servers, laptops, desktops), cloud, mobility, and wireless devices. ITS has also been held up as a model of Government partnerships and reduced contract duplication through our partnership with the Defense Information Systems Agency for satellite communication services.

We plan to provide additional capabilities and expert resources to agencies through a shift in our delivery model (aka, category management). Simply, this means a shift from focusing on contracts to helping agencies buy IT better in terms of what they are trying to buy (telecom, outsourcing, cloud, hardware, etc). This strengthened market approach will help us better structure IT acquisitions to match business markets to Government needs, further minimize redundancies in Government purchasing, and reduce total cost of ownership to the Government and taxpayers.

In each of our programs, ITS has strong partnerships with agencies and industry who work with us to develop requirements, identify market offerings, challenges, and best practices that ultimately result in Governmentwide offerings meeting the majority of Government's needs in IT.

IT SCHEDULE 70

Question. GSA's IT Schedule 70 is the largest, most widely used acquisition vehicle in the Federal Government. How is the IT Schedule 70 helping or hindering the Government's ability to acquire innovative technologies and IT services?

Answer. The IT Schedule 70 program continues to help the Government acquire innovative technologies. As a part of the Multiple Award Schedules, Schedule 70 supports agencies acquiring innovative technologies and IT services by providing pre-competed, on-demand contracts with over 4,700 industry partners. The majority of these Schedule 70 partners are small businesses. The pre-competed Schedule 70 contracts help to reduce acquisition times and redundancy in agency acquisitions. These Schedule 70 benefits are available to help Federal, State, and local agencies.

IT Schedule 70 is designed to allow quick, unassisted agency acquisitions of technology. In addition, IT Schedule 70 offers greater flexibility so agencies can tailor their own requirements at the order level and leverage other acquisition approaches such as BPAs to eliminate the need for agency-specific and redundant indefinite delivery/indefinite quantity contracts. The schedules' flexibility gives agency contracting offices the choice to retain control of their procurements, including requirements development, evaluation, award and administration.

GSA is also working to help the Government's ability to acquire innovative technologies and services that have yet to be introduced to the Federal Government, through its Special Item Number (SIN) 132–99, Introduction of New Information Technology Services and/or Products. This would allow offerors and vendors to add new and innovative information technology products and services to IT Schedule 70 that would be otherwise unclassified and out of scope to the other SINs under the program. Moreover, it provides a new service, function, task, or attribute that may provide a more economical or efficient means for Federal agencies to accomplish their mission.

Finally, for agencies that require additional assistance, GSA also offers full-service IT acquisition options through our Assisted Acquisition Services.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

SAM.GOV

Question. In 2008, the General Services Administration (GSA) began consolidating 10 Governmentwide acquisition data systems into one integrated system called the System for Award Management (SAM.gov). The intent of this approach was to enhance competition and innovation. The current SAM application includes four of those legacy systems. One of those systems is the Central Contractor Registration or CCR. Since the Government switched from CCR to SAM.gov, there has been a precipitous drop in the number of new businesses competing for Government contracts. The number of new registrations per month has dropped over 35 percent. I have heard from small businesses interested in contracting with the Federal Government about the difficulty of navigating this process.

Can you explain the drop in registrations in switching from CCR to SAM.gov? Should we expect the same drop with regards to the other systems as they are integrated into the SAM.gov?

Is there a backlog to certify new registrants? If so, how can we reduce it?

What is GSA doing to improve that system so the burden for new entrants is not as high?

Answer. The System for Award Management (SAM), and the Central Contract Registration (CCR) before it, is the Governmentwide system where entities register to do business with the Federal Government, as required by the Federal Acquisition Regulation (FAR). The trend for registrants new to the process starting in 2007, does show an overall decline. There was a significant spike up in 2009, correlated with opportunities due to the American Recovery and Reinvestment Act of 2009. Specifically the new registrant numbers by fiscal year are:

CCR 2007: 113,277
CCR 2008: 124,163
CCR 2009: 191,159
CCR 2010: 150,640
CCR 2011: 143,482
CCR 7 months 2012: 62,487 SAM: 21,393 total: 83,880
SAM 2013: 78,571
SAM 2014: 32,562 5 Months

Importantly, with the launch of SAM, the Federal governance for the GSA Integrated Award Environment (IAE) affected the decision to change the requirements for registrants interested in procurement opportunities with the Federal Government. In CCR, registrants provided general information about the entity, contacts and the necessary financial information to receive payment. However, the Representations and Certifications were not required, and were input through the separate Online Representations and Certifications Application (ORCA).

At the time that the Government migrated from CCR to SAM, only 29 percent of all entities registered to receive procurement dollars had complete and current Representations and Certifications in ORCA. Today all procurement registrants in SAM have current and completed Representations and Certifications.

In July 2012, at migration there were approximately 221,000 active procurement registrants in CCR; only about 64,000 were compliant with Representations and Certifications. As of May 27, 2014, there were in excess of 355,000 registered entities for contracts and 100 percent of these were compliant for Representations and Certifications.

As is evidenced by the number of active registrants, excluding those only seeking grants and financial assistance, the number of eligible registrants has increased over time, as many historical registrants continue to renew their registrations.

The IAE continues to work with the Federal community and registrants to improve access and functionality including updating SAM with Helper Text in plain English, implementing an open data Application Programming Interface (API) for users to be able to track status in real time, and implementing live chat at the help desk. As the Environment transitions into the planned three-core with API future state, the common services platform will standardize user identity and access management, further enhancing ease of use.

FEDERAL GOVERNMENT PROPERTY BROADBAND ACCESS

Question. In 2012, Congress enacted the Middle Class Tax Relief and Job Creation Act (Public Law 112–96), which directed GSA to develop a master contract to govern the placement of wireless service antenna structures on buildings and other property owned by the Federal Government. This plan would both enhance the wireless industry's ability to deliver high speed wireless broadband service and create revenue for the Treasury. The law required this plan to be completed within 60 days of enactment. After little progress was made, President Obama issued an Executive Order directing agencies to tackle this assignment. Yet, it is my understanding that more than 2 years after the deadline, this work is still not complete.

What is the status of this project?

Answer. GSA drafted the master contract within the 60-day period mandated by section 6409 of Public Law 112–96. Given that the contract is to be used by executive landholding agencies to facilitate streamlined contracting with private sector telecommunications carriers for the installation of the carrier's antennas on Federal facilities, the master contract is based on the contract GSA uses to outlease space for private sector antenna installations at GSA controlled facilities.

Question. When do you expect that a master siting contract will be finished and available for use?

Answer. The master contract is finished and available for use by executive landholding agencies to document an agreement between the United States and the private sector telecommunications company concerning the installation of the carrier's antenna on Federal property. The contract is publicly available at http://www.gsa.gov/portal/content/191703.

FEDERAL FLEET MANAGEMENT

Question. According to a July 2013 Government Accountability Office (GAO) report, Federal agencies spend about $3 billion annually to acquire, operate, and maintain 450,000 Federal vehicles. President Obama has directed agencies to determine their optimal fleet inventories and set targets for achieving these inventories by 2015 with the goal of a more cost-effective fleet. GAO offered a series of recommendations to achieve this goal, and notes that GSA agreed with the recommendations.

Has the GSA completed its development and published guidance for agencies on estimating indirect fleet costs? If so, could you please provide a status update?

Answer. GSA has completed its development and published guidance for agencies on estimating indirect fleet costs. We issued GSA Bulletin FMR B–38, Indirect Costs of Motor Vehicle Fleet Operations, on February 20, 2014. This bulletin provides guidance to Executive agencies regarding the estimation, identification, categorization, and reporting of indirect costs of operating a fleet of motor vehicles.

Question. What is the amount of cost savings Congress and taxpayers can expect from a smaller, more modern fleet?

Answer. GSA is tasked with coordinating a Governmentwide process whereby agencies implement vehicle allocation methodologies for right-sizing their fleets. Right-sizing is not solely about reducing costs, it is about configuring the fleets to optimally support the agencies' missions. This may entail eliminating unnecessary vehicles, which would reduce their associated costs, but it also may encompass acquiring more appropriate vehicles and shifting between vehicle types. For example, an agency may find that a minivan is more efficient use of resources than a large sport utility vehicle (SUV); or a particular mission may be more effectively achieved by using a low greenhouse gas emitting compact sedan rather than a larger passenger vehicle. In 2013 a significant shift to subcompact sedans from large, medium, and compact sedans occurred with subcompacts increasing by 6,501 vehicles while the large, medium, and compact sedan categories were reduced by 10,915 vehicles.

Additionally, the agencies are under statutory and other mandates to meet targets for acquiring alternative fuel vehicles, consuming more alternative fuel and less petroleum, meeting environmental goals, and enhancing safety. While some of these efforts may reduce costs in the long run, in some situations they may actually increase up-front costs. While cost-consciousness and reducing waste and inefficiency is always a major goal, it is balanced by the need to invest in a more modern, safe, and efficient fleet.

Question. How many Federal employees currently support the acquisition, operation, and maintenance of the Federal vehicle fleet?

Answer. The acquisition, operation and maintenance of the Federal vehicle fleet are the responsibility of the individual agencies. Although agencies report overhead costs to GSA, the number of Federal employees supporting these areas are determined by the individual agencies and not reported to GSA. In some agencies fleet management is often an ancillary function performed by employees with other duties.

Question. Of the $3 billion overall cost of fleet management, how much can be attributed to acquisition of new vehicles? What percentage can be attributed to operation of the vehicles? How much does the Government spend to maintain the fleet?

Answer. Agencies' spending specifically to purchase vehicles (excluding the United States Postal Service (USPS)) in 2013 was $1.06 billion, a 10-year low, down from over $1.9 billion in 2009. Overall fleet costs (also excluding USPS) were $2.825 billion in 2013, consisting of $875 million (31 percent of the total) in depreciation, $339 million (12 percent) in maintenance, $117 million (4 percent) in indirect costs, $32 million (1 percent) for commercial leases, $1.009 billion (36 percent) to lease vehicles from GSA, and $452 million (16 percent) for fuel.

Question. Has GSA explored using private sector technologies that would allow Federal employees to check out vehicles, much like leading short-term vehicle rental companies?

Answer. Following the lead of popular commercial car sharing ventures, GSA is actively pursuing similar initiatives to help Federal agencies reduce costs, improve efficiencies, optimize vehicle use and support sustainability. GSA's goal is to drive

agency cost savings while allowing agencies to focus resources on their mission instead of ancillary services.

GSA is interested in being able to provide its Federal customers a variety of transportation solutions designed to fit a customer's vehicle needs. For example, for customers that only need transportation intermittently, it may be more beneficial to use a car sharing service in lieu of renting, leasing and/or purchasing a vehicle.

GSA has launched several car sharing initiatives and pilots to identify which is in the best interest of the Government. In December 2013, GSA launched a pilot for a car sharing service through the newly developed GSA Fleet Vehicle Dispatch Reservation Module. The module allows customers to combine GSA fleet leased vehicles and agency owned vehicles in GSA's Federal Fleet Management System within a given agency into motor pools, schedule vehicle reservations, dispatch vehicles to drivers, and generate reservation and utilization reports. Agencies can track vehicle utilization and determine where one could potentially reduce the number of vehicles to increase their fleet efficiency and productivity through this car sharing solution. After a successful pilot period, GSA launched the tool for Governmentwide use on March 31, 2014.

Another pilot is planned to supplement the Federal fleet by utilizing commercially available hourly rentals that offer pilot customers the ability to reserve a car by the hour or by day, to meet official business needs requiring local travel. A third pilot will focus on utilizing car sharing technology on existing GSA fleet vehicles located in the downtown Chicago area. The goal is to research, procure, test, and evaluate various car sharing technologies and tools. The results from these car sharing solutions will be evaluated to identify best practices for vehicle sharing, examine business models and technologies that facilitate car sharing, and identify any obstacles that may inhibit agencies from effectively sharing vehicles.

Question. Has GSA considered installing technologies to monitor driving patterns and improve the operation and usage of vehicles?

Answer. GSA is dedicated to bringing Federal customers innovative products and services to more efficiently and effectively manage their motor vehicle fleets. GSA continually researches new technologies aimed to improve the overall efficiency of the Federal fleet. Recently GSA entered into a partnership with the National Highway Traffic Safety Administration (NHTSA) to ensure the Federal fleet is a leader in safety technology. Together, a pilot will be conducted to focus on the effectiveness of three main technologies: forward collision alert, lane departure warning and back up camera systems. Piloting these advanced vehicle technologies affords GSA and NHTSA the opportunity to implement measures, receive immediate feedback, and conduct analysis that have the potential to mitigate poor driving behavior.

Additionally, GSA is beginning to offer vehicle monitoring solutions to Federal agencies that will have the capability to collect information regarding vehicle locations, driver behavior, utilization, and unsafe driving practices.

GSA IT SCHEDULE 70

Question. GSA developed IT Schedule 70 as an acquisition vehicle for agencies to have direct access to products and services from more than 5,000 certified industry partners. How is GSA's Schedule 70 helping or hindering the Government's ability to acquire innovative technologies and IT services?

Answer. The IT Schedule 70 program continues to help the Government acquire innovative technologies. As a part of the Multiple Award Schedules, Schedule 70 supports agencies acquiring innovative technologies and IT services by providing pre-competed, on-demand contracts with over 4,700 industry partners. The majority of these Schedule 70 partners are small businesses. The pre-competed Schedule 70 contracts help to reduce acquisition times and redundancy in agency acquisitions. These Schedule 70 benefits are available to help Federal, State, and local agencies.

IT Schedule 70 is designed to allow quick, unassisted agency acquisitions of technology. In addition, IT Schedule 70 offers greater flexibility so agencies can tailor their own requirements at the order level and leverage other acquisition approaches such as Blanket Purchase Agreements (BPAs) to eliminate the need for agency-specific and redundant indefinite delivery/indefinite quantity contracts. The Schedules' flexibility gives agency contracting offices the choice to retain control of their procurements, including requirements development, evaluation, award and administration.

GSA is also working to help the Government's ability to acquire innovative technologies and services that have yet to be introduced to the Federal Government, through its Special Item Number (SIN) 132–99, Introduction of New Information Technology Services and/or Products. This allows offerors and vendors to add new and innovative information technology products and services to IT Schedule 70 that

would be otherwise unclassified and out of scope to the other SINs under the program. Moreover, it provides a new service, function, task, or attribute that may provide a more economical or efficient means for Federal agencies to accomplish their mission.

Finally, for agencies that require additional assistance, GSA also offers full-service IT acquisition options through our Assisted Acquisition Services.

Question. What is GSA doing today to ensure that the IT schedules are efficient, competitive, and delivering value to the agency customers and taxpayers?

Answer. GSA is currently undertaking a large scale effort to reshape and improve the Multiple Award Schedule (MAS) program to ensure the IT Schedule 70 contracts are efficient, competitive, and deliver value to agency customers and taxpayers. These changes are a direct result of customer feedback, the evolving acquisition environment, and changing market conditions.

The IT Schedules Program is also focused on increasing competitiveness through better pricing and price visibility, increased compliance, and meaningful and timely program data. All GSA Schedules are migrating to a Dynamic Pricing Model to reduce prices and pricing variability across Schedules contracts and demonstrate savings to customer agencies. The goal of Dynamic Market Pricing is to provide relevant transactional level data at both the MAS and order level so agencies can negotiate better pricing. This is achieved through capturing transactional data collected on various Federal Strategic Sourcing Initiative (FSSI) Solutions at the Blanket Purchase Agreement (BPA) level to reduce price variability and increase data quality and spend analysis. In addition, "Raising the Bar" language was added to MAS solicitations (April 2014) that mandated broad offering availability for products and services, part number standardization, and Most Favored Customer (MFC) pricing, which alone does not constitute fair and reasonable pricing. GSA is also implementing services labor category standards and pricing and addressing manufacturer part number standardization via a Mass Modification for all SINs with products to existing contractors.

While the above actions also deliver greater value to agencies, GSA is taking additional steps to implement solutions to enhance customer service and make MAS easier to use. GSA has added a new live chat feature on the Web site and a centralized toll-free number and e-mail address to make it easier and more efficient for agencies to contact GSA to get answers and needed support. GSA has launched the IT Solutions Navigator tool and other self-service options to help agencies find the best IT contract for the specific requirements. GSA is exploring leveraging e-commerce platforms to ensure customers have the information they need to make informed buying decisions.

GSA TECH INITIATIVE 18F

Question. GSA has launched a new pilot program called 18F. My understanding is this program is designed to help identify and address targeted IT challenges in Government and help provide solutions.

Can you please share the long-term strategy behind 18F?

Answer. 18F will be successful in the short term if we (1) properly scale the team to meet customer demand; (2) partner with several additional agencies and ship great products for those agencies early and often; and (3) provide a measurable increase in our agency partners' ability to deliver on their missions. In the long term, we hope our efforts will serve as a successful model for procuring, building and delivering digital services that are the norm in Government IT.

Question. How many employees does GSA plan to hire?

Answer. Currently, 18F has budgeted for 54 full time staff in fiscal year 2014. The success of the program will dictate how many staff GSA will eventually hire in the long term. 18F operates as a reimbursable service, and, if there is sufficient demand, the organization will scale appropriately.

Question. How does this program help create stronger competition in the acquisition market?

Answer. 18F will create stronger competition in the acquisition marketplace in three ways. First, 18F hopes to demonstrate that agile software development and lean practices are a more successful method of building and delivering technology. Success will lead more agencies to adopt these methods bringing companies into the marketplace who specialize in this type of work. Second, by demonstrating a less risky way of delivering technology, agencies will be less reluctant to modernize and develop information technology systems and services, opening up Federal expenditures that have been dedicated to operations and maintenance. Last, 18F will create demand for well functioning digital services from the public. To meet this growing

demand, agencies will need to acquire appropriate services, platforms, and even infrastructure, which will increase competition and grow the acquisition marketplace.

Question. Can you please identify agencies who have reached out to 18F with specific IT challenges or projects? How many projects were there? What is the capacity of 18F to assist agencies in this process?

Answer. Currently, there are 16 agencies that have made serious inquiries with 18F on projects that would benefit from the partnership. Eight of those agencies have either signed or are in the process of signing an interagency agreement. 18F is in various stages of business development on 24 projects across those agencies. 18F will only take on projects that it is confident in being able to meet the needs of the agency partner. If demand increases for 18F's services, GSA will work to staff the program accordingly.

QUESTIONS SUBMITTED TO HON. KATHERINE ARCHULETA

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

INCREASED PAY AND HIRE AUTHORITIES

Question. I am aware that 18F and the Digital Service are using schedule A hiring authority and that direct hire authority is available for Information Technology (IT) Management (Information Security) (GSA–2210, GS–9 and above, Governmentwide and nationwide), but not all IT positions.

Given the high demand and competition for IT-related positions, and because the private sector can often pay higher salaries for such positions, what increased hire and pay authorities are under consideration for IT positions that don't currently have any and what types of positions would these be?

What other types of hiring and pay incentives beyond those now available to Government employees and agencies should be contemplated for recruitment and retention of IT specialists?

Answer. The Office of Personnel Management (OPM) is reviewing current authorities to determine what additional flexibilities may help agencies, as well as ensuring that agencies are aware of the tools already available to meet staffing needs through existing flexibilities, authorities, and incentives. Agencies have considerable authority to provide additional direct compensation in certain circumstances to support their recruitment and retention efforts, or to request further flexibilities from OPM. Such compensation tools include special rates, critical pay, student loan repayments, and recruitment, relocation, and retention incentives.

For example, OPM has established higher special rates of pay for IT specialists, computer engineers, and computer scientists to address staffing problems in certain entry/developmental grades within the General Schedule pay system. While the fiscal year 2013 the annual quit rate for IT specialists was 1.6 percent (below the Governmentwide average), special rates and other existing flexibilities can be used to target subpopulations of IT specialists, such as cyber security experts, where there may be staffing challenges.

EFFECT OF NOT INVESTING IN IT BUDGETS

Question. For the past several years, IT budgets at agencies have been cut. This has affected projects that are designed to save money once implemented. Can you discuss some of the effects at your agency of the inability to implement planned projects?

Answer. OPM released a Strategic IT Plan in March, fulfilling a commitment to strive to modernize IT that I made during my confirmation process. OPM developed the Strategic IT Plan to ensure our IT supports and aligns to our agency's strategic plan and that OPM's mission is fulfilled. It provides a framework for the use of data throughout the human resources lifecycle and establishes enabling successful practices and initiatives that define OPM's IT modernization efforts. Some parts of the plan will require us to shift resources, while others may require additional funding. OPM will develop project-specific work plans within the leadership and governance structure established by this strategic plan. In developing these work plans, OPM will determine funding needs and opportunities for cost avoidance and savings.

25 POINT IMPLEMENTATION PLAN TO REFORM FEDERAL INFORMATION TECHNOLOGY MANAGEMENT

Question. In 2010, the Office of Management and Budget (OMB) issued the 25 Point Implementation Plan To Reform Federal Information Technology Management, which detailed action items for OPM and other agencies in order to deliver

more value to the American taxpayer. Please provide an update on the current status of those action items assigned to OPM. For those action items not completed, please explain why.

Answer. OPM launched a Project Manager Community of Practice (PM CoP) that fosters the development of IT program and project managers. OPM has collaborated with the Project Management Institute (PMI) so that participants can earn continuing education units through training, presentations, and mentoring to earn or maintain Project Management Professional (PMP) certification. Likewise, using the IT Program Management Career Path Guide, OPM focuses on developing new project managers through training, mentoring and providing hands on experience with projects. The PM CoP also partnered with the General Services Administration (GSA) for implementation of the Federal Acquisition Institute Training Application System (FAITAS) tool so OPM can track PM development and certifications.

Working with the Chief Information Officers (CIO) Council and OMB, OPM has developed the IT Program Management Career Path Guide and recommended training curriculum for the newly established IT Program Management job title. It builds upon the IT Program Management Competency Model and provides guidance to Federal agencies on the creation and improvement of the IT Program Management career path.

OPM also updated the Job Family Standard for the GS–2210 series to include the IT Program Manager definition which covers work that involves managing one or more major multi-year IT initiatives of such magnitude they must be carried out through multiple related IT projects.

OPM worked with the Office of Management and Budget (OMB) to add the title IT Program Manager to the Job Family Standard for Information Technology, and to develop IT Program Manager competencies and the IT Program Management Career Path Guide. The Federal Acquisition Certification for program and project managers (FAC–P/PMs) builds upon this work and adds core-plus specialized certifications, the first one being in the area of IT. This development supports the administration's Smarter IT Delivery Agenda. The Smarter IT Delivery Agenda aims to increase customer satisfaction with top Government digital services; decrease the percentage of Federal Government IT projects that are delayed or over budget; and increase the speed with which qualified talent is hired and deployed to work on Government IT projects.

Finally, agencies can use the Intergovernmental Personnel Act to allow for the temporary assignment of personnel, including IT program managers, between the Federal Government and State and local governments, colleges and universities, Indian tribal governments, federally funded research and development centers, and other eligible organizations.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

DEMOGRAPHIC CHALLENGES OF AGING INFORMATION TECHNOLOGY WORKFORCE

Question. The Federal information technology (IT) workforce is aging. According to the Office of Personnel Management (OPM), 46 percent of the more than 80,000 Federal IT workers are 50 years of age or older, and more than 10 percent are 60 or older. Just 4 percent of the Federal IT workforce is under 30 years of age.

What are we doing to address the demographic challenges with regards to the IT workforce?

Answer. The current Initiative to Close Cybersecurity Skill Gaps is led by the OPM Director along with the subject matter expertise provided by the initiative's sub-goal leaders from the Office of Science and Technology in the Executive Office of the President and the National Initiative for Cybersecurity Education. In addition, OPM is an active collaborative partner within the Federal cyber and human resources communities; the Chief Human Capital Officers Council; the Chief Information Officers Council; the National Initiative for Cybersecurity Education (NICE) project; and among Federal agencies to raise awareness about the vital need for strategic workforce planning across Government and within agencies to ensure that agencies have the capability to obtain the IT and cybersecurity workforce they need now and in the future.

Strategic workforce planning includes insightful decisionmaking that relies on evidence-based analyses such as the demographic challenges cited above; the knowledge that the national labor market itself is shrinking; and that our talent pipeline in IT and cyber skills need strengthening. IT and cyber hiring and development opportunities, given the current economic environment, are key decisions each agency

is addressing, as the competition nationally and globally for these skills will be fierce over the next decade.

OPM is also working with technology departments at colleges and universities to ensure that the talent pipeline is growing and will have the IT and cyber skills needed by the agencies. In addition to promoting IT and cyber disciplines, OPM reaches out to the education and academia sector to increase its awareness of Federal employment opportunities and the Federal job application process. Student internships can start as early as the high school level and graduates of community colleges and universities are also encouraged to apply for employment. Just this past year, OPM launched a new outreach effort to recruit and onboard science, technology, engineering, and mathematics (STEM) graduates; the Presidential Management Fellowship (PMF) program's new PMF–STEM portfolio attracts applicants with IT and cyber skills in disciplines such as computer science, computer engineering and computational analytics.

In working with Federal hiring officials, our outreach guidance provides agencies with up-to-date information on how to message their opportunities, encourages them to work within their communities to strengthen the local talent pipeline, the availability of hiring and pay flexibilities, and provides workforce planning tools that enable them to plan for and get the workforce they need. Our objective, given the current fiscal environment, is to raise and leverage the capabilities of the Federal agencies to get the IT and cyber workforce they need, now and in the future, when the national and global labor markets are progressively smaller and more competitive. This outreach also allows the Federal Government to reach communities like the veterans community. In fiscal year 2012, military veterans comprised 28.9 percent of total hires, marking the highest percentage of military veterans newly hired into the Federal Government in over 20 years. As part of our efforts on recruitment for cyber positions, OPM has worked with many partners, including State programs that service veterans.

Since mid-February, OPM has made presentations (face-to-face or virtually) at 36 schools, 14 of which are participants in Scholarship for Service (CyberCorps), and 13 of which are Centers of Academic Excellence Institutions. OPM has also developed a detailed outreach plan and set a goal of partnering with a total of 22 universities and colleges prior to the end of fiscal year 2014 in order to expand our recruitment and outreach presence.

OPM is also promoting academic alliances with universities and colleges so that our existing workforce can retain, enhance or develop their skills. An example is OPM's recent 2014 alliance with the University of Maryland University College that offers discount tuition opportunities to Federal employees and their dependents. Similar efforts like this are under consideration with universities and colleges that offer degrees and coursework in IT and cyber skills as well. In addition, the National Initiative for Cybersecurity Education, with OPM and the Chief Information Officer Council as collaborative partners, offers a clearinghouse resource for our employees to use in planning for and getting the training they need.

INTERDISCIPLINARY WORKFORCE

Question. Increasingly, private sector companies have a workforce that is interdisciplinary in that they understand both business and technology. In comparison, many companies and former Government employees have complained to my staff about the lack of interdisciplinary skills in the Federal workforce—the program managers have only program management skills. The IT professionals are only familiar with IT. Acquisition workforce is trained in acquisition but not the other areas.

To what extent are training funds in your budget designed to help develop a workforce that increasingly requires interdisciplinary skills?

Answer. Cross-fertilization of technical professional skills such as IT, cyber and acquisition is part of the career development models and programs for Federal agencies. OPM along with the Federal agencies and the various interagency councils encourage IT, cyber and acquisition employees to consider and pursue career development opportunities that strengthen their skills in program and project management and that develop their familiarity in other disciplines akin to their work environment. For example, since 2010 when the Office of Management and Budget (OMB) issued the 25 Point Implementation Plan To Reform Federal Information Technology Management, OPM and the Federal agencies have taken the following actions that recognize this need for cross-fertilization of business acumen with the technology IT and cyber skills.

—OPM designed and issued a formal IT program management career path. Working with the Chief Information Officers (CIO) Council and OMB, OPM's IT Pro-

gram Management Career Path Guide recommends training curriculum for the newly established IT Program Management job title. It builds upon the IT Program Management Competency Model and provides guidance to Federal agencies on the creation and improvement of the IT Program Management career path.

—OPM updated the Job Family Standard for the Information Technology 2210 occupational series to include the IT Program Manager definition which covers work that involves managing one or more major multi-year IT initiatives of such magnitude they must be carried out through multiple related IT projects.

—OPM provides guidance to and encourages Federal agencies to use the Intergovernmental Personnel Act to allow for the temporary assignment of personnel, including IT and cyber program managers, between the Federal Government and State and local governments, colleges and universities, Indian tribal governments, federally funded research and development centers, and other eligible organizations.

This cross-fertilization of business and program management disciplines for the IT, cyber and acquisition disciplines is also encouraged by the Federal leadership and agencies in other key mission critical occupations such those in the science, technology, engineering and mathematics disciplines.

OPM revised its Hiring Managers Applicant Satisfaction Survey for fiscal year 2014 so that cyber hiring managers can report how satisfied they are with the quality of cyber candidates for their vacancies and identify what type of cyber work is being addressed in their vacancies. This will give us insight into the demand and flow of cyber work in our hiring actions and development activities and will enable us to be strategically focused on getting and retaining the high caliber IT and cyber workforce agencies need. For this fiscal year, as of June 12, 2014, the survey has received 24,186 total responses with 681 of those responses indicating that the applicant performed cyber work.

Question. Where are IT and personnel investments going? How well are you tracking how IT investments are aligned to the strategic plans of agencies?

Answer. Cyber skills are particularly sensitive to the changing external forces of technology and the national security and economic prosperity. Additionally, it is important that whenever an employee is brought into the Federal Government and performs well that the Federal Government do everything possible to retain that individual. Part of this responsibility lies in making sure that person feels fulfilled by the training opportunities that are available to him or her.

OPM's Employee Viewpoint Surveys reflect that overall, the current Federal workforce is very interested in receiving training that will foster their development. OPM also knows that having the agility and funding levels and staff capacity to provide the right developmental training at the right time is a key factor in employee retention.

OPM partnered recently with the Chief Information Officers Council's workforce survey that provided employees with a self-assessment tool of their cyber skills. Over 23,000 responses were received; the March 2013 reported results give Federal agencies insight about the skills their employees have and those that are needed. Through the Closing Skill Gaps Initiative, OPM encourages the cyber and human resources communities to use these results to design development opportunities to refresh and update talent.

OPM is also reaching out, as part of the President's Second Term Management Agenda and the Closing Skill Gaps Initiative, to partner with the National Initiative for Cybersecurity Education-Department of Homeland Security (NICE-DHS) clearinghouse resource effort on the National Institute of Standards and Technology (NIST) Web portal so that training and development activities can become a part of a Governmentwide university environment for Federal employees and agencies.

EFFICIENCIES IN HIRING QUALIFIED TALENT

Question. One common complaint amount Federal agencies is the time consuming and burdensome nature of the hiring process. One flexibility that agencies do not currently have is the ability to share lists of best qualified candidates for similar jobs. For example, it my understanding that if one agency conducts a search that results in a limited number of candidates with the specific skill set, and the agency is only able to hire one, another agency looking to fill the same position is not allowed to access the names of the other candidates. Instead, each agency is required to conduct its own lengthy search, delaying hiring and slowing down the ability of agencies to make progress on important projects.

Do you believe modifying the underlying statute to allow agencies to share their list of best qualified candidates would help agencies hire quicker and more effectively?

Answer. As you may know, in 2010, OPM submitted to the House of Representatives and the Senate draft legislation that would permit agencies to share resumes and select from among top candidates who have competed for similar positions at another agency, were assessed, and were determined by the other agency to be among the best qualified candidates for the job. Should Congress develop similar such legislation, OPM would be happy to examine it.

PATHWAYS PROGRAM FOR CYBER TALENT

Question. Director Archuleta, in your testimony you discuss OPM's work to enhance the recruitment and retention of cyber security and IT professionals, particularly students. One tool you did not mention was the Pathways internship programs, which allow agencies to non-competitively convert students and recent graduates. Many agencies have reported difficulties in utilizing the program due to the large number of applications they receive resulting from public notice, inadequate ways to assess candidates without experience and inability to target specific talent sources.

What is OPM doing to make sure that the Pathways programs are an effective pipeline for bringing mission-critical entry level IT talent into Federal agencies?

What is OPM doing to educate agencies on the use of this recruitment tool? Finally, what can Congress do to help increase the use and effectiveness of the program?

Answer. Pathways is designed to be an inclusive program, that permits agencies to recruit from all segments of the population. One of its goals is to expose recent graduates and students to Government service, in order to encourage them to consider becoming further involved in Government service as an immediate or long-term career goal. By definition, therefore, a strong response from applicants is a good thing, not a problem. Nevertheless, as with any recruitment process, it is important for agencies to develop valid approaches to assessment that permit them to identify the best candidates efficiently and effectively.

OPM is working through the STEM community and with technology departments at colleges and universities and examining hiring flexibilities to recruit and onboard STEM graduates. The Presidential Management Fellowship (PMF) program and the pilot STEM track helped to attract applicants with cyber skills in disciplines such as cybersecurity and information security.

OPM has held a number of Webinars, briefings, and training and specific agency sessions to educate human resources professionals and hiring managers on how to use the program. OPM has implemented monthly meetings with agency Pathways Program Officers to address global and specific issues related to the program. In addition, OPM is also finalizing additional guidance and frequently asked questions that will aid in making sure that agencies have information that they can use for the effective implementation of this program.

QUESTIONS SUBMITTED TO HON. DAVID POWNER

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

GENERAL INFORMATION TECHNOLOGY REFORM

Question. What are the top five reforms needed to improve Federal information technology (IT) spending so that it is more efficient and effective?

Answer. Given the magnitude of the Federal Government's annual IT budget, which is expected to be more than $82 billion in fiscal year 2014, it is important that agencies leverage all available opportunities to ensure that their IT investments are acquired in the most effective manner possible. To do so, agencies can rely on the Office of Management and Budget's (OMB's) initiatives such as:

—the IT Dashboard, a public Web site that provides information on 760 major investments at 27 Federal agencies, totaling almost $41 billion;

—the mandated use of incremental IT development, the deployment of IT capabilities or functionality in release cycles no longer than 6 months;

—TechStat sessions, which are face-to-face meetings to terminate or turn around IT investments that are failing or are not producing results;

—the Federal Data Center Consolidation Initiative, which seeks to save $3 billion by fiscal year 2015 by reducing the cost of data center hardware, software, and operations; and

—PortfolioStat sessions, which we estimate could save more than $5.8 billion, are annual reviews of agencies' IT investments to eliminate duplication, move to shared services, and improve portfolio management processes.

We have examined each of these initiatives and made numerous recommendations to further increase their efficiency and effectiveness.[1] For example, we recommended that OMB make Dashboard information available independent of the budget process, and that selected agencies appropriately categorize IT investments and address identified weaknesses.[2] In addition, we recommended that OMB develop and issue realistic and clear guidance on incremental development and that selected agencies update and implement their incremental development policies to reflect OMB's guidance. We have also made recommendations to individual agencies participating in PortfolioStat to improve their implementation of PortfolioStat requirements. We have ongoing work reviewing the status of the implementation of these recommendations.

IDENTIFYING FAILING IT INVESTMENTS

Question. How well do the PortfolioStat and TechStat processes identify high risk or failing IT investments that may need to be canceled? How many such investments were canceled or put back on track through such processes? Should such tools be used more widely by Federal agencies?

Answer. While PortfolioStat was initially intended to focus on commodity IT,[3] OMB only recently updated its PortfolioStat guidance in May 2014 to also ensure that critical IT investments deliver intended impacts and meet customer needs. However, OMB's TechStat sessions—face-to-face meetings to terminate or turn around IT investments that are failing or are not producing results—are more suited to identify high risk or failing IT investments that may need to be canceled.

In June 2013, we reported that OMB and selected agencies had held multiple TechStats and determined that, as of April 2013, OMB reported conducting 79 TechStats, which focused on 55 investments at 23 Federal agencies.[4] Further, four selected agencies—the Departments of Agriculture, Commerce, Health and Human Services (HHS), and Homeland Security (DHS)—conducted 37 TechStats covering 28 investments. About 70 percent of the OMB-led and 76 percent of agency-led TechStats on major investments were considered medium to high risk at the time of the TechStat. We further reported that OMB and selected agencies tracked and reported positive results from TechStats, with most resulting in improved governance. We also found that OMB reported in 2011 that Federal agencies achieved almost $4 billion in lifecycle cost savings as a result of TechStat sessions. However, we were unable to validate the reported outcomes and associated savings because OMB did not provide supporting artifacts or demonstrate the steps that OMB analysts took to verify the agencies' data. We subsequently recommended that OMB require agencies to report on how they validated the outcomes. OMB generally agreed with this recommendation.

Agencies could use TechStats more frequently. In our 2013 report, we found that the number of at-risk TechStats held was relatively small compared to the current number of medium- and high-risk major IT investments. Specifically, the OMB-led TechStats represented roughly 18.5 percent of the investments across the Government that had a medium- or high-risk chief information officer (CIO) rating. For the four selected agencies, the number of TechStats represented about 33 percent of the investments that had a medium- or high-risk CIO rating. We concluded that, until OMB and agencies develop plans to address these weaknesses, the investments

[1] GAO, Data Center Consolidation: Strengthened Oversight Needed To Achieve Cost Savings Goal, GAO–13–378 (Washington, DC: Apr. 23, 2013); Information Technology: Additional Executive Review Sessions Needed To Address Troubled Projects, GAO–13–524 (Washington, DC: June 13, 2013); Information Technology: Additional OMB and Agency Actions Are Needed To Achieve Portfolio Savings, GAO–14–65 (Washington, DC: Nov. 6, 2013); IT Dashboard: Agencies Are Managing Investment Risk, but Related Ratings Need To Be More Accurate and Available, GAO–14–64 (Washington, DC: Dec. 12, 2013); and Information Technology: Agencies Need To Establish and Implement Incremental Development Policies, GAO–14–361 (Washington, DC: May 1, 2014).

[2] GAO–14–64.

[3] According to OMB, commodity IT includes services, such as enterprise IT systems (e-mail; identity and access management; IT security; Web hosting, infrastructure, and content; and collaboration tools); IT infrastructure (desktop systems, mainframes and servers, mobile devices, and telecommunications); and business systems (financial management, grants-related Federal financial assistance, grants-related transfer to State and local governments, and human resources management systems).

[4] GAO, Information Technology: Additional Executive Review Sessions Needed To Address Troubled Projects, GAO–13–524 (Washington, DC: June 13, 2013).

would likely remain at risk. We further recommended that OMB require agencies to conduct TechStats for each IT investment rated with a moderately high- or high-risk CIO rating on the IT Dashboard. OMB generally agreed with this recommendation.

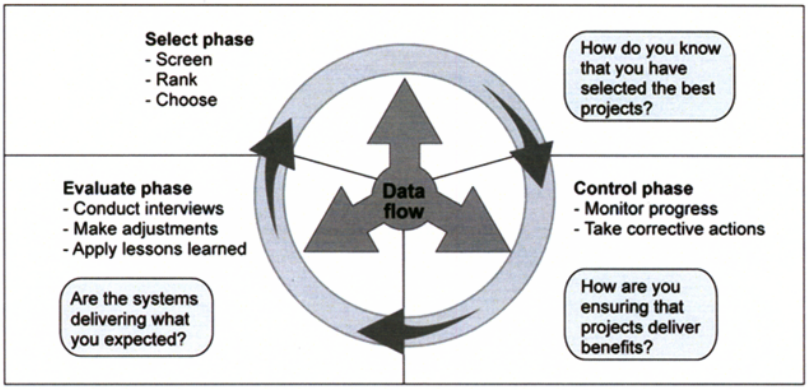
CANCELING FAILING IT PROJECTS

Question. What tools do agencies have to terminate IT investments that are critically over budget, over schedule, or failing to meet performance goals? Similarly, what tools do agencies have to replace these terminated investments with new commercial IT solutions?

Answer. As previously mentioned, agencies can utilize TechStat sessions to terminate or turn around IT investments that are failing or are not producing results. These meetings involve OMB and agency leadership and are intended to increase accountability and transparency and improve performance. OMB has told us that these sessions have resulted in investments that were either terminated or reduced in scope. Further, according to the former Federal chief information officer, the efforts of OMB and Federal agencies to improve management and oversight of IT investments have resulted in almost $4 billion in savings.

In addition to TechStat sessions, our Information Technology Investment Management (ITIM) framework can be used by agencies to improve their organizational processes and measure progress in attaining them, including ensuring that investments are delivering expected benefits.[5] As depicted in the following figure, the organization ensures that mission needs are met during the control phase. If the project is not meeting expectations or if problems have arisen, steps are quickly taken to address the deficiencies. If mission needs have changed, the organization is able to adjust its objectives for the project and appropriately modify expected project outcomes. The following figure illustrates the central components of the IT investment approach.

Figure: Fundamental Phases of the IT Investment Approach



Source: GAO.

If an agency elects to terminate an IT investment, OMB guidance on the acquisition of IT requires that agencies maximize the use of commercial services and off-the-shelf technology.[6]

TRANSITION TO CLOUD COMPUTING

Question. How well are Federal agencies implementing "cloud first" policies to drive efficiencies and savings through greater use of cloud computing services?

[5] GAO, Information Technology Investment Management: A Framework for Assessing and Improving Process Maturity (Supersedes AIMD–10.1.23), GAO–04–394G (Washington, DC: Mar. 1, 2004).

[6] OMB, Guidance On Exhibits 53 And 300—Information Technology and E-Government (2012).

Answer. In July 2012, we found that each of the seven selected agencies[7] that we reviewed incorporated cloud computing requirements into their policies and processes, and implemented at least one service by December 2011.[8] However, two agencies did not plan to meet OMB's deadline to implement two additional services by June 2012, but did plan to do so by the end of the year. As a result, we recommended that the seven agencies develop key planning information, such as estimated costs and legacy IT systems' retirement plans, for existing and planned services. The agencies generally agreed with these recommendations.

We have ongoing work looking at OMB's Cloud First initiative, where we are assessing agency progress in utilizing cloud-based solutions, determining the extent to which agencies experienced cost savings when such solutions have been deployed, and identifying any challenges agencies are facing as they use cloud computing.

FEDERAL DATA CENTER CONSOLIDATION

Question. I would like to ask about discrepancies between Federal departments and agencies when it comes to data center consolidation and optimization. Which agencies or departments seem to be taking the most advantage of such opportunities to create savings and efficiencies? Which agencies or departments seem to lag behind?

Answer. Of the 24 agencies participating in OMB's data center consolidation initiative, we believe the Departments of Defense (Defense) and Homeland Security (DHS) are two of the agencies that show the most potential for achieving planned savings and efficiencies. Specifically, as we testified in February 2014,[9] Defense reported 1,922 facilities although its original goal was to consolidate from 936 data centers to 392 and save an estimated $2.2 billion. This increase in inventory opens the possibility of consolidating even more centers and realizing billions in cost savings. Further, DHS plans to reduce the number of its large data centers from 40 to 3 and recently reported consolidation savings of $108 million through fiscal year 2013.

Regarding agencies that have been challenged to achieve their consolidation goals, we have ongoing work looking at OMB's data center consolidation initiative, including evaluating the extent to which agencies have achieved planned cost savings through their consolidation efforts and identifying agencies' notable consolidation successes and challenges in achieving cost savings. We plan to report later this year on each of the agencies' savings to date and where there is opportunity for greater savings.

TOP PRIORITY IT INVESTMENTS

Question. How can OMB help ensure the success of the administration's top priority IT investments?

Answer. While OMB's and agencies' recent efforts have resulted in greater transparency and oversight of Federal spending, continued leadership and attention are necessary to build on the progress that has been made. OMB is periodically reviewing the status of investments through its oversight of the IT Dashboard and its TechStat process. However, as we recommended in 2013, OMB needs to continue to hold TechStat sessions for major investments, hold agencies accountable for the performance of their investments, and make Dashboard information available independent of the budget process. Without this continued oversight, top priority investments may remain at risk. Additionally, with the possibility of over $5.8 billion in savings from the data center consolidation and PortfolioStat initiatives, OMB and agencies should continue to identify and pursue consolidation opportunities, by implementing a range of our recommendations intended to increase to efficiency and effectiveness of Federal IT.

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[7] The selected agencies were the Departments of Agriculture, Health and Human Services, Homeland Security, State, and Treasury; the General Services Administration and the Small Business Administration.

[8] GAO, Information Technology Reform: Progress Made but Future Cloud Computing Efforts Should Be Better Planned, GAO–12–756 (Washington, DC: July 11, 2012).

[9] GAO, Information Technology: Leveraging Best Practices and Reform Initiatives Can Help Defense Manage Major Investments, GAO–14–400T (Washington, DC: Feb. 26, 2014).

SUBCOMMITTEE RECESS

Senator UDALL. The subcommittee is hereby adjourned. Thank you.

[Whereupon, at 3:40 p.m., Wednesday, May 7, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2015

WEDNESDAY, MAY 14, 2014

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Tom Udall (chairman) presiding.

Present: Senators Udall, Coons, Johanns, and Moran.

SECURITIES AND EXCHANGE COMMISSION

STATEMENT OF HON. MARY JO WHITE, CHAIR

OPENING STATEMENT OF SENATOR TOM UDALL

Senator UDALL. Good afternoon. The subcommittee will come to order.

I am pleased to convene this hearing of the Financial Services and General Government Subcommittee to consider the fiscal year 2015 funding requests of two key Federal regulatory agencies, the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC).

I welcome my distinguished ranking member, Senator Mike Johanns, and some of our other colleagues I think will join us here throughout the day.

Joining us today are also the Honorable Mary Jo White, Chair of the Securities and Exchange Commission, and the Honorable Mark Wetjen, Acting Chairman of the Commodity Futures Trading Commission. They will discuss the critical work of their agencies, their use of resources provided over the past couple of years, and their budget needs for fiscal year 2015.

The workload for these agencies has grown dramatically in recent years. The SEC and the CFTC all play critical roles in stimulating and sustaining economic growth and prosperity in our country, in protecting the marketplace from fraud and manipulation, and in carrying out Dodd-Frank reforms. My constituents have made clear they support these reforms to prevent the reckless and abusive practices that led to the financial crisis.

Fortunately, some sectors of our country are recovering. But sadly, many families have not recovered, and they continue to struggle. I believe it is my responsibility to the hard-working and honest people of New Mexico and to all Americans who suffered as

a result of this crisis to ensure that we work to fully implement Dodd-Frank.

We need a financial system that is safe and sound because what happens on Wall Street touches every American family. Whether they are saving to buy their first home, helping to put their children through college, or planning for retirement, they put their faith in the financial markets being sound. We cannot let them down.

And they are not alone. Market users, financial investors, and the U.S. economy all depend on vigilant oversight by these two agencies, especially in today's rapid-paced, evolving, and often volatile global marketplace.

In the past few years, both Chair White and Acting Chairman Wetjen and their fellow commissioners and their respective staffs I think have worked very hard to create a more reliable regulatory structure to ensure the stability and integrity of the futures and securities markets. But there is still, I think everyone will admit, a lot of work to be done.

We depend on your leadership to implement the reforms designed to strengthen our regulatory framework, to do so promptly, prudently, and transparently, and help guard against another financial meltdown.

As the investors' advocate, the SEC has an important role in maintaining fair, orderly, and efficient stock in securities markets. The SEC conducts day-to-day oversight of the major market participants, monitors corporate disclosure of information to the investing public, and investigates and pursues enforcement action against securities laws violations.

Dodd-Frank dramatically expanded the SEC's responsibilities. The SEC was thrust into the driver's seat for issuing nearly 100 new rules, creating five new offices, issuing more than 20 studies and reports, overseeing the over-the-counter derivatives market and hedge fund advisers, registering municipal advisers and security-based swap market participants, and setting up a new whistleblower program.

The Jumpstart Our Business Startups Act of 2012 (JOBS Act) added more to SEC's plate for further rules and studies on capital formation, disclosure, and registration requirements.

Turning to the CFTC now, the CFTC carries out market surveillance, compliance, and enforcement programs in the futures and swaps arena. It detects, deters, and punishes abusive trading activity and manipulation of commodity prices, helping to prevent negative impacts both on consumers and on the economy.

Four years ago, the CFTC's mission was substantially expanded to include new oversight of the swaps marketplace, the vast once-in-the-shadows world of over-the-counter derivatives. It is a significantly transformed and highly diversified marketplace, one that is globalized, electronic, and around the clock.

The enactment of Wall Street reform in 2010 also added to the job of the CFTC. CFTC now has oversight of the once unregulated $400 trillion over-the-counter U.S. derivatives market to protect and benefit end-users and the broader American public. This complex swaps market has a notional value of nearly eight times the size of that of the futures market.

Now, the forecast for 2015, looking ahead for fiscal year 2015 for the SEC, the President seeks funding of $1.7 billion, an increase of $350 million, 26 percent above the fiscal year 2014 base enacted level of $1.35 billion. It is $236 million above the SEC's $1.464 billion current operating level. The $1.7 billion requested for fiscal year 2015 will support 5,143 permanent positions, an increase of 639 positions over the current 4,504 permanent positions, for a 14 percent growth in staff.

And for the CFTC, the President's budget requests $280 million, an increase of $65 million above the fiscal year 2014 enacted level of $215 million. This is a 30 percent increase in funding above the current level. The proposed fiscal year 2015 level will support 920 staff or 253 more when compared to the current staffing level of 667, a 37 percent increase.

Congress probably exercises its most effective oversight of agencies and programs through the appropriations process, permitting an annual checkup and review of operations, of activities, and spending. Today's hearing provides a valuable opportunity to ask some important questions.

Are the SEC and the CFTC keeping pace with the developments in the markets, particularly with more complex financial products which are emerging?

Do these agencies have the right mix of talent and specialized expertise to be vigilant watchdogs?

Do they have the state-of-the-art information technology to augment and support their human capital?

What are the top priorities for use of the resources proposed for 2015?

And what are the likely consequences of continued budget shortfalls and reduced resources?

I know Senator Johanns and I welcome the opportunity to conduct critical oversight of these two agencies. And I now turn to my distinguished ranking member, Senator Mike Johanns, for his opening remarks.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Mr. Chairman, let me just start out and say thank you to the witnesses for being here with us today. I thank you, Mr. Chairman, for holding yet another important hearing as we work our way through the various budget requests under our subcommittee's jurisdiction.

I do look forward to hearing from the witnesses today regarding the details of your requests as well as your plans to carry out core missions and implement Dodd-Frank in a responsible manner. There are three areas that I would like to highlight, looking forward to your testimony and my questions.

First, the SEC's implementation of the JOBS Act. Where is that on schedule? I am concerned that it is not on schedule, and I want to learn more about that. I do encourage the SEC and your team to move with all appropriate speed in finalizing Regulation A and the crowdfunding rules.

Second, I would like to get both of your thoughts on technological advancement in the marketplace, and what your agencies are doing on the technology front to adapt.

And finally, I ask you to be persistent in trying to work together and coordinate with your fellow regulators. Any conflicts between SEC and CFTC on cross-border swaps and lack of coordination between the SEC and Department of Labor over fiduciary standards continues to cause uncertainty and confusion.

Derivatives markets and effective oversight of those markets matter a lot to farmers, to homeowners, and to small businesses. We all benefit from a system that promotes fair and orderly markets. So I am concerned when certain agency rules seem to fragment the market and push businesses overseas.

In some instances, the CFTC has moved too quickly. Others, the Commission has simply chosen to issue guidance in what looks like an effort to avoid cost-benefit analysis. In many cases, the Commission has opted to act alone instead of properly coordinating with the SEC as well as other domestic and international regulators.

In order to be an effective regulator, transparency is critical. This need for transparency and coordination is evident in the CFTC's approach to cross-border implementation swaps regulation. CFTC's guidance, the delays, the lack of coordination with other regulators have led to confusion and concern for market participants, foreign government finance ministers, and investors here and abroad.

No doubt that both the CFTC and SEC have an important job of protecting investors who look to the markets to help secure their retirements, pay for their homes, send kids to college. Your agencies have an obligation to protect consumers, hopefully, from the next Madoff, MF Global, or Stanford.

As we look at both of your budget requests, two things come to mind. First, technological solutions are important to keep up with next-generation trading platforms that operate at lightning speeds. Two, staffing levels have to be carefully considered. We also have to make sure that they are sustainable.

All agencies have to make strategic decisions on how best to allocate resources. As we all know, simple increasing funding doesn't necessarily ensure that the agency will successfully achieve its mission.

So, to the chairs, you both have difficult tasks before you. We ask a lot. We ask that you improve transparency in our securities markets, uncover fraud and deception, without over-regulating our markets and hindering economic growth.

Chairman Udall, again, I look forward to working with you as we consider the fiscal year 2015 budget requests of the CFTC and the SEC, and I look forward to the testimony and the opportunity to ask questions.

Thank you, Mr. Chairman.

Senator UDALL. Thank you very much, Senator Johanns.

And at this time, I would invite Chair White to present testimony on behalf of the SEC, followed by Acting Chairman Wetjen on behalf of the CFTC. You each will have 5 minutes. I know you have very thorough statements, which will be put in the record, and you can use your 5 minutes as you choose.

Please proceed, Chair White.

SUMMARY STATEMENT OF HON. MARY JO WHITE

Ms. WHITE. Thank you, Chairman Udall, Ranking Member Johanns. Thank you for inviting me to testify in support of the President's fiscal year 2015 budget for the Securities and Exchange Commission.

Now more than ever, investors and our markets need a strong, vigilant, and adequately resourced SEC. To put the SEC's extensive responsibilities and its 2015 budget request into context—from fiscal year 2001 to fiscal year 2014, trading volume in the equity markets more than doubled to a projected $71 trillion. The complexities of financial products and the speed with which they are traded increased exponentially.

Assets under management of mutual funds grew by 131 percent to $14.8 trillion, and assets under management of investment advisers jumped almost 200 percent to $55 trillion. There are today over 25,000 SEC registrants, including broker-dealers, clearing agents, transfer agents, credit rating agencies, exchanges, and others.

During this time of unprecedented growth and change in our markets, the SEC also has been given significant new responsibilities for over-the-counter derivatives, private fund advisers, municipal advisors, crowdfunding portals, and more.

The President's $1.7 billion budget request would enable the SEC to address critical core priorities including enhancing examination coverage for investment advisers and other key entities who deal with retail and institutional investors; protecting investors by expanding our enforcement program's investigative capabilities, and strengthening our ability to litigate against wrongdoers; deploying and leveraging cutting-edge technology to better keep pace with those we regulate, make our operations more efficient, and improve our ability to identify a variety of market risks, including emerging frauds.

The SEC's funding, as you know, is deficit neutral, which means that the amount Congress appropriates is offset by transaction fees and thus does not impact the deficit, the funding available for other agencies, or count against the caps in the congressional budget framework.

Nonetheless, I fully recognize my duty to be an effective and prudent steward of the funds we are appropriated. I believe our accomplishments in the past year should give Congress and the public confidence that we will fulfill this responsibility.

RECENT SEC ACCOMPLISHMENTS

While certainly much more remains to be done, since my arrival in April 2013, the Commission has adopted or proposed more than 20 significant rulemakings, including many mandated by the Dodd-Frank and JOBS Acts, across the regulatory spectrum of our jurisdiction. My written testimony details these.

We are also now more aggressively enforcing the securities laws, requiring for the first time admissions to hold certain wrongdoers more publicly accountable. And in fiscal year 2013, we obtained orders for penalties and disgorgements of $3.4 billion, the highest in the agency's history.

We have intensified our data-driven disciplined approach to analyzing and appropriately addressing complex market structure issues, such as high-frequency trading and dark pools, implementing a powerful new analytical tool called MIDAS. We have begun a comprehensive review of the SEC's public company disclosure rules to make disclosures more meaningful to investors while at the same time making them more cost effective for companies.

And I want to make clear that this significant progress I am talking about was due to the incredible commitment, talent, and expertise of the SEC staff. The fiscal year 2015 budget request would permit the SEC to increase its examination coverage of investment advisers who everyday investors are increasingly turning to for investment assistance for retirement and family needs.

SEC FUNDING NEEDS

While the SEC has made the most of its limited resources, we nevertheless were only able to examine 9 percent of registered investment advisers in fiscal year 2013. In 2004, 10 years ago, the SEC had 19 examiners per trillion dollars in investment adviser assets under management. Today, in 2014, we have only eight. More coverage is plainly needed, and the industry itself has acknowledged that.

Very importantly, this budget request would also allow us to better leverage technology across the agency to support a number of key initiatives.

This budget request also allows us to continue augmenting our Division of Economic and Risk Analysis by adding financial economists and other experts to assist with economic analysis in rulemaking, risk-based selection for investigations and examinations, and structured data initiatives.

PREPARED STATEMENT

I firmly believe that the funding we seek is fully justified by our important and growing responsibilities to investors, companies, and the markets. Your continued support will allow us to better fulfill our mission and to build on the significant progress the agency has achieved, which I am committed to continuing and enhancing.

I would be pleased to answer any of your questions.

[The statement follows:]

PREPARED STATEMENT OF HON. MARY JO WHITE

Chairman Udall, Ranking Member Johanns, and members of the subcommittee:

Thank you for inviting me to testify today in support of the President's fiscal year 2015 budget request for the Securities and Exchange Commission.[1] I appreciate the opportunity to describe why and how the SEC needs the $1.7 billion requested for the coming fiscal year in order to fulfill the obligations given to the agency by Congress to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.[2]

I am pleased by the SEC's accomplishments this past year. We adopted or proposed a substantial volume of mandated and other key rules. We aggressively en-

[1] A copy of the SEC's fiscal year 2015 Budget Congressional Justification can be found on our website at http://www.sec.gov/about/reports/secfy15congbudgjust.shtml.

[2] The views expressed in this testimony are those of the Chair of the Securities and Exchange Commission and do not necessarily represent the views of the President, the full Commission, or any Commissioner. In accordance with past practice, the budget justification of the agency was submitted by the Chair and was not voted on by the full Commission.

forced the securities laws, changing a key policy that can hold wrongdoers more publicly accountable and obtaining orders for penalties and disgorgement of $3.4 billion in fiscal year 2013, the highest in the agency's history. We launched MIDAS and intensified our review of market structure issues, including high-frequency and off-exchange trading practices. And we have continued to improve our efficiency by enhancing our technology, bringing in more experts, and deploying more risk-based analytics to allow us to do more with our limited resources, and to do so more quickly.

And with last week being Public Service Recognition Week, I want to take this occasion to make clear that none of this would have been possible without the incredible commitment, talent, and expertise of the staff of the SEC.

As described in more detail below, the requested budget level would allow the SEC to build upon its strong efforts and accomplish several key and pressing priorities, including:

—Bolstering examination coverage for investment advisers and other key areas within the agency's jurisdiction;
—Strengthening our enforcement program's efforts to detect, investigate, and prosecute wrongdoing;
—Continuing the agency's investments in the technologies needed to keep pace with today's high-tech, high-speed markets; and
—Enhancing the agency's oversight of the rapidly changing markets and ability to carry out its increased regulatory responsibilities.

SIGNIFICANT GAINS, BUT WORK REMAINS

The SEC's funding mechanism is deficit-neutral, which means that the amount Congress appropriates to the agency will not have an impact on the nation's budget deficit, nor will it impact the amount of funding available for other agencies.[3] Our appropriation also does not count against the caps set in the bi-partisan Congressional budget framework for 2014 and 2015.

Nonetheless, I deeply appreciate that I have a serious responsibility to be an effective and prudent steward of the funds we are appropriated. Since my arrival just over a year ago, we have made every effort to effectively deploy our funds to accomplish our mission and the goals that Congress has set for us. And, within the last year, we have advanced a significant number of rules and other initiatives across the wide range of our responsibilities with respect to the regulatory objectives mandated for the SEC by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and the Jumpstart Our Business Startups Act ("JOBS Act"), proposing or adopting rules concerning, among other things:

—The registration and regulation of nearly a thousand municipal advisors;
—The cross-border application of our security-based swap rules in the global swaps market;
—Lifting the ban on general solicitation in certain private offerings and proposing rules to provide important data and investor protections for this new market;
—Proprietary trading and investments in private funds by banks and their affiliates, under what is commonly called the "Volcker Rule";
—Increasing access to capital for smaller companies by permitting securities-based crowdfunding;
—Programs required of broker-dealers, investment companies, and other regulated entities to address risks of identity theft;
—Further safeguarding the custody of customer funds and securities by broker-dealers;
—Updating and expanding the Regulation A exemption for raising capital;
—The retention of a certain amount of credit risk by securitizers of asset-backed securities;
—The removal of references to nationally recognized statistical rating organization ratings in our broker-dealer and investment company regulations; and
—Enhancing risk management and other standards for the clearing agencies responsible for the safe and efficient transfer of trillions of dollars of securities each year.

In addition, we put forward rule proposals to strengthen and reform the structure of money market funds and require that certain key market infrastructure participants have comprehensive policies and procedures to better insulate market infrastructure technological systems from vulnerabilities.

[3] Section 991 of the Dodd-Frank Act requires the SEC to collect transaction fees from self-regulatory organizations in an amount designed to directly offset our appropriation. The current fee rate is about $0.02 per every $1,000 transacted.

We also have taken steps to enhance the SEC's already strong enforcement program, including by modifying the longstanding "no admit/no deny" settlement protocol to require admissions in certain cases. While no admit/no deny settlements still make a great deal of sense in many situations, because admissions achieve a greater measure of public accountability, they can bolster the public's confidence in the strength and credibility of law enforcement and in the integrity of our markets. Already the Commission has resolved a number of cases with admissions, and my expectation is that there will be more such cases in 2014 as the new protocol continues to evolve and be applied. The Commission also has brought a number of significant enforcement cases across our regulatory spectrum, including actions against exchanges to ensure they operate fairly and in compliance with applicable rules, actions against auditors and others who serve as gatekeepers in our financial system, landmark insider trading cases, and additional cases against individuals and entities whose actions contributed to the financial crisis.

In the past year, the Commission also has made great strides to improve its technology, including through the development of tools that permit us to better understand and protect the integrity of our markets and inform our exam program. In October 2013, the agency brought on-line a transformative tool called MIDAS that enables us to analyze enormous amounts of trading data across markets almost instantaneously. The SEC's Quantitative Analytics Unit in our National Exam Program has developed groundbreaking new technology that allows our examiners to access and systematically analyze massive amounts of trading data from firms in a fraction of the time it has taken in years past. We are laying the technological foundation for unified access to SEC information, applications, and data across the agency, and are making a variety of other technological investments to enable us to meet our mission more efficiently and effectively.

Despite this significant progress, there is much that the SEC still needs to accomplish. Completing the rulemakings and studies mandated by Congress in the Dodd-Frank and JOBS Acts remains among my top priorities. We must continue to seek to address structural concerns about our complex, dispersed marketplace in a responsible and empirically-based manner, and also continue our current review of the SEC's public issuer disclosure rules. We also need to continue to increase our capacity to examine and oversee the entities under the SEC's jurisdiction, as well as hold accountable those that harm investors through securities law violations. We are at a critical point in the deployment of more sophisticated technology tools and platforms, and it is vital that we have the resources necessary to continue modernizing our IT systems and infrastructure.

The SEC needs significant additional resources to keep pace with the growing size and complexity of the securities markets and the agency's broad responsibilities. The agency currently oversees more than 25,000 market participants, including over 11,000 investment advisers, approximately 10,000 mutual funds and exchange-traded funds, 4,450 broker-dealers, 450 transfer agents, 18 securities exchanges, as well as the Public Company Accounting Oversight Board (PCAOB), Financial Industry Regulatory Authority (FINRA), Municipal Securities Rulemaking Board (MSRB), Securities Investor Protection Corporation (SIPC), and Financial Accounting Standards Board (FASB). The SEC also has responsibility for reviewing the disclosures and financial statements of approximately 9,000 reporting companies, and has new and expanded responsibilities over the derivatives markets, an additional 2,500 reporting advisers to hedge fund and other private funds, close to 1,000 municipal advisors, ten registered credit rating agencies, and seven registered clearing agencies. And, as you know, between the Dodd-Frank and the JOBS Acts, the SEC was given nearly 100 new rulemaking responsibilities.

The SEC's responsibilities are extensive and complex and its mission is critically important. The funding we are seeking is fully justified by our growing responsibilities to investors, companies, and the markets. With what I believe is a thoughtful and targeted approach to our resource challenges, the fiscal year 2015 budget request of $1.7 billion would allow the SEC to hire an additional 639 staff in critical, core areas and enhance our information technology.

Outlined below is a brief overview of some of the key components of our request.

EXPANDING OVERSIGHT OF INVESTMENT ADVISERS AND STRENGTHENING COMPLIANCE

There is an immediate and pressing need for significant additional resources to permit the SEC to increase its examination coverage of registered investment advisers so as to better protect investors and our markets. During fiscal year 2013, due to significant resource constraints, the SEC examined only about 9 percent of these advisers, comprising approximately 25 percent of the assets under management.

The number of SEC-registered advisers has increased by more than 40 percent over the last decade, while the assets under management by these advisers have increased more than two-fold, to almost $55 trillion. At the same time, the industry has been increasing its use of new and complex products, including derivatives and certain structured products, employing technologies that facilitate high-frequency and algorithmic trading, and developing complex "families" of financial services companies with integrated operations that include both broker-dealer and investment adviser affiliates. While the SEC has efficiently used its limited resources by improving its risk assessment IT capabilities and focusing its examination staff and resources on those areas posing the greatest risk to investors, in 2004, the SEC had 19 examiners per trillion dollars in investment adviser assets under management. Today, we have only 8. More coverage is clearly needed as the status quo does not begin to provide sufficient protection for investors who increasingly turn to investment advisers for assistance navigating the securities markets and investing for retirement and family needs.

A top SEC priority under the fiscal year 2015 request is to add 316 additional staff to the examination program in its Office of Compliance Inspections and Examinations (OCIE). This would allow the agency to examine more registered firms, particularly in the investment management industry; build out the examination program to implement newly expanded responsibilities with respect to municipal advisors, swap market participants, private fund advisers, crowdfunding portals and other new registrants; and more effectively risk-target and monitor other market participants. Additionally, OCIE would also be able to continue ongoing efforts to enhance its risk assessment and surveillance through the development of new technologies in areas such as text analytics, visualization, search and predictive analytics.

BOLSTERING ENFORCEMENT

Strong and effective enforcement of our Federal securities laws is central to the SEC's mission. In addition to modifying our settlement policy to require public admissions in certain cases, the Commission in the last year brought groundbreaking cases across the full range of the securities laws, including, among many others, a $615 million settlement of an insider trading case; a failure to supervise case against a prominent hedge fund adviser; actions against exchanges and municipal issuers; Foreign Corrupt Practices Act cases against large multinational corporations; and additional matters against individuals and entities whose actions contributed to the financial crisis.

Notwithstanding these results, the SEC's Division of Enforcement faces a number of key challenges to preserve and enhance its ability to vigorously pursue the entire spectrum of wrongdoing within our jurisdiction. Our Enforcement work includes the detection, investigation, and litigation of violations of the Federal securities laws. In each of these areas, we face significant challenges:

—*Detection.* We receive over 15,000 tips, complaints, and referrals annually, including the more than 3,000 tips that flow into the Division's Whistleblower Office, which generate a fresh stream of case leads in need of investigation. The review and analysis of these tips require significant human and technological resources. We also have focused intensively on potential misconduct in the equity markets and in connection with new rules, including those implemented under the Dodd-Frank and JOBS Acts. But detecting misconduct in constantly evolving securities markets, including as a result of the growth of algorithmic, automated trading and "dark pools," requires substantial resources.

—*Investigations.* Technological advances across the industry allow for more sophisticated schemes, which require improved technology and significant resources to unravel. We also are expanding our focus on financial reporting and auditing misconduct cases, which are highly technical and labor intensive.

—*Litigation.* We have seen an increase in litigation and trials as we focus more extensively on individual wrongdoing. And, the recent change to our long-standing settlement policy that now requires admissions in certain cases may lead to more litigation. Success at trial is critical to our ability to carry out our mission, and litigation, often against well-funded opposition.

In order to meet the challenges of our rapidly changing and expanding markets, with increasingly complex products and more sophisticated wrongdoers, Enforcement seeks to hire 126 new staff, including additional legal, accounting, and industry specialized experts, primarily for investigations and litigation. These critical resources will enable us to improve our information processing and analysis, expand our investigative capabilities, strengthen our litigation capacity, and better use technology. In addition, the Division will continue to: (1) invest in technology that en-

ables the staff to work more efficiently and effectively, and (2) collaborate with external stakeholders who assist in the Division's identification, investigation, and litigation of securities law violations, including wrongdoing that crosses borders.

LEVERAGING TECHNOLOGY

The SEC is strongly committed to leveraging technology to streamline operations and increase the effectiveness of its programs. We are developing new analytic tools designed to process data more efficiently and make timelier and better-informed decisions. For example, we apply cutting-edge analytics, such as visual data analysis, to increase the speed with which the exam and enforcement program evaluate data and develop evidence. To support these tools, we are investing in our information technology infrastructure to store and process increased volumes of data. We generated over $18 million in cost avoidance in fiscal year 2013 through a more efficient data center structure, renegotiated contracts, server virtualization, and other process improvements. Our recently initiated Quantitative Research and Analytic Data Support program is structuring vast quantities of financial market data and making it more accessible across the agency. This program will enhance the quality and speed of data-driven analyses and, importantly, link disparate sources of data to allow staff to establish connections not previously possible.

While the agency has made significant progress over the past few years in modernizing its technological systems, progress was set back by our level of funding in fiscal year 2014. Increased funding for these efforts and new technology investments are essential. The SEC's fiscal year 2015 budget request, which includes full use of the SEC Reserve Fund, would support a number of key information technology initiatives, including:

—*EDGAR modernization,* a multi-year effort to simplify the financial reporting process to promote automation and reduce filer burden. EDGAR provides the most critical window into the capital markets for investors and businesses. With a more modern EDGAR, both the investing public and SEC staff will benefit from having access to better data.

—*Enterprise Data Warehouse,* a centralized repository for the Commission to organize different sources of data, which can help the public gain easier access to more usable market data, which will facilitate easier and more effective analysis.

—*Data analytics tools,* to assist in the integration and analysis of large amounts of data, allowing for computations, algorithms and quantitative models that can lead to earlier detection of fraud or suspicious behavior. We have begun deploying these tools on a limited basis within our enforcement and exam programs, but due to current budget constraints have not yet rolled them out more broadly. Under this request, more front-line staff, including those performing examinations and investigations, would be able to leverage these tools to efficiently identify links, anomalies, or indicators of possible securities violations.

—*Examination improvements,* to improve risk assessment and surveillance tools and datasets that will help the staff monitor for trends and emerging fraud risks, as well as improving the workflow system supporting SEC examinations.

—*Enforcement investigation and litigation tracking,* to support Enforcement teams with the receipt and loading of the high volume of materials produced during investigations and litigation, to build the capability to permit the electronic transmittal of data, and to implement a document management system for Enforcement's internal case files.

—*SEC.gov modernization,* to make one of the most widely used Federal government websites more flexible, informative, easier to navigate and secure for investors, registrants, public companies, and the general public. SEC.gov receives more than 35 million hits per day, and there is high public demand for quick and ready access to the tremendous amount of data available there, including 21 million filings in the EDGAR system and 170,000 documents on SEC.gov. When fully implemented, the website will offer dramatically improved search and filtering capabilities that will enhance the transparency and availability of this data.

—*Tips, Complaints, and Referral (TCR) system enhancements,* to bolster flexibility, configurability, and adaptability. The TCR system is the SEC's central repository of tips, complaints, and referrals that maximizes our ability to search, track, and route workflow for the high volume that the agency receives each year (e.g., over 15,000 in fiscal year 2013). System enhancements will provide automated triage of the items the agency receives, as well as improved intake, resolution tracking, searching, and reporting functionalities.

—*Information security,* to upgrade security tools and processes, and to develop and train staff to monitor, respond to, and remediate ever-increasing risks and security threats and to permit continuous risk monitoring.
—*Business process automation and improvement,* to improve the efficiency and effectiveness of the agency's processes, thereby enabling us to better serve the public.

STRENGTHENING OVERSIGHT OF THE SECURITIES MARKETS AND INFRASTRUCTURE

To effectively assess constantly evolving market activity across a wide range of complex trading venues, the SEC's Division of Trading and Markets must:
—Enhance its effort to address market structure and technology developments, including through MIDAS and other tools that facilitate the analysis of trade and order data that reflects, for example, high-frequency trading and trading on off-exchange venues where pre-trade prices are not typically available to the public;
—Continue its work with self-regulatory organizations (SROs) to enhance critical market infrastructures that are essential for the operation of the securities markets; and
—Expand its oversight of clearing agencies, large broker-dealers, exchanges, and other major securities market participants.

Further, in fiscal year 2015 we expect a significant number of new registrants under the Dodd-Frank and JOBS Acts as registration requirements under those laws go into effect, including dealers and other participants in the security-based swap market and crowdfunding portals. Additional resources are needed to undertake these new market-related responsibilities, including staff focused on market supervision, analytics and research, and derivatives policy and trading practices. Accordingly, for these core and new responsibilities, in the fiscal year 2015 budget request the SEC proposes to add 25 positions in its Division of Trading and Markets.

ENHANCING CORPORATE DISCLOSURE REVIEWS AND SUPPORTING IMPLEMENTATION OF THE JOBS ACT

For fiscal year 2015, the SEC requests 25 new positions for its Division of Corporation Finance. These resources are needed for Corporation Finance to continue its multi-year effort to enhance its disclosure review program for large or financially significant companies, meet the increased workload resulting from expected improved market conditions and additional emerging growth companies confidentially submitting registration statements for non-public review, provide increased interpretive guidance, and evaluate trends in the increasingly complex offerings of asset-backed securities and other structured financial products. During fiscal year 2015, Corporation Finance also will continue to implement the rulemakings required by the Dodd-Frank and JOBS Acts and move forward on a comprehensive initiative to update the disclosure requirements for reporting companies.

FOCUSING ON ECONOMIC AND RISK ANALYSIS TO SUPPORT RULEMAKING AND STRUCTURED DATA AND RISK-BASED INITIATIVES

The SEC's Division of Economic and Risk Analysis (DERA) works to integrate analysis of economic, financial, and legal disciplines with data analytics and quantitative methodologies in support of the SEC's mission. DERA is our most rapidly growing division, having more than doubled since its creation in late 2009. In fiscal year 2014, we are planning to hire 45 additional staff for DERA, primarily for additional financial economists and other experts to perform and support economic analyses and research and further enhance our risk assessment activities. In fiscal year 2015, we seek to add 14 positions in DERA, primarily financial economists and other experts who significantly assist with:
—The rulemaking process by providing the Commission and staff with economic analysis and technical advice;
—Data analysis for risk-based selection of firms and issues for inquiries, investigations and examinations; and
—Improving structured data initiatives in order to enable the Commission, investors, and other market participants to more systematically and efficiently analyze and draw conclusions from large quantities of financial information.

DERA also seeks to hire additional technologists with mathematical and statistical programming experience to support the activities of the Division, including by assisting with the development of risk assessment models and risk metrics, data analytics, and economic analysis in the agency's rulemakings.

ENHANCING MONITORING OF THE INVESTMENT MANAGEMENT INDUSTRY

In the past 10 years, the number of portfolios of mutual funds, exchange-traded funds, and closed-end funds has increased by 17 percent, and assets under management held by those funds has increased by 123 percent to $16 trillion. And significantly, during that period, complexity in the investment management industry has increased dramatically, reflecting growing sophistication in product design and portfolio strategies.

For fiscal year 2015, the SEC requests 25 new positions for its Division of Investment Management. With additional resources, Investment Management plans to:

—Improve the reporting of information about fund operations and portfolio holdings by mutual funds, closed-end funds, and exchange traded funds;
—Continue to build capacity to manage and analyze data filed by hedge funds and other private funds;
—Bolster the technical expertise of Investment Management's disclosure review program to, among other things, identify trends and monitor the risks related to the growth and increased product sophistication in the asset management industry; and
—Enhance the ability of Investment Management's Risk and Examinations Office to manage, monitor, and analyze industry data, and provide ongoing financial analysis of the asset management industry.

ENHANCING TRAINING AND DEVELOPMENT OF SEC STAFF

Nothing is more critical to the agency's success than the expertise of the SEC's staff. And providing in-depth and up-to-date training is essential for the staff to maintain and enhance its expertise over our constantly changing markets. Historically, the SEC's training budget has not matched that of its Federal financial regulatory agency peers. The agency is requesting to increase its staff training budget in fiscal year 2015 principally to support training and development for employees directly involved in examinations, investigations, fraud detection, litigation, and other core mission responsibilities of the SEC. This will consist of specialized training about new trends in the securities industry and changing market conditions, as well as analytics and forensics. The investment in training also will allow the SEC to provide continuing education courses that staff are required to take to maintain necessary legal and financial credentials.

CONCLUSION

Thank you for your support of the agency's vital mission and the opportunity to present the President's fiscal year 2015 budget request. I would be happy to answer your questions.

Senator UDALL. Thank you very much.

And Acting Chairman Wetjen, please proceed.

COMMODITY FUTURES TRADING COMMISSION

STATEMENT OF HON. MARK P. WETJEN, ACTING CHAIRMAN

Mr. WETJEN. Good afternoon, Chairman Udall, Ranking Member Johanns, and members of the subcommittee.

Thank you for inviting me today to the hearing on the President's fiscal year 2015 funding request for the Commission.

In my written remarks, I respond to the subcommittee's request to detail on how the Commission has used its resources in the previous 2 fiscal years. My goal this afternoon is to provide this subcommittee with context to the important role the Commission plays in the financial system and the economy as a whole, as well as the important role this committee plays in helping our agency achieve its mission.

As you know, the Commission was directed by Congress to police the derivatives markets, which includes futures, options, and swaps. The CFTC also has continued its effort to implement the new regulatory framework for the swaps market required under Dodd-Frank.

The operation and integrity of the derivatives markets are critical to the efficient functioning of the global financial system and the economies it supports. Without them, a farmer cannot lock in a price for his crop; a small business cannot lock in an interest rate that would otherwise fluctuate, perhaps raising its costs; a global manufacturer cannot lock in a currency value, making it harder to plan and grow its global business; and a lender cannot manage its assets and balance sheet to ensure it can continue lending. The derivatives markets better enable these enterprises to do what they do best—create jobs and grow the economy.

When not overseen properly, failures of firms or other irregularities in the markets can severely and negatively impact the economy and cause dramatic losses for individual participants. This is why appropriately funding the Commission is so important.

CFTC RESPONSIBILITIES

Measured in percentage terms, the Commission's funding level today is substantially larger than it was through much of the last decade. Previous funding increases were necessary and appreciated. Nonetheless, the growth of the Commission's responsibilities, including under Dodd-Frank, have significantly outpaced the growth in the agency's budget. Consequently, today the Commission is underfunded.

The markets the Commission oversees and the agency's related responsibilities have grown by a variety of different measures. For instance, the notional value of derivatives centrally cleared by clearinghouses was estimated to be $124 trillion in 2010 and is now approximately $223 trillion. That is nearly a 100 percent increase.

Now more than ever, a clearinghouse's failure to follow the Commission's regulations—designed to ensure proper risk management—could have significant consequences to the economy. The amount of customer funds managed by clearinghouses and futures commission merchants was $177 billion in 2010 and is now over $218 billion, a nearly 40 percent increase.

The Commission's rules are designed to ensure customer funds are safely kept by these firms, and a failure to provide appropriate oversight increases the chance of risky practices, placing customer funds at risk.

By one measure, the total number of registrants and registered entities overseen directly by the Commission has increased by at least 40 percent in the last 4 years. This includes 102 swap dealers, two major swap participants, and more than three dozen registered entities, which include clearinghouses and trading venues.

The CFTC also oversees more than 4,000 advisers and operators of managed funds, some of which have significant outward exposures across financial markets. Additionally, the Commission directly or indirectly supervises approximately another 64,000 registrants, yet the agency's current onboard staff is just 648 employees.

The registered entities the Commission oversees are, by and large, well-run firms that perform important services for their customers. Nevertheless, those relying upon them, as well as the American public, deserve assurance that the risks the firms pose are being mitigated by an agency capable of meaningful oversight.

FISCAL YEAR 2015 REQUEST PRIORITIES

This year's budget request is a significant step towards a longer-term funding level that is necessary to fully and responsibly fulfill the agency's mission. It recognizes the immediate need for an appropriation of $280 million and approximately 920 full-time equivalents, which is heavily weighted toward examinations, surveillance, and technology functions. The request balances the need for more technological tools to monitor the markets, detect fraud and abuse, and identify risk and compliance issues with the need for expert staff to analyze and make use of the data.

PREPARED STATEMENT

Without additional funding, the consequences are plain: the Commission will be forced to perform fewer and less thorough examinations of registered entities, including those deemed systemically important or that steward customer funds; it will be less able to develop analytical systems to effectively perform surveillance of markets becoming increasingly automated; it will be deterred in its mandate to collect and analyze swaps data in an effort to enhance market transparency; and it will be less able to timely investigate and prosecute enforcement cases to address customer harm or threats to market integrity.

Thank you for inviting me today, and I will be happy to answer any questions.

[The statement follows:]

PREPARED STATEMENT OF HON. MARK P. WETJEN

Good afternoon, Chairman Udall, Ranking Member Johanns and members of the subcommittee. Thank you for inviting me to today's hearing on the President's fiscal year 2015 funding request and budget justification for the Commodity Futures Trading Commission ("Commission" or "CFTC").

During the last 2 years, despite significant budgetary constraints, the CFTC has made important progress in fulfilling its mission. As you know, under the Commodity Exchange Act, the Commission has oversight responsibilities for the derivatives markets, which include futures, options, cash, and swaps. Each of these markets is significant. Collectively, they have taken on particular importance to the U.S. economy in recent decades and, as a consequence, have grown substantially in size, measuring hundreds of trillions of dollars in notional value. Their operation and integrity are critical to the effective functioning of the U.S. and global economies.

At their core, the derivatives markets exist to help farmers, producers, small businesses, manufacturers and lenders focus on what they do best: providing goods and services and allocating capital to reduce risk and meet Main Street demand. Well-regulated derivatives markets facilitate job creation and the growth of the economy by providing a means for managing and assuming prices risks and broadly disseminating, and discovering, pricing information.

Stated more simply, through the derivatives marketplace, a farmer can lock in a price for his crop; a small business can lock in an interest rate that would otherwise fluctuate, perhaps raising its costs; a global manufacturer can lock in a currency value, allowing it to better plan and grow its global business; and a lender can manage its assets and balance sheet to ensure it can continue lending, fueling the economy in the process.

Essentially, these complex markets facilitate the assumption and distribution of risk throughout the financial system. Well-working derivatives markets are key to supporting a strong, growing economy by enabling the efficient transfer of risk, and therefore the efficient production of goods and services. Accordingly, it is critical that these markets are subject to appropriate governmental oversight.

Mr. Chairman, Ranking Member, and subommittee members, I do not intend the testimony that follows to sound alarmist, or to overstate the case for additional resources, but I do want to be sure that Congress, and this subcommittee in particular, have a clear picture of the potential risks posed by the continued state of funding for the agency. When not overseen properly, the derivatives markets may experience irregularities or failures of firms intermediating in them—events that can severely and negatively impact the economy as a whole and cause dramatic losses for individual participants. The stakes, therefore, are high.

THE CFTC'S RESPONSIBILITIES HAVE GROWN SUBSTANTIALLY IN RECENT YEARS

The unfortunate reality is that, at current funding levels, the Commission is unable to adequately fulfill the mission given to it by Congress: to prevent disruptions to market integrity, protect customer assets, monitor and reduce the build-up of systemic risk, and ensure to the greatest extent possible that the derivatives markets are free of fraud and manipulation.

Recent increases in the agency's funding have been essential and appreciated. They have not, however, kept pace with the growth of the Commission's responsibilities, including those given to it under Dodd-Frank.

Various statistics have been used to measure this increase in responsibilities. One often-cited measure is the increase in the gross notional size of the marketplace now under the Commission's oversight. Other measures, though, are equally and perhaps more illustrative.

TRADING VOLUME HAS INCREASED

For instance, the trading volume of CFTC-regulated futures and options contracts was 3,060 million contracts in 2010 and rose to 3,477 million in 2013. Similarly, the volume of interest rate swap trading activity by the 15 largest dealers averaged 249,564 swap events each in 2010, and by 2012, averaged 332,484 each (according to the International Swaps and Derivatives Association ("ISDA") data). Those transactions, moreover, can be executed in significantly more trading venues, and types of trading venues, both here and abroad. In addition, the complexity of the markets—its products and sophistication of the market tools, such as automated-trading techniques—has increased greatly over the years.

CLEARING HOUSES MANAGE MORE RISK

The notional value of derivatives centrally cleared by clearing houses was $124 trillion in 2010 (according to ISDA data), and is now approximately $223 trillion (according to CFTC data from swap data repositories ("SDRs")). That is nearly a 100 percent increase. The expanded use of clearinghouses is significant in this context because, among other things, it means that the Commission must ensure through appropriate oversight that these entities continue to properly manage the various types of risks that are incident to a market structure dependent on central clearing. A clearinghouse's failure to adhere to rigorous risk management practices established by the Commission's regulations, now more than ever, could have significant economic consequences. The Commission directly oversees 15 registered clearinghouses and two of them, Chicago Mercantile Exchange, Inc., and ICE Clear Credit LLC, have been designated as systemically important by the Financial Stability Oversight Council.

CLEARING HOUSES AND INTERMEDIARIES MANAGE MORE CUSTOMER FUNDS

The amount of customer funds held by clearinghouses and futures commission merchants ("FCMs") was $177 billion in 2010 and is now over $218 billion, another substantial increase. These are customer funds in the form of cash and securities deposited at firms to be used for margin payments made by the end-users of the markets, like farmers, to support their trading activities. Again, Commission rules are designed to ensure customer funds are safely kept by these market intermediaries, and a failure to provide the proper level of oversight increases the risk of certain practices by firms, including operational risks or fraud. In fact, recent events in the FCM community led to the temporary or permanent loss of more than a billion dollars of customer funds.

SUBSTANTIALLY LARGER NUMBER OF FIRMS NOW REGISTERED WITH THE CFTC

The total number of registrants and registered entities overseen directly or indirectly by the Commission, depending on the measure, has increased by at least 40 percent in the last 4 years. This includes 102 swap dealers and two major swap participants ("MSPs").

In addition, the CFTC oversees more than 4,000 advisers and operators of managed funds, some of which have significant outward exposures in and across multiple markets. It is conceivable that the failure of some of these funds could have spill-over effects on the financial system. In all cases, investors in these funds are entitled to know their money is being appropriately held and invested.

Additionally, the Commission directly or indirectly supervises another approximately 64,000 registrants, mostly associated persons that solicit or accept customer orders or participate in certain managed funds, or that invest customer funds through discretionary accounts. Although it leverages the resources of the self-regulatory organizations ("SROs"), the Commission itself must oversee these registrants in certain areas and provide guidance and interpretations to the SROs. The Commission does so with a total staff of only 648 employees currently onboard—about 1 percent of the number of registrants under its purview. Separately, the Commission must oversee more than three dozen registered entities, including clearinghouses and trading venues, each of which is subject to a complex set of regulatory requirements newly established or modified by the Dodd-Frank Act and designed to mitigate systemic risk.

By almost any measure, in fact, the portfolio of entities that the Commission is charged with overseeing has expanded dramatically in size and risk over the last half decade. The intermediaries in the derivatives markets are by and large well-run firms that perform important services in the markets and for their customers. Nevertheless, collectively, these firms can potentially pose risks—in some cases significant risks—to the financial system and the broader economy. Accordingly, those relying upon these firms and the public deserve assurance that such firms are supervised by an agency capable of meaningful oversight.

THE CFTC HAS MADE IMPORTANT PROGRESS BUT HAS BEEN SIGNIFICANTLY CONSTRAINED

For much of fiscal year 2013, the CFTC operated under continuing resolutions, which extended the fiscal year 2012 appropriation of $205 million. These appropriations, however, were subject to sequestration. Effectively, our operating budget for fiscal year 2013 was $195 million. Thus, the fiscal year 2014 appropriation of $215 million was a modest budgetary increase for the Commission, lifting the agency's appropriations above the sequestration level of $195 million that has posed signifi-

cant challenges for the agency's orderly operation. As directed by Congress, the agency has submitted a fiscal year 2014 Spend Plan outlining its allocation of current resources, which reflects an increased emphasis on examinations and technology-related staff.

Even with these significant budget constraints, the dedicated staff of the Commission were able to complete the majority of new rulemakings required by the Dodd-Frank Act—about 50 rulemakings in all. This was in addition to the Commission's ongoing work overseeing the futures exchange and options markets. These regulatory efforts resulted in greater transparency, which is critical to reducing systemic risk and lowering costs to end-users, while improving efficiency and supporting competition.

With regard to technology, we made progress in a variety of areas. We improved the quality of data reported to swap data repositories and have laid groundwork to receive, analyze and promulgate new datasets from SROs related to new authorities. We upgraded data analytics platforms to keep up with market growth. Financial risk surveillance tools were enhanced to support monitoring and stress testing related to new authorities. The Commission has prototyped a high-performance computing platform that dramatically reduces data analytics computation times and an on-line portal for regulatory business transactions to improve staff and industry productivity. The Commission has implemented enhanced position limit monitoring and is ready to implement pre-trade and heightened account ownership and control surveillance. Finally, the Commission has ensured that foundational server, storage, networking, and workstation technology are refreshed on a cost-effective cycle and that technology investments have cybersecurity and business continuity built-in.

In its role as a law enforcement agency, the Commission's enforcement arm protects market participants and other members of the public from fraud, manipulation and other abusive practices in the futures, options, cash, and swaps markets, and prosecutes those who engage in such conduct. As of May 1, 2014, the Commission filed 31 enforcement actions in fiscal year 2014 and also obtained orders imposing more than $2.2 billion in sanctions. By way of comparison, in fiscal year 2013, the Commission filed 82 enforcement actions, and obtained orders imposing more than $1.7 billion in sanctions.

With the bulk of rulemaking behind us, the necessary focus must be examinations, market supervision and enforcement. Simply stated, this requires appropriate staffing and technological resources sufficiently robust to oversee what are highly advanced, complex global markets, and be able to take effective and timely enforcement action.

THE FISCAL YEAR 2015 REQUEST PRIORITIZES EXAMINATIONS, TECHNOLOGY, MARKET INTEGRITY, AND ENFORCEMENT

The President's fiscal year 2015 budget request reflects these priorities and highlights both the importance of the Commission's mission and the potential effects of continuing to operate under difficult budgetary constraints.

The request is a significant step towards the longer-term funding level that is necessary to fully and responsibly fulfill the agency's core mission: protecting the safety and integrity of the derivatives markets. It recognizes the immediate need for an appropriation of $280 million and approximately 920 staff years full-time equivalents ("FTEs") for the agency, an increase of $65 million and 253 FTEs over the fiscal year 2014 levels, heavily weighted towards examinations, surveillance, and technology functions.

In this regard, the request balances the need for more technological tools to monitor the markets, detect fraud and manipulation, and identify risk and compliance issues, with the need for staff with the requisite expertise to analyze the data collected through technology and determine how to use the results of that analysis to fulfill the Commission's mission as the regulator of the derivatives markets. Both are essential to carrying out the agency's mandate. Technology, after all, is an important means for the agency to effectively carry out critical oversight work; it is not an end in itself.

In light of technological developments in the markets today, the agency has committed to an increased focus on technology. The fiscal year 2015 budget request includes a $15 million increase in technology funding above the fiscal year 2014 appropriation, or about a 42 percent increase, solely for IT investments.

In my remaining testimony, I will review three of the primary mission priorities for fiscal year 2015.

EXAMINATIONS

The President's request would provide $38 million and 158 FTEs for examinations, which also covers the compliance activities of the Commission. As compared to fiscal year 2014, this request is an increase of $15 million and 63 FTEs.

I noted earlier that the Commission has seen substantial growth in, among other things, trading volumes, customer funds held by intermediaries in the derivatives markets, and margin and risk held by clearinghouses. Examinations and regulatory compliance oversight are perhaps the best deterrents to fraud and improper or insufficient risk management and, as such, remain essential to compliance with the Commission's customer protection and risk management rules.

The Commission has a direct examinations program for clearinghouses and designated contract markets, and it will soon directly examine swap execution facilities and SDRs. However, the agency does not at this time have the resources to place full-time staff on site at these registered entities, even systemically-important clearing organizations, unlike a number of other financial regulators that have on-the-ground staff at the significant firms they oversee. The Divisions of Market Oversight and Clearing and Risk collectively have a total of 47 examinations positions in fiscal year 2014 to monitor, review, and report on some of the most complex financial market operations in the world.

The Commission today performs only high-level, limited-scope reviews of the nearly 100 FCMs holding over $218 billion in customer funds and 102 swap dealers. In fact, the Commission currently has a staff of only 38 to examine these firms, and to review and analyze, among other things, over 1,200 financial filings and over 2,400 regulatory notices each year. This staff level is less than the number the Commission had in 2010, yet the number of firms requiring its attention has almost doubled, and there has been a noted increase in the complexity and risk profile of the firms. Additionally, although it has begun legal compliance oversight of swap dealers and MSPs, the Commission has been able to allocate only 13 FTEs for this purpose. This number is insufficient to perform the necessary level of oversight of the newly registered swap dealer entities.

In fiscal year 2014, the Commission overall will have a mere 95 staff positions dedicated to examinations of the thousands of different registrants that should be subject to thorough oversight and examinations. The reality is that the agency has fallen far short of performance goals for its examinations activities, and it will continue to do so in the absence of additional funding from Congress. For example, as detailed in the Annual Performance Review for fiscal year 2013, the Commission failed to meet performance targets for system safeguard examinations and for conducting direct examinations of FCM and non-FCM intermediaries. The President's budget request appropriately calls on Congress to bolster the examinations function at the agency, and it would protect the public, and money deposited by customers, by enhancing the examinations program staff by more than 66 percent in fiscal year 2015.

Moreover, if Congress fully funds the President's request, the Commission can move toward annual reviews of all significant clearinghouses and trading platforms and perform more effective monitoring of market participants and intermediaries. Partially funding the request will mean accepting potentially avoidable risk in the derivatives markets as the Commission is forced to forego more in-depth financial, operational and risk reviews of the firms within its jurisdiction. Thus, the Commission would be reactive, rather than proactive in regard to firm or industry risk issues.

TECHNOLOGY AND MARKET INTEGRITY

The fiscal year 2015 request also supports a substantial increase in technology investments relative to fiscal year 2014, roughly a 42 percent increase. The $50 million investment in technology will provide millions of dollars for new and sophisticated analytical systems that will, in part, assist the Commission in its efforts to ensure market integrity. As global markets have moved almost entirely to electronic systems, the Commission must invest in technology required to collect and analyze market data, and to handle the unprecedented volumes of transaction-level data provided by financial markets.

The President's fiscal year 2015 budget request supports, in addition, 103 data-analytics and surveillance-related positions in the Division of Market Oversight alone, an increase of more than 98 percent over the fiscal year 2014 staffing levels. Market surveillance is a core Commission mission, and it is an area that depends heavily on technology. As trading across the world has moved almost entirely to electronic systems, the Commission must make the technology investments required

to collect and make sense of market data and handle the unprecedented volumes of transaction-level data provided by financial markets.

Effective market surveillance, though, equally depends on the Commission's ability to hire and retain experienced market professionals who can analyze extremely complex and voluminous data from multiple trading markets and develop sophisticated analytics and models to respond to and identify trading activity that warrants investigation. The fiscal year 2015 investment in high-performance hardware and software therefore must be paired with investments in personnel that can employ technology investments effectively.

Accordingly, to make use of existing and new IT investments, the fiscal year 2015 request would provide funding for 193 FTEs, an increase of 74 FTEs over fiscal year 2014. These new staff positions are necessary for the Commission to receive, analyze, and effectively surveil the markets it oversees. These new positions, together with the technology investments included in the fiscal year 2015 request, will enable the Commission to make market surveillance a core component of our mission.

The CFTC has invested appropriated funds in fiscal year 2013 and fiscal year 2014 in technology to make important progress. We have the groundwork in place to receive and effectively analyze swaps transaction data submitted to repositories and SROs related to new authorities. The fiscal year 2015 request would provide funding to continue and increase the pace of progress in the areas noted above and also support the additional examination, enforcement, and economic and legal staff. Effective use of technology is essential to our mission to ensure market integrity, promote transparency, and effectively surveil market participants.

ENFORCEMENT

The President's fiscal year 2015 request would provide $62 million and 200 FTEs for enforcement, an increase of $16 million and 51 FTEs over fiscal year 2014. The simple fact is that, without a robust, effective enforcement program, the Commission cannot fulfill its mandate to ensure a fair playing field. From fiscal year 2011 to date, the Commission has filed 314 enforcement actions and also obtained orders imposing more than $5.4 billion in sanctions.

The cases the agency pursues range from sophisticated manipulative and disruptive trading schemes in markets the Commission regulates, including financial instruments, oil, gas, precious metals and agricultural products, to quick strike actions against Ponzi schemes that victimize investors. The agency also is engaged in complex litigations related to issues of financial market integrity and customer protection. By way of example, in fiscal year 2013, the CFTC filed and settled charges against three financial institutions for engaging in manipulation, attempted manipulation and false reporting of London Interbank Offered Rate (LIBOR) and other benchmark interest rates.

Such investigations continue to be a significant and important part of the Division of Enforcement's docket. Preventing manipulation is critical to the Commission's mission to help protect taxpayers and the markets, but manipulation investigations, in particular, strain resources and time. And once a case is filed, the priority must shift to the litigation. In addition to requiring significant time and resources at the Commission, litigation requires additional resources, such as the retention of costly expert witnesses.

In 2002, when the Commission was responsible for the futures and options markets alone, the Division of Enforcement had approximately 154 people. Today, the agency's responsibilities have substantially increased. The CFTC now also has anti-fraud and anti-manipulation authority over the vast swaps market and the host of new market participants the agency now oversees. In addition, the agency is now responsible for pursuing cases under our enhanced Dodd-Frank authority that prohibits the reckless use of manipulative or deceptive schemes. Notwithstanding these additional responsibilities, however, total enforcement staff has shrunk—there are currently only 147 members of the enforcement staff. The President's budget request would bring this number to 200. More cops on the beat means the public is better assured that the rules of the road are being followed.

In addition to the need for additional enforcement staff and resources, the CFTC also believes technology investments will make our enforcement staff more efficient. For instance, the fiscal year 2015 request would support developing and enhancing forensic analysis and case management capabilities to assist in the development of analytical evidence for enforcement cases. In fiscal year 2013 and fiscal year 2014, appropriated funds invested in information technology have enabled the Commission to continue enhancing enforcement and litigation automation services, including a major upgrade to the document and digital evidence review platform that will

enable staff to keep pace with the exploding volume of data required to successfully conduct enforcement actions.

A full increase for enforcement means that the agency can pursue more investigations and better protect the public and the markets. A less than full increase means that the CFTC will continue to face difficult choices about how to use its limited enforcement resources. At this point, it is not clear that the agency could maintain the current volume and types of cases, as well as ensure timely responses to market events.

OTHER FISCAL YEAR 2015 PRIORITIES: INTERNATIONAL POLICY COORDINATION & ECONOMIC AND LEGAL ANALYSIS

The global nature of the derivatives markets makes it imperative that the United States consult and coordinate with international authorities. For example, the Commission recently announced significant progress towards harmonizing a regulatory framework for CFTC-regulated Swap Execution Facilitys (SEFs) and EU-regulated multilateral trading facilities ("MTFs"). The Commission is working internationally to promote robust and consistent standards, to avoid or minimize potentially conflicting or duplicative requirements, and to engage in cooperative supervision, wherever possible.

Over the past 2 years, the CFTC, SEC, European Commission, European Securities and Markets Authority, and other market regulators from around the globe have been meeting regularly to discuss and resolve issues with the goal of harmonizing financial reform. The Commission also participates in numerous international working groups regarding derivatives. The Commission's international efforts directly support global consistency in the oversight of the derivatives markets. In addition, the Commission anticipates a significant need for ongoing international policy coordination related to both market participants and infrastructure in the swaps markets. The Commission also anticipates a need for ongoing international work and coordination in the development of data and reporting standards under Dodd-Frank rules. Dodd-Frank further provided a framework for foreign trading platforms to seek registration as foreign boards of trade, and 24 applications have been submitted so far.

Full funding for international policy means the Commission will be able to maintain our coordination efforts with financial regulators and market participants from around the globe. If available funding is decreased, we will be less able to engage in cooperative work with our international counterparts, respond to requests, and provide staffing for various standard-setting projects. The President's fiscal year 2015 request would enable the Commission to sustain its efforts, providing $4.2 million and 15 FTEs that would be dedicated to international policy.

In addition, for fiscal year 2015, the President's budget would support $24 million and 92 FTEs to invest in robust economic analysis teams and Commission-wide legal analysis. Compared to the fiscal year 2014 Spending Plan, this request is an increase of $4 million and 18 FTEs. Both of these teams support all of the Commission's divisions.

The CFTC's economists analyze innovations in trading technology, developments in trading instruments and market structure, and interactions among various market participants in the futures and swaps markets. Economics staff with particular expertise and experience provides leverage to dedicated staff in other divisions to anticipate and address significant regulatory, surveillance, clearing, and enforcement challenges. Economic analysis plays an integral role in the development, implementation, and review of financial regulations to ensure that the regulations are economically sound and subjected to a careful consideration of potential costs and benefits. Economic analysis also is critical to the public transparency initiatives of the Commission, such as the Weekly Swaps Report. Moving into fiscal year 2015, the CFTC's economists will be working to integrate large quantities of swaps market data with data from designated contract markets and swap execution facilities, and large swaps and futures position data to provide a more comprehensive view of the derivatives markets.

The legal analysis team provides interpretations of Commission statutory and regulatory authority and, where appropriate, provides exemptive, interpretive, and no-action letters to CFTC registrants and market participants. In fiscal year 2013, the Commission experienced a significant increase in the number and complexity of requests from market participants for written interpretations and no-action letters, and this trend is expected to increase into fiscal year 2015.

A full increase for the economics and legal analysis mission means the Commission will be able to support each of the CFTC's divisions with economic and legal analysis. Funding short of this full increase or flat funding means an increasingly

strained ability to integrate and analyze vast amounts of data the Commission is receiving on the derivatives markets, thus impacting our ability to study and detect problems that could be detrimental to the economy. Flat funding also means the Commission's legal analysis team will continue to be constrained in supporting front-line examinations, adding to the delays in responding to market participants and processing applications, and hampering the team's ability to support enforcement efforts.

CONCLUSION

Effective oversight of the futures and swaps markets requires additional resources for the Commission. This means investing in both personnel and information technology. We need staff to analyze the vast amounts of data we are receiving on the swaps and futures markets. We need staff to regularly examine firms, clearinghouses, trade repositories, and trading platforms. We need staff to bring enforcement actions against perpetrators of fraud and manipulation. The agency's ability to appropriately oversee the marketplace hinges on securing additional resources.

Thank you again for inviting me today, and I look forward to your questions.

Senator UDALL. Thank you both for your testimony.

And we will now proceed on 7-minute rounds of questions.

CFTC MISSION ACTIVITIES

Chairman Wetjen, the CFTC's budget justification submitted to the committee suggests that the fiscal year 2015 request, and I quote from that budget justification, "A significant step towards the longer-term funding level that is necessary to fully and responsibly fulfill the agency's core mission."

What do you consider to be the optimum funding level necessary for the CFTC to fully and responsibly perform its work? What functions would the CFTC not be able to adequately address if the funding level enacted for 2015 is less than the full $280 million requested?

Mr. WETJEN. Thank you, Chairman, for the question.

This request is especially focused on three key areas for the agency and with regard to the agency's mission. The key mission activities are enforcement, surveillance, and examinations. And as I just said in my opening statement, we are not going to be able to do as much as we should, I believe, in each of those three key areas.

So we are not going to be able to do as many examinations of some of these critical entities and intermediaries in our marketplace. I mentioned clearinghouses. There is a tremendous and enormous amount of risk that is now being housed at clearinghouses. That has increased quite substantially in recent years. We have 15 clearinghouses under our jurisdiction, and we are able to annually examine 2 of them which have been deemed systemically important.

We have, with current staffing, been able to get around to some of the other clearinghouses as well, but we are not in a position with the current staffing to examine all 15 of those on a regular basis. So the staff has been forced to make judgments about which clearinghouse might be a little more risky than others and focus attention in that way. And I think ideally—again, just focusing on the category of clearinghouses—you would have examinations of all of them on an annual basis.

Senator UDALL. How about the optimum level? Do you have a thought on that?

Mr. WETJEN. Well, the $280 million request I think gets us very, very close to optimal, based on my judgment. The request this year is slightly below what was asked for last year.

Primarily that was because we wanted to be respectful of the direction the Congress gave us in passing the budget resolution, which called for a very modest increase in overall discretionary spending. So in light of that, it seemed appropriate to adjust the request this year accordingly.

Senator UDALL. Thank you.

Chair White, the SEC is seeking $1.7 billion for fiscal year 2015. This would be a 26 percent increase in resources compared to the level enacted for the current year.

KEY PRIORITIES FOR THE SEC

What are the top priorities to which these additional resources will be devoted? What consequences can be expected if the funding level approved for the SEC is less than the amount requested by the President?

Ms. WHITE. The priorities are to fund our exam program, our enforcement program, our—really, our core areas, including our Division of Economic and Risk Analysis.

IMPORTANCE OF SUFFICIENT SEC FUNDING

I don't think we can overstate the importance of sufficient funding, what we request in this budget request, for technology. We are at a critical juncture at the SEC with a number of our systems enhancements, a number of our risk-based tools that allow us to be smarter and more efficient in detecting problems in the marketplace, including emerging frauds.

Just as an illustration, I alluded to this in my oral testimony as well—there are 11,000 registered investment advisers now under the SEC's jurisdiction. And under current levels, we were only able to cover 9 percent of those last year. And that is using very smart, targeted, risk-based tools to go to the areas where we think the highest risk is.

But there are 40 percent of those investment advisers who have not been examined. So that is a very, very high priority for us, as it was in the 2014 request, but we did not actually receive funding for that.

Strong enforcement of our Federal securities laws is always at the top of our highest priority list, along with others. And this budget request does seek 126 additional enforcement staff, including market experts, which I think is enormously important to do our job better and more efficiently.

So if we were not to receive funding at that level, clearly all of our functions really across the board would suffer. I have tried to illustrate the areas of greatest need, and certainly our request is intended to be quite targeted and surgical to those core needs.

We obviously have the new responsibilities that you alluded to in your opening remarks to implement the reforms in the over-the-counter securities-based swap markets. We have new advisers we are responsible for. All of that needs to be implemented as well as, obviously, the rules put in place.

WALL STREET REFORMS

Senator UDALL. Thank you.

In a couple of months, we will mark the fourth anniversary of the enactment of comprehensive Wall Street reforms aimed at strengthening the oversight in the wake of the financial crisis of 2008. And recent analysis by outside monitoring entities reflect that of the 398 total rulemakings required under Dodd-Frank, 95—24 percent—are under the jurisdiction of the SEC, and 60—15 percent—are under the jurisdiction of the CFTC.

A report by Davis Polk analysts issued last month indicates that of the 95 rules under the SEC, 42—that is 44 percent—had been finalized, and 10—11 percent—have not yet been proposed. Of the 60 CFTC rules, 50—83 percent—have been finalized, and 3—5 percent—have not yet been proposed.

Both of you, I am interested in hearing how the independent progress reports square with your agency's own internal tracking of your implementation timetable. I think the best thing for me to do is come back to that question, let Senator Johanns question, because I have a couple of additional questions on that. And if you can keep that in mind, I may end up repeating some of that.

Senator Johanns, I am going to go to you for questioning at this point.

BUDGET INCREASE REQUEST

Senator JOHANNS. Thank you, Mr. Chairman.

Chairman Wetjen, let me get started with you. If you look at the Budget Control Act and then the Ryan-Murray agreement that was reached last fall after, as you know, some very, very difficult negotiations, total discretionary spending is due to increase this year by about $1.4 billion—or in the next budget year, I should say. That is less than 1 percent increase over last year.

So I think the bipartisan message sent to everybody is that this is going to be very tight, very challenging, very difficult. However, in the budget request we get from CFTC, you are asking for a 30 percent increase.

Now, I think by anybody's definition that is significant. But it is especially high when you recognize what everybody else is faced with across the Federal Government.

So I would ask you a couple questions. One is how do you justify it, recognizing that colleagues across the Federal Government with very important missions like yours are also going to be held to this agreement?

And then, second, what if it doesn't happen? Do you have contingency plans as to how you will deal with that and how you will get your budget in line with what the Ryan-Murray agreement calls for?

Mr. WETJEN. Thank you, Senator, for the question.

The request was based on a number of different factors. But first and foremost, what are we responsible for doing under the law? And again, I will go back to the three key areas of our agency's mission—enforcement, surveillance, and examinations.

Those are the key mission activities. But meanwhile, the number of entities we oversee has increased by a variety of different meas-

ures that I just recently went through in percentage terms that are even higher than the percentage increase we sought with our budget request this year.

And so, I think our first responsibility—or my first responsibility in my capacity at the moment is trying to make my best judgment and best case for the kind of funding we need to make sure we are complying with the law. And so, that formed the basis of this.

And as I said before, we recognize the passage of the budget agreement last year, and so we tried to be more modest this year in the request. But we have to make sure that we are executing on these key mission activities. Otherwise, I worry that we are not fulfilling our responsibilities to the American public.

There is quite a bit at stake. As I tried to lay out in my testimony, there are enormous amounts of risk being managed by the firms that we oversee. That is why we have fulsome rule sets that they are required to comply with. It is primarily for that purpose, to make sure they are managing risk in an appropriate way.

And unfortunately, we have seen over the past number of years the sorts of outcomes that can happen when they fail to do that or when they fail to follow our rules. So that is the basis for the request.

Your second—remind me again, Senator, the second part of your question.

Senator JOHANNS. The second part of the question is what if you don't get there? How are you going to——

Mr. WETJEN. Right.

Senator JOHANNS [continuing]. Describe for us how you are going to deal with that if your argument isn't adopted and your request isn't granted?

Mr. WETJEN. Well, I think we will have to continue doing—we would be forced to continue doing what we have been doing. And that is using our best judgment about which entities to examine, which ones we are going to have to take a pass on in a particular year, make judgments about which matters to pursue by way of investigations once some incident comes to light, whether by referral from another division within the agency or through some other way outside of the agency. Judgments will be have to made there—be made there.

And as far as those cases that are already under development, enforcement cases under development, again, judgments will have to be made about how to allocate resources. Do we devote more to some cases based on, you know, certain risks of success or risk of not succeeding, and so it might involve an assessment of litigation risk in that way.

So these are the sort of judgments you prefer not to have to make, given the responsibilities we have been given under the law.

TECHNOLOGY SPENDING

Senator JOHANNS. In this general vein, let me ask a question about the technology piece of your budget.

CFTC technology spending has grown less than 7 percent since fiscal year 2011. The overall budget is up by 12 percent during that same period of time. My concern is that the CFTC is operating

with Selectric typewriters while the industry is operating with the latest technology, and I just worry that you are getting behind.

It seems to me that what we are trying to achieve with your agency is a faster, more technological advanced agency than we have today that can keep up with what is going on in the marketplace. Not necessarily a bigger agency. Bigger doesn't necessarily solve the problems that you are dealing with out there.

So tell us why the Commission has, it seems to me, downplayed technology investment while spending in other areas of the budget. It would seem to me technology would be critical for you to keep up.

Mr. WETJEN. Sir, you are absolutely right. It is critical. And by no means should this year's request be viewed as downplaying the importance of technology. It is critically important.

But what we have had to do, again, is given the fact that there are finite resources and trying to be responsible in our request and in light of other responsibilities of the agency, we just had to make a judgment about how much is appropriate to allocate to technology spending right now and how much is appropriate to spend on these other important mission activities.

And as important as technology is, we still need human capital to use it and deploy it. And as important as technology is, we need to be doing our level best on these key functions such as examinations.

And I hate to beat this drum continually, but these entities that we oversee are critically important, and the amount of risk that they house is very, very significant. And some of these intermediaries also manage billions and billions of dollars of customer money, and we have seen instances of FCMs, they are called, fail in the last number of years.

And in the case of MF Global, we had more than $1.5 billion tied up in a bankruptcy proceeding. Now there is a variety of different reasons why MF Global failed, but the point is oversight is important, and the rules we have are designed to prevent that sort of incident from taking place.

So $50 million is a slight increase, as you said, above where we have been spending currently. I would like to spend much more than that. But in the context of an overall budget request that has limitations, that was my best judgment about where we should be in the short term.

Senator JOHANNS. Mr. Chairman, I will yield back to you. And I anticipate another round?

Senator UDALL. Yes, yes. Of course. Thank you, Senator Johanns.

STATUS OF MANDATORY RULEMAKING

I outlined a little bit on that Davis Polk analysis and the numbers there. And going back to that question, how the independent progress report squares with your agency's own internal tracking of your implementation timetable. Yes? For both of you.

Ms. WHITE. Essentially, yes, whether the particulars match up precisely, essentially, they do. I mean, the SEC, as you mentioned in your opening remarks, was given nearly 100 rulemakings by

Dodd-Frank, and then some additional ones under mandated rulemakings and then additional ones under the JOBS Act.

And I did from the beginning of my tenure and continue to prioritize the completion of those rulemakings under both Dodd-Frank and the JOBS Act. And I am pleased with the progress. We have proposed or adopted about over 80 percent, but we clearly have a ways to go.

Among those that we have adopted and proposed since I have been at the agency for about a year now, I think there are 20-quite significant ones. Among those adopted, the Volcker rule is obviously one of them. The bad actor rule, which is very important to investors, specifies that certain offerings should not be exempt if they are associated with bad actors.

We have proposed all of the title VII rulemakings under our jurisdiction and adopted some. It is a very high priority for 2014 for us to complete those. We have adopted the municipal advisors rule. A number of others have been adopted. And again, we have completed nearly all the mandated studies that were assigned to us under Dodd-Frank.

It is very important that these rulemakings are done, obviously, promptly—and that is certainly one of my commitments and one of the commitments I made at my confirmation—but also to be done well and to be done after careful and appropriate economic analysis. And so, you know, we are all very closely focused as one of our highest priorities on completing those mandated rulemakings under the Dodd-Frank Act and under the JOBS Act.

STAFFING EXPERTISE

Senator UDALL. Do you feel you have the necessary expertise on staff to adequately issue and enforce the rules required by Dodd-Frank?

Ms. WHITE. I think we have the necessary expertise on staff. Obviously, some of our rulemakings are also done jointly or in consultation with our fellow regulators, both domestically and internationally.

But you make an excellent point, which is what we are talking about is not just adopting those robust, strong rules, but also then implementing them following their adoption. And that is one of my significant resource concerns, that we actually do have the resources to adequately and robustly implement and enforce those rules once they are adopted.

Senator UDALL. And do you have staffing plans adapted to bring on more expertise in areas that contributed to the financial crisis?

Ms. WHITE. Again, a very high priority of mine since I began was to bring on more experts, including economists. So you will see that prioritized in our budget again this year as it was last year with expertise certainly in areas that were involved in the financial crisis and also in modern-day issues with respect to our equity market structure.

And we have done that in the enforcement space as well. So there is full understanding of the rules we are enforcing with the requisite expertise. And that is one of the very important things that we are seeking the funding for in this budget request.

RULEMAKING

Senator UDALL. Chair Wetjen, how are you coming on the rules that you are promulgating, the ones that are in the pipeline? Does it square pretty much with the independent analysts, or do you take issue with their numbers?

Mr. WETJEN. No, I believe it does. The primary rulemakings that come to mind when I think about those that we were required to do under Dodd-Frank but have not yet finalized, it is the rulemaking for margin requirements for uncleared swaps, capital requirements for those firms entering into uncleared swaps, and then the third one would be a final rule on position limits, another rulemaking required under Dodd-Frank.

So I believe that Davis Polk study had the same count—they might have mentioned one more, I believe you said. But those are the three that I think of in terms of unfinished business.

On position limits, we proposed a rule there last fall. So staff is working on the common file, creating a response to that proposal.

On the other two, staff is working on a re-proposal. Those were rulemakings that were actually proposed a couple of years ago. But in light of significant international work done through the auspices of a number of different key international organizations, the decision was made to actually re-propose the rule, those two rules. And so, we hope to have something in circulation for the Commission very, very soon on those two.

Senator UDALL. Now how would you characterize the efforts to harmonize rules among multiple regulators? Why don't you take a stab at that.

Mr. WETJEN. Thank you sir.

It is difficult. It is—everyone has their own responsibilities and obligations to their own country and to their own legislative bodies. But there has been considerable effort through some of these same international organizations I mentioned. The International Organization of Securities Commissions (IOSCO) is a key one that comes to mind.

There is another group that was formed specifically related to derivatives reforms, the OTC Derivatives Regulators Group (ODRG) it is called. And so, those groups meet on a regular basis all in an effort to try and get countries to adopt reforms that are sufficiently comparable and comprehensive in nature.

Senator UDALL. Chair White.

COORDINATION IN RULEMAKING

Ms. WHITE. Yes. I think, again, a high priority we have both domestically and internationally is to try to—even on rulemakings that are not required to be joint, ensure that there is very close consultation and coordination to try to make them as robust, but as consistent or at least compatible as possible really around the globe.

When you talk about the title VII rulemakings and the over-the-counter derivatives market, that is obviously a uniquely global market. And so, we need to get that right. And I think we are all working very hard to try to do that.

I think the fact that the agencies charged with implementing the Volcker rule actually worked together and came out with a joint rule, including the CFTC and the SEC, was enormously important, both to the strength of the rule and the consistency and certainty for the marketplace.

Senator UDALL. Thank you.

Senator Moran, would you like to——

Senator MORAN. Mr. Chairman, thank you very much.

Senator Johanns was—this may be based upon the relationship I have had with other CFTC chairmen—telling me that the presumption exists that if you are a Creighton grad, you can do no wrong.

Chairman Wetjen, thank you very much for joining us today. I appreciated the conversation that we had in my office yesterday. You have indicated to me, and I have seen evidence of it, the desire to work hard to develop good, solid relationships with Congress, and I am very grateful for that. I look forward to accomplishing that as well with you. Let me just ask a question that in part we discussed yesterday.

Implications of rulemakings mandated by Dodd-Frank. What are you able to do to mitigate what is always described as unintended consequences? You and I have been in touch in regard to a real-time reporting rule, which may unintentionally identify swap participants in transactions, and you indicated this is something you are looking into.

Would you bring me up to date? And maybe can put on the record the conversation—the nature of the conversation we had yesterday and where you are headed.

REPORTING TRADES

Mr. WETJEN. Thank you, sir.

We did pass a rulemaking that puts in place a real-time reporting obligation of swaps activity. And depending on the entity or the counterparty in the trade, there is a timeline by which the party has to report their trade to the public.

And the matter you and I discussed, as you know, relates to certain instruments that are not terribly liquid, meaning there is not a lot of trading activity in some of these products. And because of that fact, it becomes easier to identify the identity of one of the counterparties.

And so this is a problem and a challenge for the agency because the statute does say one of the considerations that has to be made is that in this reporting obligation, the identity of the party not be revealed. On the other hand, there is tremendous public benefit in having information about a trade available as quickly as possible. That is very useful in terms of price discovery, which is one of the key functions of our marketplace.

So that is where the tension is. And so, I have directed the staff at the CFTC to examine this problem, to look into it, and to see whether or not we can confirm that this is, in fact, a problem.

The other analysis here is, again, I think we need to review what the statute says and look carefully at that and determine what was meant when we were cautioned not to have a reporting obligation that could reveal someone's identity. It is not like anyone said,

"Hey, it is so and so." But just that, again, so few people are trading in a particular instrument that the marketplace tends to figure out relatively easily who those parties are.

So staff is looking at this. I actually had a conversation after you and I spoke yesterday, a follow-up conversation with the staff. They are doing a new type of analysis that I wasn't aware of when you and I spoke. So they are looking at another way to see if they can confirm some of what has been reported by the parties in these particularly illiquid swaps. So we will keep looking at it and keep you up to date.

FINANCIAL STABILITY OVERSIGHT COUNCIL DESIGNATIONS

Senator MORAN. Thank you very much.

Let me turn to the SEC. Chair White, thank you very much for your presence today. I am pleased to see you here, as I sometimes do in the Banking Committee as well.

Two asset managers were recently graduated to Stage 2 of the Financial Stability Oversight Council (FSOC's) review process for systemically important financial institutions. And I am concerned that asset managers who simply administer customer accounts may be proceeding down a path of additional regulation that, in my view, may be inappropriate for that industry.

Can you give me a better sense of how this designation process for asset managers is progressing at the FSOC, and given the understanding that the assets in question are not owned by the companies in question? And then I have a couple of follow-ups, I think, based upon what you say.

Ms. WHITE. I think although there have been media reports to the effect of your question, I don't think there has been a public announcement of the precise status, if any, with respect to specific asset managers, which is the protocol of the FSOC with respect to any company that might be considered.

Senator MORAN. That is encouraging. Because what I would ask you is—because I understand there is a roundtable discussion to occur in the next couple of weeks. And so, part of my concern is why are we making designations now when there is more work yet to be done?

Ms. WHITE. Well, again, I think that FSOC officials—the Secretary of Treasury, obviously, the chair of the FSOC—are engaged in a process of learning about and gathering data on the asset manager industry. Again, I can't go beyond what I can say publicly about the process otherwise.

I think it is a good development that there is the asset manager conference on Monday, and it is a public forum, so that the representatives of the FSOC, staff of the member agencies will hear from the industry and other interested parties and knowledgeable parties.

I do think it is important—and again, the FSOC is given the responsibility to decide whether there are systemically important institutions that aren't banks, are insurance companies, et cetera. And if so, if they pose systemic risk to the financial system, one of the powers Congress gave to FSOC was to designate.

Now that doesn't say what that process should be, what the data should be before one does that. I think those are very important

questions. And I think it is also very important—and actually, the OFR study, which came out in September about the asset management industry, not specific parties, pointed out the very fact that you mentioned, which is the asset manager business is an agency business.

And so, when you are considering what, if any, systemic risk it may or may not pose, you are not talking about a balance sheet of positions. You are talking about an agency model. And I think it is very important that that be understood by all who are considering this and that the right expertise be brought to bear on that analysis.

SIGNIFICANCE OF AGENCY RELATIONSHIP IN FSOC DESIGNATIONS

Senator MORAN. In your analysis, what is the significance of that agency relationship? How do you personally, or how do you at the SEC as chair, see this issue within your role at FSOC?

Ms. WHITE. Well, again, as the Chair, I am a member of FSOC, as you know. I think it is an extremely important factor.

Essentially, if you are looking to what kinds of entities and why they may create systemic risks, if these assets are not yours and not on your balance sheet, that is a very different situation before you to assess in terms of whether such an entity, if it were to fail, fails in any sense similarly to a bank, which does carry positions on the balance sheet, obviously.

So I think it is a critical fact. Not the only fact to look at, but a critical distinction between asset managers and some of the other entities that have been considered.

Senator MORAN. Thank you both. My time has expired.

Senator UDALL. Senator Johanns.

CHANGES MADE AT THE SEC

Senator JOHANNS. Chair White, if I could turn to you. If you look at the history of the SEC budget, even predating the Obama administration going back to the year 2000, the budget has grown from $377 million to $1.35 billion in 2014, very, very significant growth by any definition.

But despite this tremendous growth in resources, the SEC—and I acknowledge this was prior to your time. But it failed to detect Ponzi schemes like Madoff, Stanford; didn't sound the warning on the collapse of the U.S. financial system—or near collapse. That describes for me a very serious problem within the SEC. You may disagree with that. You may agree with that.

But I would like you to spend some time, since this is a great opportunity for oversight, to talk to us on the committee about your view of what needs to be done to avoid a future Madoff, a future Ponzi scheme.

What are you doing at the SEC that changes the culture of that dynamic of how people look at their role and responsibility in terms of dealing with characters like that and in terms of dealing with the financial system of the United States?

SEC ENHANCEMENTS AND IMPROVEMENTS

Ms. WHITE. I think several points there. One is—and the agency has obviously acknowledged this—that there were weaknesses and issues where before my arrival the agency had made significant progress on addressing, and very important that that did happen, I think.

For example, in terms of a Ponzi scheme, today one of the items in our budget request that we are seeking to enhance even further is the tips, complaints, and referral system whereby we get about 15,000 complaints at the SEC every year. Three thousand plus of those come into our whistleblower office, but 15,000 in toto, so to speak. And so, those are now all centralized, automated, assessed electronically, quickly, and sent out to where they need to be sent out.

One of the enhancements that we actually weren't able to do last year because of the funding was to automate the triaging of those complaints. But there is no question that that feature, which did figure in those incidents you are mentioning, is now quite, quite different at the SEC.

A number of other changes were made, both in the exam program—enhancement, improvements—and in the enforcement division as well. I mean, one of the things that I think is enormously strengthening the enforcement program, for example, is the specialty units, where you now have expertise residing in different market strata that the SEC is responsible for. And again, I think nothing is more important at the SEC than to have a very strong compliance function, very strong enforcement function.

On the examination side, also enhancements, improvements have been made, really very significant ones. We have been helped by our technology there. We have been helped by our economists as part of that effort, which is basically that we now have technological tools that allow us to analyze, assess, and access massive amounts of data much more quickly.

For example, one of our newer tools in the examination program is called NEAT, which is National Exam Analytics Tool. Basically, it allows our examiners when they go in to an investor adviser to examine, to look at all of their trading.

And so, we have one instance recently where I think 17 million transactions were accessed and analyzed in 36 hours. The SEC of yesterday couldn't have come close to that.

And what do we do when we get that data analyzed? We look for patterns of insider trading. We look for Ponzi schemes. We look for front running. We look for other kinds of patterns that may suggest wrongdoing.

So it is a much stronger SEC in those respects, I think. No one could responsibly sit here and say that any law enforcement agency will never miss a scheme going forward. But it is an extraordinarily strong enforcement and exam function today.

PREVENTION OF ANOTHER MADOFF

Senator JOHANNS. Would you be confident in testifying to the subcommittee today that under the current atmosphere, the cur-

rent approaches, that Madoff could not repeat what he did some years ago?

Ms. WHITE. From what I know of what occurred—and again, I wasn't here, but I have studied what occurred. I think the systems we were just talking about, among others, certainly at the SEC, I believe that activity would have been detected and proceeded upon.

Again, you can never guarantee that you will catch every Ponzi scheme, every fraudster, every criminal in any agency. But I do think it has been built to prevent that from happening again.

SEC'S ABILITY TO USE FUNDS IN AN ABBREVIATED TIME PERIOD

Senator JOHANNS. The budget request you are making this year admittedly is sizeable. I appreciate you are a little bit different circumstance. But having said that, it is our job to provide oversight wherever the dollar comes from.

Given recent past experience, history would probably tell us that we might be facing a continuing resolution and that you would not receive your full request for some period of time into the budget year. We haven't done a lot of budgets around here, unfortunately. Consequently, what would then happen is your budget request may be met in January, February, March of next year.

Under those circumstances, would you in that limited period of time, between when you received that and the end of the fiscal year—the end of September 2015, would you be able to responsibly deal with that? Hire up the people you want to hire up, do the things you want to do, within an abbreviated period of time?

PRUDENT SPENDING

Ms. WHITE. I think there is no question, and we have done this in prior years as well. We take into account the likelihood of a continuing resolution, and how long it may last. And that clearly leads to prudent deferred spending. We do have no year funds, however, so that we are able to more flexibly deal with getting our money somewhat later in the year.

But there is no question. One place where it is a particular challenge is in our long-term mission-critical information technology (IT) projects. I mean, for those of necessity, you need to know you have the money. And then there is a relatively lengthy procurement process. So they do present challenges.

But I think our financial management folks, and I have talked at length to them about these issues as well, are geared up to be able to use if we would get the funding, as much of it as is possible. And then they can carry over and be able to use the funding in the following year, but having projected the uses for it in this year.

Senator JOHANNS. I yield, Mr. Chairman.

Senator UDALL. Thank you very much, Senator Johanns.

And thank you for those answers.

VOLCKER RULE

I wanted to shift over to the Volcker rule, which you all know is a very, very important one. Chair White and Chairman Wetjen, on September 10, 2013, five Federal financial regulatory agencies issued uniform final regulations implementing the Volcker rule.

The first question. How is the Volcker rule being enforced, and what is the relevant role of each of your agencies in overseeing compliance?

Ms. WHITE. I think the rule itself actually became effective April 1 of this year. But the compliance period is still out into 2015 and beyond that. It is a scaled compliance approach, both in terms of extent and also in terms of timing.

And again, I think I alluded to this a few minutes ago, it is critical that the agencies did enact a joint rule. I think it is a better rule, a stronger rule, and it plainly for the marketplace was necessary to do that.

And one of the commitments, and I actually said this in my opening statement when the SEC adopted the rule, is that we need to be focused from this day forward on continuing that coordination as we get into the compliance and enforcement period.

And so, there is an interagency working group that all five agencies have very active senior members on who are focused on questions of interpretation, questions of compliance, questions of enforcement. And we will try to stay as consistent and in sync as we can. We are obviously independent agencies at the end of the day.

With respect to entities who are covered by the rule—for example, broker-dealers—the SEC is the primary regulator there. And so, we will have the voice as to whether there is compliance or not and proceed with enforcement, but we will still coordinate with each other on questions of interpretation that affect compliance and enforcement.

AGENCY COORDINATION

Senator UDALL. Chair Wetjen, do you have thoughts on that?

Mr. WETJEN. I would like to echo what Chair White said. I think there is a continued commitment to coordinating among the agencies.

Another good example, in addition to what Chair White shared, is we actually issued an interim final rule, I believe that was late January, and it related to a special investment vehicle issue that materialized and had come to the attention of the agencies and to the Congress. And so, all five agencies adopted this interim final rule very, very rapidly.

And again, I just think that is another example that there is a continued commitment to solve these problems jointly, again, in an effort to avoid any kind of uncertainty that not doing so could create for the marketplace. So I expect that to continue.

MONEY MARKET MUTUAL FUNDS

Senator UDALL. Shifting now to money market mutual funds. Chair White, as you know, Senator Johanns and I and several other Senators wrote to you at the SEC in 2012, highlighting the concerns raised by our local governments on changes to money market mutual funds. And I keep hearing from folks back home about this issue.

In fact, a little over 2 weeks ago, I had a conference call with constituents representing local governments and businesses in New Mexico, and they continue to express concern about possible changes. As you know, local governments rely on these money mar-

ket mutual funds as a cash management tool and as an important source of low-cost, short-term financing.

Can you give us an update on where the SEC is on the rule? And how do you plan to address these concerns of local governments and others?

Ms. WHITE. Yes. The SEC commissioners and staff are actively involved, quite actively involved in finalizing those rules and those reforms of money market funds. They are a priority for 2014. I expect in the relative near term to proceed to finalizing those rules.

As you know, when we proposed the rules, we proposed two alternatives. One is a floating net asset value (NAV) for prime institutional funds and the other a fees and gates approach. Government funds were actually exempted from the floating NAV, but municipalities weren't. I think that is the issue that is being raised.

We have gotten a lot of comments on precisely that point. The staff has met with a number of representatives of municipalities expressing that concern. Should we go in that direction of a floating NAV, there is an exemption for retail funds, which would cover some of the municipal funds, but I think not all. We are very carefully focusing on all of the comments, but quite focused on the concern that has been expressed by the municipalities.

Senator UDALL. Right. Thank you very much.

Senator COONS. Welcome. Good to have you here.

IT FUNDING

Thank you. I appreciate the opportunity to join you and thank you both for your service and for the opportunity to discuss with you your proposals.

If I might first ask CFTC Chair Wetjen, the core to your funding request is about investments in technology and staff. And your fiscal year 2015 request calls for a $15 million increase in IT funding.

Could you just comment on the risks posed to your organization, on the markets if your IT infrastructure isn't upgraded or modernized, and what role it plays in your taking on an expanded role?

Mr. WETJEN. Thank you, Senator Coons.

We have a plan developed by our Office of Data and Technology on how to use the $50 million. It would include some enhancements to current systems we have in place which are necessary for surveillance purposes.

And the one system I would point out is one that tries—well, tracks positions taken on by market participants. And so, it is a critical tool that we have now, but it still needs to be enhanced if it is going to be as effective as possible.

Going forward, I think what the agency should consider doing is investing in new initiatives, technological initiatives so that we can get a better understanding of not only consummated trading activity, but order messaging, which is something that happens a lot in automated markets.

You have firms or entities sending in orders that don't always match with another counterparty. So it is important because some firms inappropriately might use a number of different order messages sent into a marketplace as a way to engage in some kind of a manipulative scheme. And so, going forward, you know, if we are

able to get additional funding for IT, I think that is the next key initiative we might want to invest in.

CFTC ENFORCEMENT ACTIONS

Senator COONS. You had a budget of roughly $200 million last year and collected north of $1.7 billion in fines. That is about an eightfold return on taxpayer investment. So I just wondered if you wanted to take a moment and explain, as an entity that literally pays for itself, what enforcement actions you pursued last year and how a more fully funded CFTC would benefit taxpayers, as well as benefit the marketplace.

Mr. WETJEN. Yes, thank you, Senator, for that question.

I think we initiated and completed around 150, 160 enforcement actions last year, in fiscal year 2013, which, as you mentioned, resulted in over $1.5 billion in fine collections. So it was in that sense a good return on the investment, when you consider the level of funding for the agency.

Right now, we are on pace to probably have fewer enforcement actions consummated and completed based on numbers midway through the year—midway through the fiscal year. There is a variety of reasons for that, but one of which is that we have lost some staff in the Division of Enforcement. So that does give you some indication about what the impact of reduced staffing can have.

Again, there could be other reasons for that as well. It could just be the nature of incidents that have been brought to the attention of the agency this year are different than in years past, but it is one thing you might want to take a look at.

So I have some concerns about that. That is one of the reasons why we have asked for additional attorneys for the Division of Enforcement at the agency. Our request would bring us roughly 50 additional FTEs. And again, I think we would continue to demonstrate with that enhanced team an ability to bring a good return for the taxpayer.

Senator COONS. Thank you.

Thank you for what you do, Chair White, at the SEC. I have a sense that you are charged with overseeing more than 25,000 market participants roughly who engage in trillions of dollars worth of economic activity, and I think what the SEC does is, like the CFTC, critically important to a well-functioning capital market that is secure and transparent.

SEC ENFORCEMENT EFFORTS

And as we continue to heal from the financial crisis, I think it is critical we take steps to ensure that doesn't happen again. Given the very broad range and significant expansion in your responsibilities and given that, as is the case I just referred to, you don't cost anything to the taxpayers, net-net, I support funding the President's request at $1.7 billion. But I would be interested in your comments on the trends of security frauds that you are seeing in current enforcement efforts and what sort of risks retail investors are exposed to. I would also be interested in how you see progress in rulemaking to implement the JOBS Act.

Ms. WHITE. In terms of the enforcement efforts, I think there is nothing more important than a strong, a very strong enforcement

presence by the SEC to protect investors—retail, as well as institutional—to protect the integrity of our markets, to protect the markets so that capital formation will be facilitated.

The SEC had, and much of this before I arrived, but in terms of the financial crisis cases, I think an extraordinarily strong record. The agency charged over 165, I think it was 169, entities and individuals. Seventy-plus of those were actually senior executives—chief executive officers (CEOs) and chief financial officers (CFOs). Enforcement actually got orders to return over $3 billion in fines and disgorgement. So there is obviously value—not only value added there, but it is actually returning under our Fair Funds provision money to investors.

So we are just about through. We have some additional financial crisis cases that obviously we are focused on completing. One of the things that we have done—really, two of the things that we have done since I have been there to strengthen the enforcement function is to form two new task forces. One is a financial reporting and auditing task force, which I think is the core of investor protection. And that is something that is already yielding results for the benefit of investors and the markets.

We have also formed a microcap fraud task force, which particularly targets that brand of securities fraud on retail investors.

Another very disturbing pattern—and I have seen this when I was a prosecutor, too. And it is some of the most egregious frauds you see are what I call the affinity frauds, when somebody commits a Ponzi scheme or other kind of investment scam really against their own communities. And we are certainly seeing really a growth in those, and so we are very focused on dealing with those. We have brought a number of different cases.

We have also intensified our enforcement efforts vis-à-vis the obligations of exchanges to make sure they are following the various what I call the market structure rules of our equity markets, which I think is important to everyone.

INVESTMENT ADVISOR EXAMINATIONS

And then one final point I would make is just talking earlier about our need for resources to increase the number of examinations we do of investment advisers. And of course, they are the ones that are really day-to-day dealing with your everyday investor, and we are only able to cover a very small percentage of those under current funding.

And when we go to those places—and frankly, when we go to the broker-dealers we examine as well—we find a lot of issues. So it is these issues that make us at least understand the critical importance of sufficient funding to be able to carry out those responsibilities for investors.

And actually, by just showing up on an exam—I think since fiscal year 2012, just showing up and pointing out, "By the way, those fees should not have been charged to those investors or those funds. They should have been for your account." We have returned, I think, $28.8 million just by showing up. So it shows you across the span I think the benefits to investors.

SEC TRAINING FOR NON-U.S. REGULATORS

Senator COONS. One last question, if I might, Mr. Chairman.

One other area that I was surprised to see in your report is that I didn't realize you were engaged in training non-U.S. regulators.

Ms. WHITE. Yes.

Senator COONS. It was roughly 1,700 in fiscal year 2013, I think it is 1,400 this fiscal year and next. What are the benefits of that program? How does it benefit us to provide training to non-U.S. regulators whose markets may not be as robust or scalable or secure?

Ms. WHITE. I think there has been significant benefit and has for decades, frankly, but even more so now. The securities markets, and certainly the securities frauds markets, are quite global. I mean, they don't respect borders.

And so, I think the training that we provide is invaluable to the American investor who may well be defrauded from any country you could name abroad. If they have a strong enforcement function, we are protecting the American investors there.

And we have seen an awful lot of progress. There is much more to go, but I think it is an invaluable service to the American investors. It is also I think an invaluable service really to the global markets and the integrity of them.

Senator COONS. Thank you.

Thank you, Mr. Chairman.

Senator UDALL. Senator Coons, thank you very much.

Senator Johanns, please proceed.

Senator JOHANNS. Mr. Chairman Wetjen, let me ask you a question. But let me also, if I might, lay some groundwork for this question so you know where I am coming from.

EFFECTS ON END-USERS

I think all of us agree that the CFTC must have smart, forward-leaning regulation. The market changes so dramatically. And yet, we still have to be sensitive to the potential to over-regulate. We don't want to regulate everything that moves. So trying to be—to strike that balance I think is key.

One example of regulatory overreach that I have been working on since Dodd-Frank passed is margin requirements on end-users when trading derivatives. I can state unequivocally Congress never intended for nonfinancial end-users to be subject to costly margin requirements, and yet here we are, almost 5 years later, still battling with this.

So I have introduced legislation that exempts end-users from margin requirement. This is not a Republican versus Democrat issue. The measure has gained strong bipartisan support. A companion bill has already passed the House with over 400 votes.

This is one of those things that should be done. I don't know of a Senator that opposes it. Maybe there is one out there that I haven't come across yet. But again, I think Congress is nearly unanimous on this.

I asked Gary Gensler about it one time, and I always felt that he had a pretty aggressive view of regulating things. I think that is what he saw his job as, and he was going to regulate stuff. But

he even agreed that nonfinancial end-users don't pose a risk to the system and, therefore, should not be burdened with what I would call a job-killing margin requirement.

I would like you—I know this is an issue now in the Fed's hands, but I would like your thoughts personally, as the acting chair of the CFTC, on what I am trying to get done here.

Mr. WETJEN. Senator, I agree with you that Dodd-Frank tried to, if I can use these words, hold harmless as much as possible the end-user community as it related to title VII in particular.

Senator JOHANNS. Right.

Mr. WETJEN. And we have a number of rules that provided exemptions from clearing requirements for end-users, and we have taken a number of different other actions as well to build out that general principle. And one specific area has to do with interaffiliate trades between companies that are not swap dealers. And so, we have done a considerable amount of work there.

So I agree with you in principle that that was a message and intent behind Dodd-Frank. At least as it relates to title VII, end-users are supposed to largely be left out of the grip, so to speak, of the new rulemakings implementing title VII.

I am not familiar with the details of the Fed's proposal, and I don't recall exactly where they are in the process. But I agree in principle with what you are saying as it relates to end-users in title VII.

Senator JOHANNS. Mm-hmm. See, Mr. Chairman, the Creighton education kicks in, and good, practical, common sense stuff come out.

Thank you. I will yield.

Senator UDALL. Senator Coons, did you have additional questions? Okay.

Chair White, one of the key components of Dodd-Frank was a mandate that the SEC adopt a number of new rules relating to credit rating agencies. And all of us remember what a key role credit rating agencies played in the kind of meltdown that we were in back in that time period.

And of these new rules, we included annual reports on internal controls, conflict of interest with respect to sales and marketing practices, various disclosure requirements, and consistent application of rating symbols and definitions.

What is the status of the SEC's efforts to comply with the mandates under Dodd-Frank relating to credit rating agencies, and what further developments can we expect from the SEC on this?

CREDIT RATING AGENCIES

Ms. WHITE. A very important area, a very high priority for the agency.

The agency did in January 2011 adopt, actually, a new rule requiring Nationally Recognized Statistical Rating Organizations (NRSROs) to disclose representations and warranties and how investors might enforce breaches of those. In May 2011, the agency proposed the rules you are alluding to. I think they proposed that 11 be amended to accomplish the objectives that you listed and 5 new ones. We are moving those forward quite actively, and they are a priority to complete this year.

Senator UDALL. Do you believe there are additional reporting requirements or controls necessary to prevent another crisis?

Ms. WHITE. There is no question in my mind that the credit rating agency issues played a significant role in the financial crisis. And I think the issues you have identified are ones that do need further reforms, and that is the objective of these rulemakings.

Senator UDALL. Okay. And I know that some of the critics have kind of come at this and said we should start over again. I assume that isn't the position of the SEC at this point.

Ms. WHITE. Well, we are certainly listening to all comments. Obviously, the formal comment period is closed, but we are listening very carefully to those who think that certain aspects perhaps should be re-proposed or done differently and perhaps not require a re-proposal.

So we are trying to come out with very robust rules, and we are continuing to listen to all critics and all supporters and really all ideas on it.

Senator UDALL. Right. Thank you very much.

Senator Johanns, do you have—and it looks like Senator Coons has completed his questioning here.

Let me thank both of you. We really appreciate having you here today. We appreciate this frank discussion and exchange of ideas.

We want to thank everyone who participated in preparing for this hearing. You have excellent staff. We do also, and we very much appreciate their help.

Today's discussion I think has provided helpful insights into these—your operations and I think shows us what the challenges are that are ahead of us. This information will be instructive as we further consider the budget proposals and develop our fiscal year 2015 bill during the coming weeks.

ADDITIONAL COMMITTEE QUESTIONS

The hearing record will remain open until next Wednesday, May 21 at 12 noon for subcommittee members to submit statements and/or questions to be submitted to the witnesses for the record.

[The following questions were not asked at the hearing, but were submitted to the agencies for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO HON. MARY JO WHITE

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

STRENGTHENING EXAMS AND OVERSIGHT—FREQUENCY OF REVIEWS

Question. The SEC's Office of Compliance, Inspections and Examinations (OCIE) is responsible for conducting examinations of the Nation's registered entities. These include broker-dealers, transfer agents, investment advisers, the securities exchanges, clearing agencies, as well as self-regulatory organizations.

Chair White, your budget materials state that during fiscal 2013, the SEC was able to examine only about 9 percent of registered investment advisers. That means only 1 of every 12 of investment advisers is inspected. What do you believe would be a more suitable frequency?

Answer. As you point out, during fiscal year 2013, the SEC examined about 9 percent of registered investment advisers, comprising approximately 25 percent of the assets under management. As I stated in my testimony, clearly more coverage is needed, as the status quo does not provide sufficient protection for investors who increasingly turn to investment advisers for assistance navigating the securities markets and investing for retirement and family needs.

Examination staff uses a risk-based approach designed to focus its limited resources on those firms and practices that pose the greatest potential risk of securities law violations that can harm investors and the markets. These high-risk firms frequently are large and complex entities, and examinations of them often take significant time to complete.

While we believe our risk-based approach has helped us to more efficiently use our resources to better protect investors, an increase of exam frequency to between 30 and 50 percent of investment adviser firms annually would further enhance our effectiveness and bring us closer to the current broker-dealer coverage level that, combined with examinations conducted by the Financial Industry Regulatory Authority, is approximately 50 percent.

Going forward, we will continue to use technology and risk-based data analytics to be as efficient as possible with our limited resources.

Question. What are the drawbacks of sporadic inspections?

Answer. OCIE staff's direct engagement with registrants allows the staff to provide first-hand information to the Commission and other SEC staff regarding the activities of our regulated entities, helping us prevent fraud, identify compliance deficiencies, promote compliance, inform policy, and monitor risk. Less frequent examinations therefore limits the information available to the Commission in discharging its mission to protect investors, including by reducing the instances in which we may identify potential fraud and other wrongdoing and also reducing incentives for registrants to put in place rigorous internal controls and compliance programs.

Sporadic or less frequent examinations also factor into business decisions that may not always be in the best interests of clients or customers. For example, OCIE staff has identified an increase in firms choosing to de-register as broker-dealers, or to conduct a greater percentage of their business as investment advisers. The staff believes that in some cases this shift could be due in part to the perception of less rigorous oversight of investment advisers.

Question. Your request for fiscal 2015 seeks $373 million, a $72 million increase for the exams function above current spending. This will support 316 additional staff positions above the 967 current level. What impact will those enhanced funds have on accelerating the frequency of exams?

Answer. The number and percentage of investment advisers examined each year depends on a number of factors, including the type and scope of the examinations conducted, the program priorities, the complexity of the advisory business, and staffing levels. Of the 316 positions for OCIE, we anticipate using 240 for investment adviser exams.

Our best estimate, as reflected in the budget request, is an investment adviser coverage level of 9 percent in fiscal year 2014 and 12 percent in fiscal year 2015. The time it would take in fiscal year 2015 to hire and train new employees likely means we would not realize the full effect from this staffing increase until future years. OCIE estimates that with the requested fiscal year 2015 staffing increase, the exam program would be able to cover at least 14–15 percent of the population in fiscal year 2016. This outcome could vary depending on a number of factors, including new program priorities or higher than expected staff attrition/turnover rates. To achieve an annual examination level of 30 percent to 50 percent would require incremental increases in subsequent budgets to permit the agency to hire and sufficiently train the necessary complement of examiners.

MARKET TRANSFORMATION AND HIGH-FREQUENCY TRADING

Question. Chair White, as the leader of one of our key financial regulators, you are acutely aware of the growing challenges facing your agency in monitoring the markets. We now have significantly transformed, globalized, round-the-clock, and highly diversified marketplace. Stock exchanges can now execute trades in less than a half a millionth of a second.

What is the current status of the SEC's oversight of high-frequency trading and automated trading environments?

Does the SEC presently have the necessary talent and technology in place to monitor and analyze high-frequency trading, to inform your regulatory and enforcement work, and guard the integrity and safety of the markets? What are the deficiencies?

Answer. Generally, the SEC's ability—in enforcement, examination, and regulation—to monitor and analyze high-frequency trading (HFT) activity in the U.S. markets has increased as more tools have become available to SEC staff, including software that can handle larger data sets and more advanced and powerful computers.

Data and Analysis of HFT Activity

The SEC has developed improved data sources and capabilities that can be used to analyze HFT activity.

Most prominently, we have launched an equity market structure website[1] that builds on an analytical tool called MIDAS (Market Information Data Analytics System), which enables us to quickly analyze enormous amounts of trading data across markets.[2] Though MIDAS does not identify individual firms, MIDAS data is now used in conjunction with existing investigations of specific firms. In particular, OCIE examiners and Enforcement staff use MIDAS to compare the individual trades and quotes of a particular firm (acquired from the firm itself) in the context of all other contemporaneous market trades and quotes. These types of analyses can help inform investigations on a variety of issues, such as those relating to insider trading and market manipulation.

SEC staff also is now analyzing information that recently has become available to it though the Large Trader Reporting Rule[3]—which provides SEC staff access to information about the trading activity of the largest market participants, including many HFT firms, upon request—into its policy-making, examination, and enforcement efforts.

Barriers to the development of comprehensive and reliable analyses of HFT remain, however, and include: (1) the limitations of available data;[4] (2) the absence of a clear, commonly agreed definition of HFT; and (3) inherent complexities in the econometric techniques available for assessing the effect of HFT on market quality. To help surmount these barriers, the SEC is in the midst of an initiative to expand the data available to regulators. Specifically, in July 2012, the SEC adopted Rule 613, which requires the self-regulatory organizations to submit a national market system (NMS) plan to establish a consolidated audit trail (CAT) for NMS securities, across all U.S. markets, from the time of order inception through routing, cancellation, modification, or execution.[5] When the consolidated audit trail is fully implemented, regulators will be able to readily tie all order and trade activity in NMS securities throughout the U.S. markets back to particular accounts and to properly sequence that activity in time. Fully implementing CAT is a high priority for the Commission.

A significant impediment to the SEC's ability to monitor and analyze HFT trading is the absence of comprehensive data that links orders and trades to individual market participants. Although current data resources allow the SEC to monitor and analyze overall market quality, questions regarding outcomes for end-users and intermediaries are often difficult to answer without account-level data. Data from CAT will facilitate many types of studies that are difficult to conduct with current data.[6] CAT will also significantly improve regulators' ability to monitor the trading activity of individual firms, the overall level of HFT activity in the market, and the outcomes realized by end-users of the market.

Oversight of Operational Risks in Automated Trading

To address the risk of instability and disruption that can arise in an automated trading environment, the SEC and the securities industry have undertaken a series of responsive initiatives. "Limit up-limit down," for example, is now fully implemented and moderating price volatility in individual securities.[7] Market-wide circuit

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[1] The web site is located at http://www.sec.gov/marketstructure/and is broadly intended to promote a market-wide dialogue and fuller empirical understanding of the equity markets. It serves as a central location for SEC staff to publicly share evolving data, research, and analysis about HFT and other market structure issues.

[2] MIDAS is an SEC system that collects equity quote and trade data from the consolidated public tapes as well as the individual data feeds that are commercially available from each equity exchange. That system supports a variety of powerful applications across the SEC's enforcement, examination, and regulatory functions, including research to better understand a market structure with a significant amount of HFT trading. This research in turn helps better inform policy decisions related to market structure issues, including HFT.

[3] *See* Exchange Act Release No. 64976 (July 27, 2011), 76 FR 46959 (August 3, 2011).

[4] There currently is no comprehensive data source that enables regulators to tie all order and trade activity in the U.S. equity markets back to particular accounts. Accordingly, an exhaustive analysis of HFT activity is not possible at this time.

[5] *See* Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722 (August 1, 2012).

[6] Examples of such studies include: how different types of market participants provide liquidity, and how liquidity provision from different market participants impact market quality at times of market stress; whether aggressive HFT strategies increase investor trading costs or serve to provide short-term liquidity at a premium; whether certain HFT strategies crowd out passive liquidity suppliers, and if so, how the costs of end-users are affected; and whether improvements in price efficiency allow liquidity providers to provide more liquidity to institutional orders.

[7] SEC Press Release No. 2012–107, "SEC Approves Proposals to Address Extraordinary Volatility in Individual Stocks and Broader Stock Market" (June 1, 2012).

breakers are in place to address volatility across the equities, options, and futures markets.[8]

The SEC has taken additional steps to require market participants to address their technology risks. We adopted—and are vigorously enforcing—the Market Access Rule, which requires brokers to have risk controls in place before providing their customers with access to the market.[9] Last March, the Commission proposed Regulation Systems Compliance and Integrity (SCI) to put in place stricter requirements relating to the technology used by exchanges, large alternative trading systems, certain exempt clearing agencies, and securities information processors—the SIPs.[10] The staff is now completing a recommendation for final rules.

The SEC has closely focused on certain market infrastructure systems that are "single points of failure" that can halt or severely disrupt trading when a problem occurs. The exchanges have responded with technology audits of the SIPs and a series of specific enhancements to improve SIP robustness and resilience. In addition, the exchanges have developed more robust SIP backup capabilities, and at the end of June 2014 implemented a new "hot-warm" backup, with a 10-minute recovery standard.

Further Enhancements to HFT Oversight

In addition, I recently publicly outlined a series of initiatives that will, among other things, enhance the SEC's oversight of HFT firms and automated trading tools.

—The SEC staff is now developing a recommendation to the Commission for an anti-disruptive trading rule that would address the use of aggressive, destabilizing trading strategies in vulnerable market conditions. Such a rule will need to be carefully tailored to apply to active proprietary traders in short time periods when liquidity is most vulnerable and the risk of price disruption caused by aggressive short-term trading strategies is highest.

—The SEC staff is also preparing two recommendations for the Commission that are focused on using our core regulatory tools of registration and firm oversight: (1) a rule to clarify the status of unregistered active proprietary traders to subject them to our rules as dealers; and (2) a rule eliminating an exception from Financial Industry Regulatory Authority (FINRA) membership requirements for dealers that trade in off-exchange venues. Dealer registration and FINRA membership should significantly strengthen regulatory oversight over active proprietary trading firms and the strategies they use.

—Finally, the SEC staff is preparing recommendations for the Commission to improve firms' risk management of trading algorithms and to enhance regulatory oversight over their use.

I also have asked the exchanges and FINRA to consider including a time stamp in the consolidated data feeds that indicates when a trading venue, for example, processed the display of an order or execution of a trade. With this information, users of the consolidated feeds would be able to better monitor the latency of those feeds and assess whether such feeds meet their trading and other requirements.

ENHANCING CORPORATE DISCLOSURE OF MATERIAL RISK: CLIMATE CHANGE AND ENVIRONMENTAL IMPACTS

Question. Generally, publicly traded companies disclose business risks to investors through regular financial reports (called "10–K filings") submitted to the SEC.

Recently, there have efforts to ensure that environmental costs and risks are also reported to investors because they impact a company's bottom line. In July 2010, the SEC issued guidance requiring companies to address how climate change (and climate change regulation) could potentially impact their businesses. Like all SEC disclosures, this is aimed at informing market price and protecting investors. Yet, concerns have been raised that despite existing disclosure guidance, reporting by companies is not as robust as it should be. In response to this subcommittee's fiscal 2014 report, the SEC submitted an updated staff report focused on the quality, specificity, and thoroughness of disclosure related to climate change.

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[8] *Id.*

[9] SEC Press Release No. 2010–210, "SEC Adopts New Rule Preventing Unfiltered Market Access" (November 3, 2010). One market access risk is the potential for erroneously submitting a single large order or a flood of small orders that disrupt trading. *See* SEC Press Release 2013–222, "SEC Charges Knight Capital With Violations of Market Access Rule" (October 16, 2013).

[10] SEC Press Release No. 2013–35, "SEC Proposes Rules to Improve Systems Compliance and Integrity" (March 7, 2013).

I would be interested in hearing more about how the SEC is reviewing climate disclosures and the extent to which public companies are conforming to the guidance and making full disclosures.

Answer. The Commission's 2010 *Guidance Regarding Disclosure Related to Climate Change* provides interpretive guidance about how companies should evaluate climate change related issues when considering what information to disclose to investors under existing disclosure requirements, such as risk factors or management's discussion and analysis. Companies that are subject to SEC disclosure rules must provide climate change related disclosure if the information is material. The U.S. Supreme Court has held that information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision. Companies must consider their own particular facts and circumstances in evaluating whether information would be considered to be material.

As you noted, the SEC submitted a report on public company disclosures about climate change related matters to the Subcommittee earlier this year. The staff of the Division of Corporation Finance prepared the report based on its survey of climate change related disclosures by a number of companies in selected industries. Of those companies surveyed, most included risk factor disclosure about climate change related matters. The companies surveyed also disclosed climate change related matters in the business, management's discussion and analysis, executive compensation discussion, and legal proceedings sections of their filings.

The Division of Corporation Finance staff routinely reviews new issuer filings and periodic reports of public companies for compliance with applicable disclosure requirements and inclusion of material information. The goal of the staff's reviews is to monitor and enhance compliance with applicable disclosure requirements. In conducting its filing reviews, the staff will continue to consider whether a company has complied with applicable disclosure requirements, including with respect to climate change, in their filings. Where the staff has concerns about the adequacy of the disclosure in a filing, the staff will issue a comment letter asking the company for further explanation or additional disclosure.

ECOLOGICAL DISCLOSURE—POLLUTION EXTERNALITIES

Question. There is also growing concern that while the SEC requires public companies to disclose certain financial information, its disclosures do not take into account the possible costs imposed on public by corporate activities that have an adverse impact or pose material risk to public health and the environmental such as pollution damages.

What actions are underway at the SEC to evaluate public company disclosure of environmental and ecological risks?

Answer. A number of Commission rules and regulations may trigger disclosure of the possible costs and environmental and ecological risks stemming from corporate activities, depending on a company's particular facts and circumstances. The following provisions of Regulation S–K may require disclosure of environmental and ecological risks and associated costs, based on a company's particular facts and circumstances.

—Item 101 requires companies to disclose the material effects that compliance with environmental laws may have upon the company, as well as any material estimated capital expenditures for environmental control facilities.

—Item 103 requires disclosure of certain proceedings arising under environmental laws, including proceedings that involve a claim for damages, potential monetary sanctions, capital expenditures, deferred charges or charges to income if the amount involved exceeds 10 percent of the company's consolidated assets.

—Item 503(c) requires a discussion of significant risk factors, which could include environmental and ecological risks.

—Item 303 requires companies to identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance.

The Division of Corporation Finance staff routinely reviews public company disclosures to monitor and enhance compliance with applicable disclosure requirements. Where the staff has concerns about the adequacy of the disclosure in a filing, including with respect to environmental and ecological risks and associated costs, the staff will issue a comment letter asking the company for further explanation or additional disclosure.

USTR SPECIAL 301 REPORT

Question. The United States Trade Representative (USTR) "Special 301" Report is an annual review of the state of intellectual property rights (IPR) protection and enforcement among our trading partners around world.

Does the SEC or the major U.S. exchanges take into account a foreign company's inclusion in the USTR Special 301 Report when considering whether to permit the company to be publicly listed?

Should the SEC or major U.S. exchanges take into account a foreign company's inclusion in USTR's Special 301 Report or its Special 301 Out-of-Cycle Review of Notorious Markets before allowing the company to be publicly listed?

What role do the SEC and major U.S. exchanges have in ensuring that US capital markets do not enrich companies that profit from intellectual property rights (IPR) infringement?

Answer. The U.S. Federal securities regulatory system as applied to listed companies is based on the principle of full and fair disclosure of information to investors, and the Commission does not consider the merits of the transaction or company during the registration process. A company is, however, required to provide disclosure of material risks and litigation to which the company is subject, including any material risks associated with a company's intellectual property or the enforcement of rights related to intellectual property.

As to the U.S. exchanges, section 6(b)(5) of the Exchange Act requires that, among other things, the rules of a registered securities exchange be designed to "prevent fraudulent and manipulative acts and practices," "promote just and equitable principles of trade," "remove impediments to and perfect the mechanism of a free and open market and a national market system," and "protect investors and the public interest." The exchanges have adopted rules relating to the qualification, listing and delisting of foreign issuers on their markets, which have been determined by the Commission to be consistent with the Exchange Act. These rules, among other things, set forth financial, corporate governance, and disclosure requirements that issuers must comply with in order to be eligible for listing. Furthermore, the exchanges generally retain broad discretion in their rules to deny the listing of a company (or suspend dealings in, or delist, a company's securities once listed) even if the company meets the listing or continued listing standards, if the exchange determines there are circumstances that make the initial or continued listing of the company inadvisable or unwarranted. Thus, pursuant to this broad authority, an exchange could take into account a company's country's inclusion in the USTR Special 301 Report or the Special 301 Out-of-Cycle Review of Notorious Markets when considering whether to permit the company to be publicly listed.

We understand that the exchanges are considering adopting procedures to ensure companies on the Special 301 Out-of-Cycle Review of Notorious Markets list are identified in the listing application process and would generally not warrant listing. The USTR Special 301 Report does not actually list foreign companies, but rather lists countries that have a particular problem with respect to intellectual property rights protection, enforcement, or market access for persons relying on such rights. To the extent a company from one of these foreign countries has applied to list on an exchange and has disclosed that there is a material risk or litigation about an issue related to intellectual property rights, the listing exchange would inquire about the issue and take it into consideration when considering the listing application of the company.

EXECUTIVE COMPENSATION

Question. The Dodd-Frank Wall Street Reform and Consumer Protect Act required a number of regulations on executive compensations to allow for greater transparency and to discourage the excessive risk taking that contributed to the economic crisis, including those outlined in section 956. There was also significant outcry after it was reported that banks who relieved taxpayer bailouts awarded their top executives nearly $1.6 billion in salaries, bonuses and other benefits the following year.

On March 2, 2011, the SEC issued a proposed rule made jointly with other regulators that would require certain financial institutions to disclose the structure of their incentive-based compensation and prohibit compensation that encourages inappropriate risks.

What is the expected timeline for the rule to be finalized?

How does the SEC plan to address the criticisms of the proposed rule?

Does the SEC believe that the proposed rule would have discouraged the troubling practices that contributed to the economic crisis? Will it help prevent future excessive risk-taking?

Is the SEC considering additional measures or actions on this issue?

Answer. In the spring of 2011, the SEC, acting jointly with the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the National Credit Union Administration, and the Office of Thrift Supervision proposed a rule pursuant to section 956. As required by the statute, the proposed rule would apply to bank holding companies, banks, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, broker-dealers, credit unions, and investment advisers.

In general, the jointly proposed rules drew upon the Guidance on Sound Incentive Compensation Policies finalized by the Federal banking agencies in the summer of 2010. The banking agency guidance is designed to address compensation structures that could cause imprudent risk taking.

The proposed joint rule is comprised of three parts:

—*Disclosures:* A covered firm would be required to file an annual report describing the firm's incentive-based compensation arrangements.

—*Prohibition on Encouraging Inappropriate Risk:* All covered firms would be prohibited from establishing or maintaining an incentive-based compensation arrangement that encourages inappropriate risks. This portion of the rule draws upon the banking agency guidance.

—*Deferral for Large Firms:* For covered firms with $50 billion or more in total consolidated assets, executive officers would have at least 50 percent of their incentive-based compensation deferred for at least 3 years. The deferred compensation could not be paid faster than on a pro-rata basis, and would have to be adjusted to reflect actual losses. The firm's board also would approve incentive compensation for individuals determined to have the ability to expose the firm to substantial losses.

The comment period for the proposed rule closed on May 31, 2011. The SEC and its fellow regulators received approximately 10,000 comment letters. Common themes in the comment letters included:

—Concern in applying a single mandatory deferral requirement to a broad array of firms with dramatically different businesses;

—How the proposed rule would apply to affiliates regulated by multiple agencies;

—How the proposed rule would apply to certain types of investment advisers; and

—Tax and accounting consequences.

The SEC staff is working closely with the staff of the banking regulators to consider these comments and how the jointly proposed rules could be revised to address commenters' concerns with those rules.

The SEC is also moving forward with enhanced disclosures related to executive compensation required by the Dodd-Frank Act. In the fall of 2013, the Commission proposed a new rule that would require public companies to disclose the ratio of the compensation of its chief executive officer to the median compensation of its employees. Advancing the other executive compensation rules required under the Dodd-Frank Act is also a near-term priority.

QUESTIONS SUBMITTED BY SENATOR RICHARD C. SHELBY

Question. In recent years, the SEC has responded to events like the 2010 flash crash or the concerns raised by Michael Lewis with narrowly focused studies of the problem at hand. While examining the latest problems and reassuring market participants is important, ad hoc reviews and immediate responses to crises often crowd out the opportunity to engage in deeper assessments of complex reform issues such as market infrastructure, off-exchange trading, and Regulation National Market System (NMS).

Given the growing complexity and fragmentation of our equity markets, are you supportive of calls for the SEC to undertake a comprehensive review of market structure?

Answer. Yes. As reflected in a recent public speech, I set forth three core principles that are grounding the SEC's review of equity market structure and guiding further actions: (1) all issues must be evaluated through the prism of the best interest of investors and the facilitation of capital formation for public companies; (2) we must account for the varying nature of companies and products, with a particular sensitivity to the needs of smaller companies; and (3) our review of market structure

must be comprehensive, including testing assumptions about long-standing rules and market practices.[11]

Addressing the issues of our current market structure demands a continuous and comprehensive review that integrates targeted enhancements with an expansive consideration of broader changes.[12] Accordingly, as we evaluate the merits of broader changes, we will also continue to assess and address specific elements of today's market structure that work against the interests of investors and public companies. In these remarks, I outlined the initiatives we are advancing across five broad sets of issues: market instability, high frequency trading, fragmentation, broker conflicts, and the quality of markets for smaller companies.[13] These initiatives are designed to address discrete issues that will, among other things, enhance transparency and the Commission's ability to oversee HFT firms.

While our review in each of these five areas has already resulted in discrete actions targeting specific issues, the more fundamental policy questions demand—and are receiving—close attention at the SEC. To facilitate engagement with market participants and the public, SEC staff will populate our market structure website with summaries of key issues that provide a framework for further analysis, identifying areas that the staff is focused on and where public perspectives are essential. To help in our review of equity market structure, I have also recommended to the Commission the creation of a new Market Structure Advisory Committee comprised of experts with a diversity of backgrounds and viewpoints. The new committee will serve as an additional forum and resource for reviewing specific, clearly articulated initiatives or rule proposals.

Question. In early July, the Commission's rules providing for the regulation and registration of municipal advisors will become effective. The Commission routinely publishes updated and final "Frequently Asked Questions" (FAQs) which provide practical information to firms seeking to comply with the rule. The Office of Municipal Securities provided general interpretive guidance on certain aspects of the final rules on May 19, 2014. However, FAQ's detailing the manner in which the rule treats wholly owned bank subsidiaries making tax exempt loans have not been finalized and published. It is my hope that these would be published well before the effective date so that covered entities have the time and opportunity to understand and comply with the rule.

When will you publish Commission FAQs relating to wholly owned bank subsidiaries?

Answer. The Commission's final rules for municipal advisor registration became effective on July 1, 2014. To address specific questions arising from market participants and to facilitate a smooth implementation of these major new rules, the staff in the Office of Municipal Securities provided interpretive guidance, in the form of frequently asked questions (FAQs), in January and May of this year.

In the May FAQs, the staff specifically addressed several questions raised by banks regarding implementation of the final rules, including: (1) the treatment of so-called "dual employees" of banks (i.e., individuals who are employed by a bank and also are associated with the bank's broker-dealer affiliate); (2) the applicability of the bank exemption to banks that provide advice to a municipal entity regarding the structure, timing, and terms under which the bank would purchase municipal securities for its own account; (3) the treatment of proceeds of pension obligation bonds; and (4) transitional guidance for identifying existing proceeds of municipal securities held in existing accounts or existing investments.

Although the staff did not provide specific guidance regarding the treatment of transactions in which wholly-owned bank operating subsidiaries make tax-exempt loans under the final rules, the staff issued an FAQ regarding the purchase of municipal securities by an institutional buyer in a principal capacity that may be relevant for these transactions. Specifically, in this FAQ, the staff stated that an institutional buyer would not be engaged in municipal advisory activity under the final rules if the institutional buyer only provides information regarding the terms under which the institutional buyer would purchase municipal securities for its own account and does not provide advice to the municipal entity regarding an issuance of municipal securities that would be offered to other investors. The staff believes that this guidance could be relevant to and useful for advice on transactions involving those wholly-owned bank operating subsidiaries that meet the general parameters specified in the FAQ.

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[11] *Enhancing Our Equity Market Structure,* Speech by SEC Chair Mary Jo White, at Sandler O'Neill & Partners, L.P. Global Exchange and Brokerage Conference New York, N.Y. (June 5, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370542004312.

[12] *Id.*

[13] *Id.*

QUESTION SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. Chair White, you have received several letters, one signed by the Illinois Secretary of State (and 7 others) and the other by the Illinois Securities Commissioner (and 17 other Commissioners), expressing concerns about the SEC's proposal to preempt the States from reviewing Regulation A offerings. Under the JOBS Act, issuers are exempt from State review for shares traded on a national exchange or sold to a "qualified purchaser." The SEC's proposed rules define a qualified purchaser as "all offerees of securities in a Regulation A offering and all purchasers in a Tier 2 offering," applying to anyone and eliminating State review.

Many have suggested that with smaller offerings and newer issuers also comes greater risk and likelihood of fraudulent activity. Although your points on investor protection and costs associated with complying with State law are well-taken, states currently offer review on these smaller offerings that can further protect investors. States also have taken steps to harmonize review processes, streamlining requirements among states in response to concerns about the time and costs associated with complying with State review.

How will the SEC work with State regulators' to address concerns that preempting State authority beyond what Congress intended under the JOBS Act would limit the additional investor protections states can offer, especially in light of commitments to streamline State review processes to address issuer concerns?

Answer. As part of our ongoing dialogue with State securities regulators, Commission staff and I periodically meet with representatives of the states and the North American Securities Administrators Association (NASAA) to discuss developments in the securities markets and, where applicable, to address areas of specific concern.

With respect to the Commission's proposed rules for implementing Title IV of the JOBS Act, the Commission has received more than 100 comment letters on its rule proposal, many of which addressed the proposed approach to State securities law compliance. The staff is carefully reviewing the comments as it works to develop recommendations for final rules for the Commission's consideration. In addition, the staff is closely monitoring the development and implementation of NASAA's multi-State coordinated review program for Regulation A offerings. It should also be noted that the proposed rules would not limit in any way the states' authorities to pursue fraudulent offerings and would permit that all offers under proposed Regulation A be filed with a State with such a requirement.

I look forward to continuing our ongoing dialogue with State securities regulators and NASAA, including with respect to the Commission's proposal to adopt rules to implement title IV of the JOBS Act. Our objective for this rulemaking is to ensure that the framework and requirements for Regulation A offering are both workable and protective of investors.

QUESTIONS SUBMITTED BY SENATOR CHRISTOPHER A. COONS

Question. Since becoming Chairman, have you found the SEC to have the right resources necessary to go after those that commit fraud, regardless of where the security is bought?

Answer. Since my arrival, we have made every effort to effectively—and efficiently—deploy our funds in order to identify, investigate and prosecute those within our jurisdiction that commit fraud. These efforts have resulted in a number of significant enforcement cases across our regulatory spectrum, including actions against exchanges to ensure they operate fairly and in compliance with applicable rules, actions against investment advisers and broker-dealers for taking undisclosed fees and for disrupting the markets through failures in their automated trading systems, important financial reporting cases against issuers, actions against auditors and others who serve as gatekeepers to our financial system, Foreign Corrupt Practices Act (FCPA) cases against large multinational corporations, actions against municipal issuers, landmark insider trading cases, and additional cases against individuals and entities whose actions contributed to the financial crisis.

That said, the SEC needs significant additional resources to keep pace with the growing size and complexity of the securities markets and the agency's broad responsibilities. Specific to our Enforcement program, we face a number of key challenges to preserve and enhance our ability to vigorously pursue the entire spectrum of wrongdoing within our jurisdiction. Our Enforcement work includes the detection, investigation, and litigation of violations of the Federal securities laws. In each of these areas, we face significant challenges:

—*Detection.* We receive over 15,000 tips, complaints, and referrals annually, including the more than 3,000 tips that flow into the Division's Whistleblower Office, which generate a fresh stream of case leads in need of investigation. The

review and analysis of these tips require significant human and technological resources. We also have focused intensively on potential misconduct in the equity markets and in connection with new rules, including those implemented under the Dodd-Frank and JOBS Acts. But detecting misconduct in constantly evolving securities markets, including as a result of the growth of algorithmic, automated trading and "dark pools," requires substantial resources.

—*Investigations.* Technological advances across the industry allow for more sophisticated schemes, which require improved technology and significant resources to unravel. We also are expanding our focus on financial reporting and auditing misconduct cases, which are highly technical and labor intensive.

—*Litigation.* We have seen an increase in litigation and trials as we focus more extensively on individual wrongdoing. And, the recent change to our long-standing settlement policy that now requires admissions in certain cases may lead to more litigation. Success at trial is critical to our ability to carry out our mission, and litigation, often against well-funded opposition.

In order to meet the challenges of our rapidly changing and expanding markets, with increasingly complex products and more sophisticated wrongdoers, Enforcement seeks to hire 126 new staff, including additional legal, accounting, and industry specialized experts, primarily for investigations and litigation. These critical resources will enable us to improve our information processing and analysis, expand our investigative capabilities, strengthen our litigation capacity, and better use technology. In addition, the Enforcement Division will continue to: (1) invest in technology that enables the staff to work more efficiently and effectively, and (2) collaborate with external stakeholders who assist in the Division's identification, investigation, and litigation of securities law violations, including wrongdoing that crosses borders.

Question. I believe private enforcement and investors' right to recover losses is very important, and serves as a deterrent to securities fraud. Would you agree and can you discuss how the SEC can work with victims of securities fraud to recover losses?

Answer. The SEC is fully committed to its mission of protecting investors and continuously strives to maximize the return of funds to victims of securities fraud whenever possible. This may consist of ill-gotten gains required to be disgorged and/or penalties imposed by a court in the Commission's enforcement actions. The Sarbanes-Oxley Act of 2002 enhanced the Commission's ability to more fully compensate harmed investors by giving us authority, in appropriate cases, to create Fair Funds through which we can distribute civil penalties (along with disgorgement) to victims. Prior to the Act, the Commission was required to transmit all penalties obtained to the U.S. Treasury. This Fair Fund authority is an important part of our effort to help harmed investors recover losses. Additionally, meritorious private actions can help supplement regulatory enforcement of the securities laws.

The SEC's Office of Distributions (OD) within the Division of Enforcement is responsible for overseeing the Commission's distributions program. The OD handles all distributions to victims in enforcement actions where a disgorgement fund exists or where the Commission or a court has created a Fair Fund that includes monetary penalties. The office was reorganized in 2011 to centralize the handling of distributions, develop expertise, and improve speed and efficiency in the distribution process. Its mission is to return money to harmed investors whenever practicable in a fair, reasonable, cost-effective, and efficient manner. It also seeks to promote awareness among injured investors about the distributions process through proactive outreach and targeted mailings.

The OD handles an average of 200 distribution funds at any given time. Since the passage of the Sarbanes Oxley Act, the SEC has returned more than $9.9 billion to harmed investors through its distributions. In fiscal year 2013, the SEC returned over $250 million to harmed investors through 22 different distribution funds. We are committed to continuing to work to maximize the return of funds to harmed investors whenever possible.

Question. There are reports that the SEC is considering allowing U.S. companies to utilize accounting standards from the International Standards Board to report their financial results in the United States. Could you comment on the validity of these reports, as well as the strengths and weaknesses of such an approach?

Answer. The Commission has long promoted the objective of a single set of high-quality globally accepted accounting standards. The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have been working together to more closely converge U.S. Generally Accepted Accounting Principles (U.S. GAAP) and International Financial Reporting Standards (IFRS) since 2002. The FASB's ongoing work with the IASB on convergence projects has resulted in the elimination of many significant differences between U.S. GAAP and IFRS.

The Commission continues to monitor the progress of the remaining convergence projects.

Under the Commission's rules, foreign private issuers are permitted to file financial statements in accordance with IFRS as issued by the IASB without reconciliation to U.S. GAAP. Today, over 500 companies, representing trillions of dollars of market capitalization, avail themselves of this method of reporting by submitting reports to the Commission as foreign private issuers using IFRS. Therefore, high-quality IFRS standards are critically important to the U.S. markets.

The Commission has not yet made any determinations as to whether there would be any further incorporation of IFRS into the U.S. financial reporting system. I believe it is important for the Commission to continue to consider the potential benefits and challenges of further incorporating IFRS into the U.S. financial reporting system. As we do, it is imperative to fully consider the interests of U.S. investors, the FASB's role as the standard setter of accounting standards for U.S. companies, and the role the United States plays in the development of global accounting standards.

QUESTIONS SUBMITTED BY SENATOR JERRY MORAN

SEC REGISTRATION THRESHOLD UNDER SECTION 12(G)

Question. In implementing Section 401 of the JOBS ACT, the SEC proposed Regulation A+, which is intended relieve the reporting burden for small businesses by exempting securities offerings of less than $50 million annually from the registration requirements of the Securities Act. Additionally, the JOBS Act increased one of the registration thresholds under section 12(g) of the Exchange Act, by allowing up to 2000 accredited investors for companies with over $10 million in assets. Recently, Kansas businesses have expressed concerns about increasing asset threshold under 12(g) in order to match the exemption provided for public offerings in Regulation A+.

Has the SEC examined the effects of increasing the 12(g) asset threshold?

What is the policy rationale for such an increase? Do you believe that rationale is consistent with Congressional intent?

What is the SEC doing to make certain the reporting requirements for companies with assets of $10 million and 2000+ accredited investors are not more burdensome than requirements for companies with potential assets of up to $50 million?

Answer. As described in the Commission's rule proposal to implement new section 3(b)(2), often referred to as Regulation A+ exemption, a company raising capital under that exemption would have to comply with the requirements of Exchange Act Section 12(g) just as any other company would. That is, no matter how much a company raised in a Regulation A+ offering, if, at the end of the year it had more than $10 million of assets and 2,000 holders of record, it would be required to register under the Exchange Act.

Under the rule proposal, certain Regulation A+ issuers would be required to file annual and semiannual ongoing reports and current event updates that are similar to the requirements for public company reporting, but scaled for these issuers. In the proposing release, the Commission noted that such disclosures would benefit investors by providing a regular flow of information and would further the development of a market for the securities. The reporting obligations would be required even if the issuer has fewer than 2,000 holders of record and therefore does not meet the thresholds under section 12(g). The staff is carefully reviewing the public comment received on this rule proposal as it works to develop recommendations for final rules for the Commission's consideration.

With regard to Exchange Act Section 12(g), Congress established a $1 million total assets threshold in 1964. The Commission subsequently used its authority under Exchange Act Section 12(h) to raise the asset threshold several times, and raised it to $10 million in 1996. The changes made by the JOBS Act, which were effective immediately upon enactment, codified the $10 million threshold in the Exchange Act, but did not raise it.

The Commission staff is preparing rule recommendations to revise its rules to implement the changes made by the JOBS Act to section 12(g). When undertaking these rulemakings, as is the case with all rulemakings, the Commission and its staff are mindful of the economic effects associated with the requirements proposed or adopted, including the costs and benefits of regulation and potential effects on efficiency, competition and capital formation.

ACCREDITED INVESTORS

Question. Section 413 of the Wall Street Reforms and Consumer Protection Act of 2010 requires the SEC to examine its definition of an accredited investor to determine whether it should be modified "for the protection of investors, in the public interest, and in light of the economy." To qualify as an accredited investor, SEC requires an investor to earn an annual income over $200,000 or a net worth over $1 million, excluding a primary residence. There is concern among the angel investing community and new businesses across the country that a dramatic increase in the threshold for qualification as an accredited investor could limit the number of individuals who are able to provide capital to early stage businesses at their most critical juncture. GAO analysis of Federal data on household net worth showed that adjusting the $1 million minimum threshold to approximately $2.3 million, to account for inflation, would decrease the number of households qualifying as accredited from approximately 8.5 million to 3.7 million, or approximately a 56 percent drop in eligible accredited investors.

What criteria will the SEC use to determine whether or not to increase the threshold for qualification as an accredited investor?

Is there strong evidence that the current thresholds pose any risk for investors? What data suggests current accredited investors do not understand risk when making investments?

Answer. The Commission staff, including staff from the Division of Corporation Finance and the Division of Economic and Risk Analysis, currently is engaged in a comprehensive review of the accredited investor definition. The review and the feedback received through that process will inform the Commission's consideration of whether to change the definition of accredited investor, including whether net worth and annual income should be used as tests for determining whether a natural person is an accredited investor. As part of this review, Commission staff is also independently evaluating alternative criteria for the accredited investor definition suggested by the public and other interested parties. Careful consideration is being given to both the need to facilitate capital formation and the need to protect investors. Any possible changes to the definition would subsequently occur through the rulemaking process, which includes opportunities for public comment on any such changes and a thorough economic analysis of their potential effects.

ACCOUNTING RULES UNDER JOBS ACT

Question. The section 4(a)(6) exemption of the JOBS Act was intended to provide investors with protection in the form of disclosure while allowing companies an easy pay to accessing investment capital. Balancing these goals is why Congress included mandatory financial disclosures for companies seeking investment. However, Congress did not stipulate the basis of accounting required and deferred to the SEC to make that determination. In response, the Commission has proposed U.S. generally accepted accounting principles (U.S. GAAP), a standard basis of accounting designed for use by larger and public corporations. Many companies and crowdfunding platforms believe this requirement is unnecessary, unduly burdensome, and inconsistent with Congress's intent to create an exemption that was compatible with the reality of small business. As the National Federation of Independent Business (NFIB) has shown, most small businesses do not use U.S. GAAP accounting. In fact, only a small minority uses any sort of pure accrual-based accounting (of which U.S. GAAP is a subset) with the vast majority using either cash-based accounting or a hybrid method. Small businesses choose the method of accounting that makes the most sense for their needs, both in terms of how it reflects the reality of their business and the costs of preparation and compliance.

Why did the SEC decide to require U.S. GAAP as the preferred accounting practice?

Answer. As you know, the Commission has proposed rules to implement the crowdfunding provisions of the JOBS Act.[14] Under the proposal, companies would be required to provide financial statements prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). The Commission considered a variety of factors when issuing the proposal, including that (i) financial statements prepared in accordance with U.S. GAAP are currently required for offerings under Regulation A, which is another exemption available to smaller issuers to raise capital; (ii) financial statements prepared in accordance with U.S. GAAP are generally self-scaling to the size of the issuer, which should reduce the burden of preparing financial statements for many early stage issuers; and (iii) some commenters suggested that the Commission require financial statements prepared in accordance with U.S. GAAP.

The Commission requested comment on the proposal and alternatives, such as whether financial statements should be prepared differently than under U.S. GAAP and, if so, which changes from U.S. GAAP would be appropriate The Commission also requested comment on whether the Commission should allow issuers to prepare financial statements using a comprehensive basis of accounting other than U.S. GAAP.

The Commission has received approximately 320 comment letters, including 30 form letters, on the crowdfunding proposal. Comments received on this aspect of the proposal were mixed, and contained a variety of suggested approaches. The Commission staff is reviewing these letters and will consider them carefully as they develop recommendations for final rules for the Commission's consideration.

AUDIT THRESHOLD

Question. In the JOBS act Congress established a tiered system of required financial disclosures that companies would have to meet in order to participate in an offering under Regulation Crowdfunding. Under the law, issuers offering more than $500,000 within a 12-month period, or such other amount as the Commission may establish, by rule, are required to provide audited financial statements. The Commission has proposed keeping the threshold for requiring an audit at $500,000. The $500,000 audit threshold as proposed has received criticism in both the media and comments to the Commission because of the prohibitive cost of audits for small companies, especially since the audit will need to be undertaken prior to the company being certain that it will secure funding. The Commission proposes to keep the threshold at $500,000 because "Congress specifically selected" it. However this is not true; Congress specifically gave the SEC authority to select a different threshold amount to avoid the very scenario that appears to be developing—that the audit requirement is too onerous for companies to comply with, excluding them from being able to take advantage of crowdfunding.

Is the SEC aware of concerns raised by small businesses interested in using crowdfunding?

Will the SEC monitor and potential modify these thresholds over time?

Answer. Title III of the JOBS Act, which establishes a new crowdfunding exemption, contains a number of requirements mandated by Congress, including those to ensure investor protection. As you note, the Commission proposed rules designed to implement the crowdfunding exemption and received approximately 320 comment letters, including 30 form letters, on the proposal. While some commenters were supportive of the Commission's proposal, other commenters expressed concerns about costs that may arise under the proposal, including costs associated with preparing audited financial statements. Commission staff is reviewing these comment letters and has been meeting with individuals and groups interested in sharing their views about the rule proposal. The staff is considering all of the feedback provided as it works to develop recommendations for final rules for the Commission's consideration. The Commission and staff appreciate the need to develop rules to implement the crowdfunding exemption in a way that both promotes capital formation while at the same time providing key protections for investors.

In issuing the proposal, the Commission noted its understanding that the proposed rules, if adopted, could significantly affect the viability of crowdfunding as a capital-raising method for startups and small businesses. Rules that are unduly burdensome could discourage participation in crowdfunding. Rules that are too permissive, however, may increase the risks for individual investors, thereby undermining the facilitation of capital raising for startups and small businesses.

The Commission also directed the staff to develop a comprehensive work plan to review and monitor the use of the crowdfunding exemption under section 4(a)(6) and the rules the Commission adopts to implement crowdfunding. Upon adoption of the final rules, the Commission staff will monitor the market for crowdfunding offerings, focusing in particular on the types of issuers using the exemption, the level of compliance by issuers and intermediaries, and whether the exemption is achieving its objectives. This monitoring program will assist the Commission's efforts in evaluating the development of market practices in offerings made in reliance on the crowdfunding exemption and related rules. These efforts also will facilitate future Commission consideration of any potential amendments to the rules implementing crowdfunding.

ONGOING AUDIT REQUIREMENT

Question. The Commission has proposed a requirement that companies subject to an initial audit must undergo audits on a yearly basis until the securities are retired, the company becomes a reporting company, or the company liquidates or dis-

solves. This proposal is in no way mandated by the JOBS Act. The Commission justifies this requirement on the grounds of providing investors and potential secondary purchasers with up-to-date information. While this is an important objective, and was the reason for Congress requiring certain limited ongoing disclosures in the JOBS act, requiring ongoing audits is excessively expensive, burdensome, and ultimately contrary to the needs of small businesses and potential investors. The ongoing audit requirement will also render the cost-of-capital of crowdfunding higher than other sources of funding, possibly creating an adverse selection problem where the best companies avoid crowdfunding in favor of other types of offerings with less onerous requirements such as offerings made in reliance on Rule 506(c), leaving only companies for whom crowdfunding is the last resort in the marketplace.

Is the Commission aware of the concern about this requirement?

Why would the Commission treat crowdfunding investments differently than securities sold under Regulation A, which do not require a yearly audit?

Answer. While some commenters were supportive of the Commission's proposal, other commenters expressed concerns about costs that may arise under the proposal, including costs associated with preparing ongoing annual reports with audited financial statements. As indicated above in response to Question 3, Commission staff is reviewing these comment letters and has been meeting with individuals and groups interested in sharing their views about the rule proposal.

The crowdfunding provisions of the JOBS Act require ongoing disclosure, which differs from current Regulation A. Under the proposal to implement the crowdfunding provisions, a company's ongoing disclosure about its financial condition would have to meet the financial statement requirements that were applicable to its initial offering of securities. As a result, only companies whose offering statement included audited financial statements would be required to provide audited financial statements on a yearly basis until one of three terminating events occurs. The Commission requested comment on the proposed ongoing annual reporting requirement and will consider carefully the comments submitted on this requirement when adopting final rules.

QUESTIONS SUBMITTED TO HON. MARK P. WETJEN

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

IMPORTANCE OF CONDUCTING ANNUAL EXAMS

Question. Chairman Wetjen, the Commodity Futures Trading Commission (CFTC) regulates the activities of over 68,000 registrants who handle customer funds, solicit or accept orders, or give trained advice. These include commodity pool operators, futures commission merchants, floor brokers, floor traders, and salespersons. I understand that due to resource constraints, the CFTC is unable to conduct reviews more frequently than once every 3 years. Because of the triennial cycle, the ability to check compliance is diluted. Your fiscal 2015 budget request seeks $38.1 million dollars which will support 158 staff. That is 63 more staff than the 95 supported by the current spending level of $23.6 million dollars.

Would the requested funding permit more frequent reviews?

Answer. Yes. Currently, the Commission's review cycles of registered entities varies depending on many factors, including the Commission's available resources and whether an entity is considered systemically important. By fully funding the President's budget request, the Commission can move toward annual reviews of all significant clearinghouses and trading platforms and perform more proactive monitoring of higher risk market participants and intermediaries. Partially funding the request will mean accepting potentially avoidable risk in the derivatives markets as the Commission is forced to reduce the frequency of reviews and forego more in-depth financial, operational and risk reviews of the firms within its jurisdiction.

Question. What are some of the benefits CFTC could realize from the proposed increase in resources for the Exams functions?

Answer. The CFTC would be in a better position to monitor risk in the markets and entities we oversee, verify that registered entities are complying with our rules, and proactively monitor the activities of our registrants. This would also help the CFTC to ensure that the financial, risk, compliance and operational reports that we receive are materially correct. Likewise, the CFTC would be better able identify industry trends and assess new and emerging risks in the industry. Lastly, the CFTC would be in an improved position to proactively monitor and detect problems at firms sooner. The benefit to customers would be just as important as closer monitoring would help ensure the firms are following our customer protection rules.

Question. Would more frequent reviews require adding staff with enhanced expertise?

Answer. While our staff has, on average, 23.6 years of experience, the industry is constantly changing and becoming more complex. In enhancing its examinations program, the CFTC would expect to hire individuals with more specialized skills, and possibly train current employees to provide those specialized skills. The skills necessary for an effective examinations program include risk management, technology (including data security and data management), swaps expertise, liquidity analysis, market risk analysis, and operational risk analysis.

Question. Is the CFTC encountering any problems in acquiring the skills and experience needed to support the growth you project to need?

Answer. The key challenges the CFTC faces in this regard are having adequate resources to train existing staff and hire qualified new staff. An additional challenge the Commission faces when hiring new staff is that it competes for qualified staff directly with private sector employers who have significant financial resources at their disposal and are often able to provide greater compensation than public sector employers. Regarding our existing staff, the Commission faces challenges in retaining some of its most experienced and knowledgeable staff. In recent years, the Commission has had to reduce investments in training opportunities for existing staff. Such training is vital to retaining employees and updating their skills and knowledge about the markets we regulate and our agency's increased regulatory responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

MARKET TRANSFORMATION AND HIGH-FREQUENCY TRADING

Question. Chairman Wetjen, as the leader of one of our key financial regulators, you are acutely aware of the growing challenges facing your agency in monitoring the markets. We now have significantly transformed, globalized, round-the-clock, and highly diversified marketplace. Rapid, electronic, algorithmic trading platforms are replacing the traditional open-outcry trading floors.

What is the current status of the CFTC's oversight of high-frequency trading and automated trading environments?

Answer. The Commodity Exchange Act (Act) and Commission regulations are designed to protect market participants and the public from fraud, manipulation, abusive practices, and systemic risk related to futures and swaps. The Commission oversees designated contract markets (DCMs), swap execution facilities (SEFs), clearinghouses, futures commission merchants (FCMs), swap dealers (SDs) and other entities and intermediaries to monitor their compliance, and in the case of DCMs and SEFs, reviews their self-regulatory programs. DCMs are subject to 23 core principles under the Act and SEFs are subject to 15. As the front-line self-regulatory organizations, DCMs and SEFs have primary responsibility for identifying misconduct by all market participants, including those engaged in automated trading and high-frequency trading (HFT). The CFTC's Division of Market Oversight conducts rule enforcement reviews of DCMs' self-regulatory programs and evaluates their compliance with the Act and Commission regulations.

The Act and Commission regulations do not distinguish between HFT and non-HFT. "High-frequency trader" is not a distinct category of market participant within the Commission's regulations, nor is it a defined term or separate registration status. Applicable regulations and resources developed by the Commission to detect trading abuses are equally relevant regardless of the trading strategy used to effectuate the abuse. Many Commission rulemakings implementing Dodd-Frank apply to automated trading and HFT because the rules address trading on DCMs and SEFs, or apply to registrants who may engage in automated trading of HFT activity.

In April 2012, the Commission adopted Regulations 1.73 and 23.609 requiring FCMs, SDs and major swap participants ("MSPs") that are clearing members to establish risk-based limits based on "position size, order size, margin requirements, or similar factors" for all proprietary accounts and customer accounts. The rules also require FCMs, SDs and MSPs to "use automated means to screen orders for compliance with the [risk] limits" when such orders are subject to automated execution. The Commission also adopted rules in April 2012 requiring SDs and MSPs to ensure that their "use of trading programs is subject to policies and procedures governing the use, supervision, maintenance, testing, and inspection of the program."

In June 2012, the Commission adopted rules to implement the 23 core principles for DCMs. Regulation 38.255 requires DCMs to "establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions, including, but not limited to, market restrictions that pause or halt

trading in market conditions prescribed by the designated contract market." Regulation 37.405 imposes similar requirements on SEFs.

The DCM rules also set forth risk control requirements for exchanges that provide direct market access ("DMA") to clients. Regulation 38.607 requires DCMs that permit DMA to have effective systems and controls reasonably designed to facilitate an FCM's management of financial risk. These systems and controls include automated pre-trade controls through which member FCMs can implement financial risk limits. Regulation 38.607 also requires DCMs to implement and enforce rules requiring member FCMs to use these systems and controls. The DCM rules also implement new requirements in the Act related to exchanges' cyber security and system safeguard programs. The Act and Commission regulations also address cyber security and system safeguards within SEFs.

Finally, the Division also conducts direct surveillance of its regulated markets, and continues to improve the regulatory data available for this purpose. For example, in November 2013 the Commission published final rules to improve its identification of participants in futures and swaps markets (OCR Final Rules). While enhancing the Commission's already robust position-based reporting regime, the OCR Final Rules also create new volume-based reporting requirements that significantly expand the Commission's view into its regulated markets, including with respect to HFT.

In addition to its current rules, on September 12, 2013, the Commission published a Concept Release on Risk Controls and System Safeguards for Automated Trading Environments. The Concept Release proposes consideration of a series of 23 additional pre-trade risk controls; post-trade reports; design, testing, and supervision standards for automated trading systems (ATS) that generate orders for entry into automated markets; market structure initiatives; and other measures designed to reduce risk or improve the functioning of automated markets. The Concept Release is intended to foster a public dialogue and inform the Commission as it considers what additional measures, if any, might be necessary to address automated and high-frequency trading.

The initial 90-day comment period closed on December 11, 2013, but was reopened from January 21 through February 14, 2014, in conjunction with a meeting of the CFTC's Technology Advisory Committee (TAC). The Commission received over 40 public comments on the Concept Release, including comments from DCMs; an array of trading firms; trade associations; public interest groups; members of academia; a U.S. Federal reserve bank; and consulting, technology and information service providers in the financial industry. CFTC Staff is currently studying all publicly submitted comments received and upon completing the review will make initial recommendations if necessary.

Question. Does the CFTC presently have the necessary talent and technology in place to monitor and analyze high-frequency trading, to inform your regulatory and enforcement work, and guard the integrity and safety of the markets? What are the deficiencies?

Answer. As noted above, the Commission's rules do not distinguish between HFT and non-HFT trading. The Commission does face challenges in making sure its technology and personnel are adequate to oversee trading in the markets, including HFT trading. The most significant impediment to enhanced Commission surveillance of HFT is insufficient staff and resources. In particular, the Commission does not have the resources in place to receive and analyze complete messaging (e.g., order book) data from DCMs or SEFs. Access to messaging data is critical to overseeing electronic trading because it permits analysts to reconstruct what actually happened during a particular trading period. With appropriate staff and technology, staff can use this data to detect disruptive trading practices such spoofing. Achieving comprehensive surveillance of electronic trading will require additional financial, staff and other resources not currently available to the Commission.

SUBCOMMITTEE RECESS

Senator UDALL. The subcommittee hearing is hereby adjourned.

[Whereupon, at 3:25 p.m., Wednesday, May 14, the subcommittee was recessed, to reconvene subject to the call of the Chair.]

FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2015

WEDNESDAY, MAY 21, 2014

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 1:45 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Tom Udall (chairman) presiding.

Present: Senators Udall and Johanns.

SMALL BUSINESS ADMINISTRATION

OFFICE OF THE ADMINISTRATOR

STATEMENT OF HON. MARIA CONTRERAS–SWEET, ADMINISTRATOR

OPENING STATEMENT OF SENATOR TOM UDALL

Senator UDALL. The subcommittee will now come to order. Good afternoon.

I am pleased to convene this hearing of the Appropriations Subcommittee on Financial Services and General Government on the fiscal year 2015 budget request for the Small Business Administration and the Community Development Financial Institutions Fund.

First, I want to welcome Ranking Member Senator Mike Johanns. Others may be joining us today. We are not sure on that. But they may participate with us as we progress.

With us today are two distinguished witnesses, the new Administrator of the Small Business Administration, Maria Contreras-Sweet, and the Acting Assistant Secretary of Financial Institutions of the Treasury Department, Amias Gerety.

Thank you for your service, and I look forward to hearing your testimony.

Last week was National Small Business Week, recognizing small-business owners and entrepreneurs. Small businesses, as we all know, are the backbone of our American economy, creating two out of every three jobs in the United States. In my home State of New Mexico, small businesses make up 96 percent of all employers.

I welcome the opportunity today to conduct oversight of these two Federal entities. They play an important role in supporting small businesses, creating jobs, revitalizing distressed communities, and strengthening our economy.

The Small Business Administration does four important things. It offers training and mentorship services with partner organiza-

tions across the country. It helps small businesses compete for $80 billion in Federal contracts. It provides $36 billion in guaranteed loans to help small businesses start up and grow, and another $1 billion in direct loans to help small businesses rebuild after natural disasters.

The Community Development Financial Institutions (CDFI) Fund at the Treasury Department also provides valuable support to financial institutions that serve distressed communities and to help develop these underserved areas. It supports over 800 CDFI institutions across the country with financial assistance, tax credits, and a new bond program. The CDFI Fund was awarded $1.7 billion in financial assistance for community development organizations and $33 billion in tax credits.

The Small Business Administration (SBA) and CDFI Fund are crucial for new entrepreneurs needing help with creating a business plan. For well-established businesses, it is crucial because they are still struggling to recover from the economic crisis and need help with credit.

These programs help entrepreneurs open grocery stores in neighborhoods without healthy food options. They help new homeowners afford their first homes. And together, the SBA and the CDFI Fund provide access to capital, and they leverage funds to help grow our economy and create new jobs.

The fiscal year 2015 budget request for the SBA is $865 million, a decrease of $64 million from the fiscal year 2014 level. In large part, this reduction is the result of a stronger economy with small-business owners less likely to default on their federally guaranteed loans, saving taxpayer dollars.

However, there are the reductions that are troubling. The request eliminates the State Trade and Export Promotion program, a program that helps small businesses increase their exports.

As a Senator from a border State, I know firsthand how such programs can help an economy grow.

Similarly, the total request for the CDFI account is $225 million. That is slightly less than the fiscal year 2014 level. With this total, the request eliminates the Bank Enterprise Award program, a program that provides financial incentives to FDIC-insured banks to increase their investments in distressed communities.

I look forward to hearing from both witnesses on why these reductions were requested.

Both agencies have also requested to extend programs that help provide access to capital that is not available on the private market.

SBA's 504 loans provide credit for small businesses to purchase real estate and equipment. The budget proposals to allow 504 loans to be used to refinance commercial mortgages so small-business owners can lock in low interest rates and free up resources to reinvest in their businesses, helping them get back on their feet.

The CDFI bond program currently provides $750 million in 30-year bonds to CDFIs, which are then leveraged to community investors to support development. The budget proposes to continue and increase this bond program for another year.

Both proposals would provide credit to reinvest in our communities at no cost to the taxpayer. I look forward to hearing from

these witnesses about the resources they need to do their jobs and how the subcommittee can help to support their vital missions and help this recovery reach Main Street, which I think should be an important focus of this hearing.

I now turn to my distinguished ranking member, Senator Mike Johanns, for his opening comments.

STATEMENT OF SENATOR MIKE JOHANNS

Senator JOHANNS. Mr. Chairman, thank you for calling this hearing today.

To our witnesses, welcome. We are glad to have you here. I look forward to your testimony. I look forward to testimony about the Small Business Administration and other efforts to promote economic growth in our Nation.

The American economy is still facing rocky times. Unfortunately, I believe many current policies are hindering rather than helping growth. We especially need to do more for our country's small businesses. In States like mine, and across the country, they are the backbone of the economy and represent the majority of all new jobs created over the last decade.

When I meet with small businesses in business roundtables and that sort of environment, it doesn't take very long before they are talking to me about regulatory reform and the need for that. An uncertain regulatory environment affects lenders and small-business owners.

I constantly hear from financial institutions all over Nebraska about how correct regulatory burdens and ever-changing rules are negatively affecting availability and access to credit. Businesses have to have capital to grow. They have to have capital to expand, to create jobs, so we need to ensure that the Government is not throwing up roadblocks in terms of capital development.

The SBA has a critical mission in our Nation, providing a helping hand to small businesses through guaranteed and direct loans. SBA also does important work to help businesses, homeowners, and communities affected by disasters.

We have, unfortunately, seen the unbridled hand of Mother Nature affect communities in Nebraska. Just 10 days ago, tornadoes devastated the areas of Beaver Crossing, Sutton, Nebraska, Cordova, and elsewhere. In just one example, 1,200 Nebraskans volunteered, though, to help with cleanup in a community of 400 people. What a remarkable response.

It signifies the true character of a great State. But that does not mean these folks who lost everything won't need some help in terms of loans from the SBA. They need that to get back on their feet.

I have been in close contact with the Governor and others in the State. I have every indication that a request will be forthcoming, probably this week. And I know that the SBA will very carefully, attentively, and responsibly look at the request. These good people need your help.

These folks had a rough Mother's Day, and I am hopeful that we can get them appropriate assistance quickly.

On the CDFI program, the President's budget request proposed a slight reduction for the program. While I appreciate the efforts

to hold down spending, I do question some of the rearranged priorities in this CDFI account.

For instance, the President's budget zeroed out the bank enterprise award program in order to finance increases to the healthy foods financing program. So there are instances where I will have some questions that I would like to have answered today.

I would say that both of these agencies have very worthy goals. The job of both agencies is to generate economic growth. Given our Government's fiscal restraint, we must carefully review every agency budget to ensure that taxpayers are receiving the best value for the dollar.

I look forward to hearing from our witnesses about the efforts they are making to work with small businesses and community lending institutions to ensure that these programs are having an impact in both urban and rural America.

Mr. Chairman, again, thank you for calling this hearing. I look forward to the testimony.

Senator UDALL. Senator Johanns, thank you for very much for that opening statement.

Administrator Contreras-Sweet, I invite you to present your remarks on behalf of the Small Business Administration.

SUMMARY STATEMENT OF HON. MARIA CONTRERAS-SWEET

Ms. CONTRERAS-SWEET. Thank you, Mr. Chairman. And thank you, Ranking Member Johanns, and the distinguished members of the subcommittee. Thank you for this opportunity to testify before you today.

We appreciate your ongoing leadership and your support for the SBA as we work to assist the entrepreneurs who are so critical to economic growth and local job creation. We all know that they create right now two out of three new jobs, and they employ half of the private sector workforce. So it is important, the work that we are doing.

I have been on the job, I am pleased to say, for about 6 weeks now, 38 days to be precise. And I have traveled across the country to meet with our core constituencies, meaning the small-business owners, veteran entrepreneurs, SBA lenders, procurement officials, exporters, and victims of the devastating mudslide in Washington.

I can tell you that at every stop, I have heard powerful testimony about how SBA has been a critical force in helping our small businesses succeed.

Again, I want to thank this committee, in particular, for enabling SBA to increase access to capital, to counseling, and to contracts, and, of course, to disaster assistance for small businesses throughout our country.

This budget request gives me the tools I need to pursue three core goals: number one, to expand access to capital to create more quality jobs; two, to embrace an inclusive vision for SBA; and three, to ensure our programs are giving taxpayers a strong return on their investment, a real bang for their buck.

With respect to the first goal, to create jobs through our loan programs, last year was the third straight year that SBA supported over $29 billion in lending to more than 47,000 small businesses.

We also assisted 46,000 businesses and individuals through $2.8 billion in disaster loans.

For fiscal year 2015, SBA is requesting an appropriation of $710 million plus an additional $155 million for our disaster assistance program. This request would enable us to guarantee loans totaling $36.5 billion over the next year, and it would help us facilitate access to $80 billion in Federal contracts for our small businesses.

We are also requesting full funding for disaster loan assistance, as we continue to make process reforms to ensure that homeowners, renters, and businesses have access to rapid SBA assistance when they need us the most.

We have dramatically reduced our subsidy for the 504 loan program down to $45 million. And for the second year in a row, SBA is requesting no credit subsidy for the 7(a) loan program.

Overall, our fiscal year 2015 request represents a $64 million reduction because of the subsidy decrease, as you aptly pointed out.

These two lending programs, both 7(a) and 504 together, will support an estimated 650,000 jobs for fiscal year 2015.

This budget also seeks authority to extend 504 refinance lending. The 504 refi helps entrepreneurs unlock equity that they already own in their businesses. A restructured loan under 504 refi means a better rate on long-term debt, allowing owners to use their equity to create jobs and to grow.

Before expiring at the end of fiscal year 2012, the 504 refi supported $5.5 billion in lending over 2 years. And the good news is, again, this request is at zero subsidy cost to the taxpayer.

In terms of the next core value, in terms of an inclusive vision for entrepreneurship, this budget would help SBA get more loans into the hands of entrepreneurs from diverse backgrounds. And toward that end, we encourage our lending partners to approve more small-dollar loans.

SBA is once again setting fees to zero under our 7(a) loans under $150,000.

This budget would allow us to continue working with our resource partners to counsel and train more than 1 million small-business owners annually.

To that end, we are seeking funding for our nationwide network of Small Business Development Centers (SBDCs), our Women's Business Centers (WBCs), our Veteran's Business Outreach Centers (VBOCs), and our volunteer SCORE counselors. Each year more than 250,000 servicemembers transition out of the Armed Forces. Our Boots to Business program allows them to continue to serve their country and become job creators.

We are requesting $7 million to meet the Department of Defense's request to train transitioning servicemembers at more than 200 installations worldwide. We are making it easier for veterans to access capital by reducing or eliminating their fees on certain SBA loans.

We are also investing more in our Native American programs, working in 84 communities across America to facilitate new business opportunities for this underserved population. Through our 8(a) program, we have helped native entrepreneurs and tribal businesses secure more than $10 billion in Government contracts in fiscal year 2012.

Finally, a return on investment for the taxpayer, in terms of ensuring that they are getting the maximum Return on Investment (ROI), the SBA continues to focus on rooting out waste, fraud, and abuse in contracting and lending programs. Since 2008, SBA has suspended and debarred more companies and individuals for abusing SBA programs than in the previous 10 years combined.

I am committed to ensuring that Federal dollars go to deserving small businesses that play by the rules.

At the same time, we have tightened our belts within our own operations, saving $600,000 in rent by moving our DC district office, reducing our fleet expenses by more than 9 percent, and reducing SBA travel by 25 percent over fiscal year 2012 levels.

Our fiscal year budget ensures that America's small businesses have the resources and the tools and the training to realize their potential, strengthen our economy, grow communities, grow jobs, and grow America.

PREPARED STATEMENT

With that, I thank you. I thank the subcommittee for its leadership, for its support for small businesses. And I would be delighted to take your questions at the appropriate time.

[The statement follows:]

PREPARED STATEMENT OF HON. MARIA CONTRERAS-SWEET

Chairman Udall, Ranking Member Johanns, and distinguished members of this subcommittee, thank you for this opportunity to testify today.

We appreciate your ongoing support for the Small Business Administration (SBA) as we work to assist the entrepreneurs who are so critical to economic growth and local job creation.

I've been on the job for 6 weeks now. I've traveled across the country to meet with our core constituencies: small business owners, veteran entrepreneurs, SBA lenders, Certified Development Companies (CDCs), procurement officials, exporters, and victims of the devastating mudslide in Washington State.

At every stop, I've heard powerful testimonials about how SBA has been a critical force in helping our small businesses succeed. We're a small agency with a big mission. We call it "3 Cs and a D"—providing access to capital, counseling, contracts and disaster assistance. Our fiscal year 2015 budget will help us fulfill that mission and support the entrepreneurs who are creating most of the new jobs in America.

Last year was the third straight year that the SBA supported over $29 billion in lending to more than 47,000 small businesses. We also assisted more than 46,000 businesses and individuals through $2.8 billion in disaster loans.

For fiscal year 2015, the SBA is requesting an appropriation of $710 million, plus an additional $155 million for our disaster assistance program.

This request would enable us to guarantee loans totaling $36.5 billion over the next year and help us facilitate access to $80 billion in Federal contracts for small businesses.

This budget request gives me the tools I need as Administrator to pursue three core goals: expand access to capital to create more quality jobs; embrace an inclusive vision for the SBA in which our borrowers better reflect the geographic and socioeconomic diversity of America; and ensure our programs are giving taxpayers a strong return on their investment—real bang for their buck.

It would allow us to work with our resource partners to counsel and train more than 1 million small business owners. To that end, we're seeking full funding for our Small Business Development Centers, Women's Business Centers, Veteran's Business Outreach Centers and our national network of SCORE chapters and volunteer mentors.

We're also requesting full funding for disaster loan assistance as we continue to make process reforms to ensure that homeowners, renters, and businesses have access to rapid SBA assistance when they need us the most.

We've dramatically reduced our subsidy for the 504 loan program down to $45 million, and for the second year in a row, the SBA is requesting no credit subsidy

for the 7(a) loan program. Overall, our fiscal year 2015 request represents a $64 million reduction because of the subsidy decrease.

Our borrowers report that these two lending programs—7(a) and 504—together have supported more than 650,000 jobs.

This budget seeks authority to extend 504 Refinance lending. 504 Refi helps entrepreneurs unlock equity they already own in their businesses. Restructuring a loan under 504 Refi means better rates on long-term debt, allowing owners to use their equity to create jobs and grow.

504 Refi supported $5.5 billion in lending over 2 years when it was originally authorized, but it expired at the end of fiscal year 2012. This is a zero subsidy request. The tremendous benefits of reinstating this program would come at zero subsidy cost to the taxpayers.

Each year, more than 250,000 servicemembers transition out of the armed forces. Our Boots to Business program allows them to continue to serve their country as job creators. In fact, on my very first day at the SBA this week, I met with a group of these heroes who've started their own businesses.

We're requesting $7 million to meet the Department of Defense's request to train transitioning servicemembers at more than 200 installations worldwide. We're also making it easier for veterans to access capital by reducing or eliminating their fees on certain SBA loans.

This budget will help SBA get more loans into the hands of entrepreneurs from diverse backgrounds.

Toward that end, the SBA is once again setting fees to zero to encourage our lending partners to approve more 7(a) loans under $150,000.

We're also investing more in our Native American programs, working in 84 communities across America to facilitate new business opportunities for this underserved population. Through our 8(a) program, we helped Native entrepreneurs and tribal businesses secure more than $10 billion in government contracts in fiscal year 2012.

Finally, the SBA continues to focus on rooting out waste, fraud, and abuse in our contracting and lending programs.

Since 2008, SBA has suspended and debarred more companies and individuals for abusing SBA programs than in the previous 10 years combined. I have a zero-tolerance policy for these and I am committed to ensuring that Federal dollars go to deserving small businesses that play by the rules.

At the same time, we've tightened our belts within our own operations. The SBA is saving $600,000 in rent by moving our DC office into our SBA national headquarters. We've reduced our fleet management expenses by more than 9 percent through reductions in our fleet. We've invested in new equipment that will save us a half-million dollars in copying expenses over the next 5 years. And we've reduced SBA travel by 25 percent over fiscal year 2012 levels.

In closing, I would like to share something Federal Reserve Chair Janet Yellen said last Thursday when she addressed small business leaders from all 50 States during National Small Business Week: "America has come a long way since the dark days of the financial crisis, and small businesses deserve a considerable share of the credit for the investment and hiring that have brought that progress. Although we have come far, it is also true that we have further to go to achieve a healthy economy, and I am certain that small businesses will continue to play a critical role in reaching that objective."

Our fiscal year 2015 budget ensures that America's small businesses have the resources, tools and training to realize their potential and strengthen our economy. With that, I want to thank this subcommittee for its leadership and support of small businesses, and I am happy to take your questions.

Senator UDALL. Thank you very much for your testimony.

Mr. Gerety, please present your testimony on behalf of the Treasury Department.

DEPARTMENT OF THE TREASURY

OFFICE OF FINANCIAL INSTITUTIONS

STATEMENT OF AMIAS GERETY, ACTING ASSISTANT SECRETARY FOR FINANCIAL INSTITUTIONS

Mr. GERETY. Thank you, and good afternoon, Chairman Udall, Ranking Member Johanns, and other members of the subcommittee. Thank you for inviting me to speak in support of the President's fiscal year 2015 budget request for the Treasury Department's Community Development Financial Institutions Fund, or CDFI Fund.

I would like to start by expressing my appreciation to the subcommittee and to Congress for its long history of support for the CDFI Fund, and by requesting your continued strong support for its critically important mission.

The 2015 budget requests $225 million for the CDFI fund's flagship program, the CDFI program, which spurs economic growth and increases access to capital in low-income communities; for the Healthy Food Financing Initiative, which supports the growth of businesses that increase access to affordable, healthy food in low-income communities; the Native American CDFI Assistance Program, which increases access to credit, capital, and financial services in Native American communities; and resources for the administration of the CDFI Fund.

The budget also proposes a 1-year extension of the CDFI bond guarantee program, which provides a source of long-term capital to financial institutions that support lending in underserved communities.

The CDFI Fund programs create economic growth in communities often considered too risky for mainstream financial institutions. Let me offer you an example from a business I visited in New Orleans earlier this month.

Circle Foods is a grocery store that opened in 1939, and was New Orleans' first African-American owned and operated grocery store. In 2005, it was heavily damaged by Hurricane Katrina, and for 7 years, the owner tried to secure financing to renovate and reopen his business, but he was unable to find any willing investors and lenders.

In 2012, Hope Credit Union, a leading CDFI serving the Midsouth, provided Circle Foods with financing through a partnership that included the city of New Orleans' fresh food retail initiative. And this year, a new 22,000-square-foot Circle Foods reopened and is now providing access to fresh produce and affordable food.

In addition, the grocery store has created 62 new jobs, the majority of them filled by people who live in that community.

The President's 2015 budget reflects a careful balance of savings proposals and targeted investments in key priorities. Continued

strong funding is needed if the CDFI Fund is to be able to continue its critical work, generating new economic opportunity where it is needed most.

PREPARED STATEMENT

Mr. Chairman, this concludes my formal statement, and I will be happy to answer any of your questions. Thank you very much.

[The statement follows:]

PREPARED STATEMENT OF AMIAS GERETY

INTRODUCTION

Good afternoon Chairman Udall, Ranking Member Johanns, and distinguished members of the subcommittee. Thank you for inviting me to speak today on behalf of the Department of the Treasury's Community Development Financial Institutions Fund (CDFI Fund) and in support of the President's fiscal year 2015 budget request. I would like to start by expressing my appreciation to this subcommittee and to Congress for its long history of support for the CDFI Fund.

During my tenure at Treasury it has always been an honor to work with the dedicated men and women at the CDFI Fund. They're talented public servants who are focused on strengthening our country and they performed with excellence under quite difficult conditions over recent years. So I want to thank them for their service and commitment.

The President's fiscal year 2015 budget requests your continued strong support for the CDFI Fund and its critically important mission: To increase economic opportunity and promote community development investments for underserved populations and in distressed communities in the United States. As a vital component of the Treasury, the CDFI Fund is closely aligned with Treasury's core priority of promoting domestic economic growth.

In fiscal year 2015 the CDFI Fund requests $224.9 million. This is slightly below the fiscal year 2014 enacted level. The budget includes:

—$151.3 million for the CDFI Fund's flagship program, the CDFI Program, which spurs economic growth and increases access to capital in low-income communities;

—$35 million for the Healthy Food Financing Initiative (HFFI), which supports the growth of businesses that increase access to affordable, healthy food in low-income communities;

—$15 million for the Native American CDFI Assistance Program, which increases access to credit, capital, and financial services in Native communities; and

—$23.6 million for administration of the CDFI Fund.

The budget also proposes a 1-year extension of the CDFI Bond Guarantee Program, which provides a source of long-term capital to financial institutions that support lending in underserved communities.

The CDFI Fund's programs create economic growth in communities often considered too risky for mainstream financial institutions. The CDFI Fund accomplishes much of its work through a nationwide network of over 850 certified Community Development Financial Institutions, or CDFIs. CDFIs are mission-driven financial institutions that are dedicated to community development and provide financial products and services for businesses, consumers, affordable housing developers, and community service providers. CDFIs fill a critical gap in the financial industry by serving markets that are historically underserved and by providing the economic development expertise and specialized financial products and services that these communities urgently need. CDFIs provide loans for small businesses and job creation; finance the development of affordable housing for low-income Americans; support community-based social service organizations and create high-quality community facilities; and provide retail banking services to the unbanked and others often targeted by predatory lenders.

When I was in New Orleans earlier this month, I had the opportunity to see firsthand how CDFIs are providing critically needed financing for communities most in need. One of the sites I visited was Circle Foods, a grocery store that opened in 1939 and was New Orleans' first African American-owned and -operated grocery at a time when African-Americans were not allowed to shop in other parts of the city. In 2005, Circle Foods was heavily damaged by flooding in the 7th Ward caused by Hurricane Katrina. For years, the owner tried to secure financing to renovate and reopen the store, but was unable to find any willing lenders and investors.

That changed in 2012, when Hope Credit Union, a leading CDFI serving the Midsouth, provided Circle Foods with financing through a partnership that included the City of New Orleans' Fresh Food Retail Initiative. Thanks to Hope Credit Union, a new 22,000-square-foot Circle Foods reopened earlier this year and is now providing access to fresh produce and affordable food in the 7th Ward. In addition, the grocery store has created 62 new jobs, the majority of them are filled by people who live in the local community. And Hope Credit Union soon will open a branch within the new Circle Foods that will provide convenient access to financial services and give people in the community a reliable, affordable alternative to the payday lenders that moved into the Ward following Hurricane Katrina.

This story is just one of many examples of the way that CDFIs are helping to meet critical needs in underserved communities. CDFIs all across the Nation are truly making a difference.

THE CRITICAL ROLE OF THE CDFI FUND

One of the main factors that makes the critical work of CDFIs possible is this subcommittee's support of the CDFI Fund.

CDFIs take a variety of forms. There are CDFI loan funds, credit unions, community banks, and venture capital funds. There are small local and regional CDFIs that focus on serving particular communities, as well as large national CDFIs with offices in several States and cities. But all CDFIs share a commitment to stimulating economic and community development in distressed communities. These organizations have decades of experience providing financial products and services that offer the people they serve a way to enter the financial mainstream and build successful, productive lives.

The CDFI Fund is dedicated to expanding the capacity of these invaluable organizations, and it accomplishes that in two main ways: by certifying CDFIs and by providing a variety of financing and capacity building programs for CDFIs.

CDFI CERTIFICATION

To be eligible for most of the CDFI Fund's programs, any financial institution must be certified as a CDFI in order to participate in our programs. In addition, formal certification of a CDFI is important to many prospective financing partners, including banks and foundations. To be certified, a CDFI must meet a strict set of criteria, including having a primary mission of community development and serving a target market that meets at least one of the CDFI Fund's definitions of a distressed or low-income community. One common type of target market is a census tract that has a poverty rate of at least 20 percent, or a median family income at or below 80 percent of the statewide or metropolitan average.

In 2013 the CDFI Fund undertook a formal process to recertify all existing CDFIs whose most recent certification was more than 3 years old. This process was both an investment in the integrity of the certification status for organizations and a way to position the CDFI Fund for the future. During fiscal year 2013, the CDFI Fund recertified 425 CDFIs and certified 76 new CDFIs. Today, there are over 850 certified CDFIs headquartered in all 50 States and the District of Columbia, as well as in Guam, Puerto Rico, and the U.S. Virgin Islands.

PROGRAMS AND INITIATIVES

In addition to certifying CDFIs, the CDFI Fund provides programs to support them. The oldest of these is the Community Development Financial Institutions Program (CDFI Program), through which the CDFI Fund provides financial assistance awards and technical assistance awards to enable CDFIs to expand their services and to build their technical capacity. Over the years, the demand for CDFI Program awards has continued to grow. For the fiscal year 2014 award round, the CDFI Fund received 336 applications requesting $393 million in funding, which was nearly three times the $146.4 million available through the program.

Within the CDFI Program, the CDFI Fund administers the Healthy Food Financing Initiative (HFFI), an innovative interagency program created to address the problem of food deserts in underserved communities. An estimated 23.5 million Americans lack convenient access to healthy food. Through the HFFI, the CDFI Fund provides flexible financial and technical assistance awards to CDFIs that invest in businesses that increase access to healthy food in low-income communities. In fiscal year 2014, the CDFI Fund received applications from 33 eligible organizations requesting $85 million through the HFFI, almost four times the $22 million available.

Another program is the Native American CDFI Assistance Program (NACA Program). As a part of the CDFI Fund's Native Initiatives, the NACA Program pro-

motes economic opportunity in Native communities that lack adequate access to affordable financial products and services by providing financial and technical assistance awards to CDFIs that focus on serving Native American, Alaska Native, and Native Hawaiian communities. The Native Initiatives also include specialized training programs to help CDFIs expand their capacity to serve Native communities. Since the NACA Program's inception in 2001, the number of certified CDFIs that serve Native communities has increased from 7 to 68. For the fiscal year 2014 funding round of the NACA Program, the CDFI Fund received 46 applications requesting more than $22 million in funding, almost double the $12.3 million available.

The CDFI Fund's Capacity Building Initiative complements the CDFI Program, HFFI, and the NACA Program, by providing direct technical assistance and training to CDFIs. The Capacity Building Initiative helps CDFIs improve their ability to deliver financial products and services and to achieve long-term sustainability. By offering training workshops, webinars, market research, customized technical assistance, and informational resources, the Capacity Building Initiative helps CDFIs develop, diversify, and grow.

The Capacity Building Initiative training series focuses on specialized issues of critical importance to CDFIs and the communities they serve. Among the training series presented thus far are: CDFI Capitalization; Financing Healthy Food Options; Foreclosure Solutions; Innovations in Small Business Lending; Portfolio Management; Leadership Journey for Native CDFI Growth and Excellence; Scaling up Microfinance; Preserving and Expanding CDFI Minority Depository Institutions; Financing Community Health Centers; and Strengthening Small and Emerging CDFIs.

In addition to offering these training programs, the CDFI Fund compiles training materials, webinars, and research reports that supplement the training topics and provides them in a Resource Bank on the CDFI Fund's Web site. The Resource Bank is a one-stop source for current information on topics of critical importance to CDFIs, and it is available to anyone—members of the CDFI industry and the general public alike—at no charge.

The CDFI Fund's newest program is the CDFI Bond Guarantee Program, a groundbreaking effort to accelerate community economic growth and development. The CDFI Bond Guarantee Program offers CDFIs unprecedented access to significant, long-term capital. Because Treasury fully guarantees the bonds, CDFIs can borrow for up to 30 years at an attractive fixed interest rate and use the funds to finance community development projects. Because participating CDFIs must have excellent performance histories and management and be financially capable of carrying the programs strong loan requirements, the guarantees are projected to have no cost to taxpayers. For the fiscal year 2013 round of the CDFI Bond Guarantee Program, $500 million in guarantee authority was available. The CDFI Fund received eight guarantee applications requesting a total of $825 million in bond guarantees. Treasury entered into agreements to guarantee and approved term sheets for bonds totaling $325 million.

THE CDFI FUND'S IMPACT AND PERFORMANCE

CDFIs are dedicated to serving distressed and low-income communities, and the data indicate that they are doing just that. On average, 70 percent of the customers of certified CDFIs are low-income and 60 percent are members of a minority community. Moreover, the CDFI Fund strives to proportionately serve both urban and rural areas. In fiscal year 2013, 53 percent of the CDFI Program's financial assistance awardees served major urban areas, 27 percent served minor urban areas and 20 percent served rural areas. The CDFI Fund also recently released an analysis on 10 years of data provided by CDFIs on their total portfolios. The data demonstrated that 25.4 percent of loans and investments (19.2 percent of total dollars) were made in non-metropolitan rural areas by CDFIs from 2002–2012. Approximately 17 percent of Americans reside in non-metropolitan areas, so it is clear that CDFIs are giving these traditionally underserved target markets the opportunity to benefit from services that they could not receive from mainstream financial institutions.

It is also clear that these services have a tangible impact. CDFI Program awardees reported on the most recent activities in 2012 and indicated that they had:

—Created or maintained more than 35,000 full-time jobs (up from 25,600 in fiscal year 2011);

—Originated almost 6,500 small business and microenterprise loans (up from 6,345 in fiscal year 2011);

—Financed more than 17,700 units of affordable housing (down from 24,466 in fiscal year 2011);

—Provided more than 293,000 individuals with financial literacy training and other financial education (up from 233,100 in fiscal year 2011); and

—Made more than 24,000 loans and investments totaling almost $2 billion (up from 17,500 loans and investments totaling almost $1.3 billion in fiscal year 2011).

In addition, all 12 of the first-round HFFI awardees reported on their first year of investments, which included 43 projects totaling $29 million in eligible HFFI activities. Of these 43 projects, 30 were retail projects—ranging from small green grocers to large supermarkets serving low-income communities—that created 339,226 square feet of new retail space. The other 13 HFFI projects involved other activities such as production and distribution facilities needed to increase access to healthy food.

The CDFI Fund is committed to rigorous evaluations that measure the impact of its programs. In 2012, the CDFI Fund commissioned a study to examine the financial performance and social impact of its flagship CDFI Program. That study is now underway and will be completed by the end of fiscal year 2014. In addition, the CDFI Fund has begun the "Access to Capital and Credit in Native Communities" study, a follow-up to a 2001 study that looked at access to financial services in Native American, Alaska Native, and Native Hawaiian communities, and that established some of the key guidelines of the NACA Program. The study will use a combination of existing research, consultations with tribes, and focus groups to identify important economic issues in Native communities. The results of both of these studies will allow the CDFI Fund to assess its programs more effectively and to determine ways to serve low-income communities even better in the years ahead.

The performance of CDFIs speaks volumes about their strength, commitment, and ability. And that's what the work of CDFIs and the CDFI Fund is all about. It's about more than creating programs and providing services; these are just the means to a greater end. The work is ultimately about expanding opportunities for families and communities to reach their full potential and contribute to the Nation's economic growth.

CONCLUSION

CDFIs have established a strong track record of leveraging the CDFI Fund's awards with private investment. Indeed, on average, CDFI Fund awardees leverage their awards with private investment by a factor of more than 6:1, which means that the total of $201 million in program funding requested in this budget may ultimately generate more than $1.2 billion dollars of investment. Clearly, the funding requested offers strong potential for significant local impact at a relatively small Federal cost.

The President's fiscal year 2015 budget reflects a careful balance of savings proposals and targeted investments in key priorities. As the numbers reflect, the CDFI Fund has been and remains one of those key priorities. Continued strong funding is needed if the CDFI Fund is to be able to continue its critical work generating new economic opportunity in communities where economic opportunity is needed most.

On behalf of everyone at Treasury and the CDFI Fund, I would like to again express our gratitude for the support of this subcommittee, and I look forward to continuing to work with you in the future.

Mr. Chairman, this concludes my formal statement, and I will be happy to answer any of your questions.

Senator UDALL. Thank you very much. And both of your full statements will be put into the record.

We are at this point now going to start 7-minute rounds of questioning. I will start out.

ECONOMIC DEVELOPMENT

To both of you, a few weeks ago, this subcommittee held a hearing on the Treasury Department, and Secretary Lew testified about the growing economy. The economy is slowly recovering from the recession. The unemployment rate is slowly improving.

But for many States, towns, and neighborhoods, including many in New Mexico, they are not yet feeling the effect of this growth, and many Americans are still looking for jobs.

For both witnesses, can you please explain how the fiscal year 2015 budget request for the SBA and the CDFI will help grow the economy and create jobs? And then how will you target underserved populations, including Native American communities, which have become some of the hardest hit communities in our country?

Ms. Contreras-Sweet, please, you can start.

Ms. CONTRERAS-SWEET. Thank you.

SBA intrinsically does just that. In terms of our entire portfolio, what we are focused on is spurring economic activity. And to that extent, I think that as we think about small businesses, and we think about their journey through entrepreneurship, as they first start to think about entrepreneurship, we want them to think about it more aggressively. So whether you are a veteran, to your point, Mr. Chairman, we want to have the Boots to Business program.

First, it starts with sort of just a general conversation about it. Then we put them through a 2-day program. We put them through an 8-week program to get them to think about entrepreneurship. So that is one way in which we do it.

But throughout our partnerships, whether it is the volunteers at SCORE or the women at the Women's Business Center, or it is in disadvantaged communities, this is what SBA is. It is our strength. We go out and we talk to people who are thinking about entrepreneurship, and we take them through a training program. We give them the tools, the tips, and the relationships that they need to help develop the right business plan.

And then after that, if it makes sense, then we introduce them to possible work. The contracting opportunities, whether it is in the Government sector though our contracting opportunities or through our American supplier initiative, where we introduce entrepreneurs to private sector opportunities, we help create jobs.

And then after that, they tell us that sometimes they need a performance bond or bid bond, so we have for the surety program.

And finally, when they are ready and they have work, we provide them the debenture, the Government guarantee to provide them the access to capital.

And so that is, if you will, the journey. The key milestones that exist in entrepreneurship, the SBA is there.

So at the end of the day, we are delighted that essentially what we are, are job creators.

Thank you very much for the question, Senator.

Senator UDALL. Thank you.

Mr. Gerety.

Mr. GERETY. Thank you. I think the issue of the growth in our economy and the disparate effects in different communities is particularly important to the CDFI Fund, which has as its mission over the last 20 years, focusing particularly on those communities, whether urban, rural, or Native American communities, that are underserved by traditional financial institutions.

Within the President's budget, we have both the core program, which includes grants, and other opportunities to support the financial capacity of CDFIs. We have two programs within that, one focused on small and emerging CDFIs and other focused on more established CDFIs.

The budget also includes specific $15 million funding for the Native American CDFI assistance program, recognizing that Native American communities are particularly underserved. And this is part of a more than 10-year effort to develop and support both the financial and the technical capacity of Native American CDFIs, CDFIs that serve Native American communities.

I think it is also important to recognize that underserved communities are not just found in urban areas, but they are found all across this country. And as we have looked at the past 10 years of CDFI funding, we found that over 25 percent of the loans and investments that are made by CDFIs are in rural communities, which only have 17 percent of the population.

So across each of these types of communities, we are very focused on building the capacity of lenders and supporting those lenders in providing capital and job support to those institutions that are really focused on developing those communities and providing the flow of capital to small businesses, entrepreneurs, and affordable housing.

Senator UDALL. Thank you.

Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman.

LOAN SUBSIDIES

Let me start out, if I could, Administrator, and ask you a question about the loan guarantee program. For fiscal year 2014 and 2015, the 7(a) loan program, as you know, doesn't require a subsidy. That is a good thing. We celebrate that.

However, it is my understanding that the 504 program, which guarantees loans for major assets like real estate and heavy equipment, will again require an appropriation to subsidize the cost of the loan guarantees.

What is your thought about where we go from here? Is this an area where we can reasonably expect that someday you will come in and say we don't need the subsidies for this program? I would like your thoughts on that.

Ms. CONTRERAS-SWEET. Thank you. I am delighted to have an opportunity to address that point.

As I understand, and my research has indicated, because it was an important question as I came on board, and as I have seen historically, it did not require—you remember the downturn began in 2008. And as I saw in the prior years and leading up to, I believe it was 2012, we did not require a subsidy. So there was a lag, if you will.

And then you saw that, 2011, 2012, 2013, is where we required the subsidy. So I am delighted that it flattened out first. It came on and then it flattened. Now we are seeing a dramatic decrease.

It is based on commercial real estate values. So I think that as we continue to see this coming back up, it allows for the entrepreneur to use their debt more appropriately, and make sure that they are fulfilling the terms of the SBA guaranteed loan.

So just based on the trajectory, the flattening out and now the decrease, I am hopeful that that will continue to decrease, so that you get the trajectory that you want. Then we will be able to come back to you and say we are back to a zero subsidy.

Senator JOHANNS. Great.

AFFORDABLE CARE ACT

In testimony before the House Appropriations Committee last month, then-Acting Administrator Marianne Markowitz stated that she conducted about 30 outreach seminars on Obamacare. I will be very honest, that caught my attention. I didn't know that is what this agency should be doing.

Do you currently have Obamacare outreach programs scheduled? Are you planning on doing more of the same? Do you have staff assigned to this? Is there a budget for it?

Ms. CONTRERAS-SWEET. Thank you, Senator.

The way the counseling centers work throughout the country is that they are there to respond and to counsel small businesses about the laws, about the way programs work, and about how to grow the business. And so we are there to implement the law.

And when they come in, or we are out doing the work that we do, and they ask us about the Affordable Care Act (ACA), that is what we respond to. We respond to a panoply of questions, including the laws that they have to face and deal with.

So yes, we are out in the field, sometimes answering those questions. And we are delighted to say that when we are out in the field responding to any question that they might have, including the ACA, and we respond, we are learning that they get to know us better, they get to understand and make important decisions.

And what we have learned from that process is that entrepreneurs see their small business as family, and they are wanting to know how to provide for their families.

The ACA, fortunately, has provided them an opportunity to, in some instances, draw from a pool so they can get more competitive rates on health care. That has helped them.

And it has also helped them learn more about SBA. So in that regard, we are able to pivot and direct them to other resources that we provide to continue to help them grow and prosper.

Senator JOHANNS. That is interesting, because I have had the opposite experience. Small businesses really are frustrated with Obamacare, very frustrated. And I have had small businesses in Nebraska tell me they won't grow past 50 because they don't want to go over the limit.

Have you ever had anybody tell you that?

Ms. CONTRERAS-SWEET. I have traveled now across the country with seven stops, and I have not had anybody share that with me.

On the contrary, they said that, in one instance, they were able, if they were below 50, that they were able to partake in the tax credit that provided them a break in order to provide for their employees.

Senator JOHANNS. I would welcome you to Nebraska sometime, and we will get a business roundtable together, and you can hear what I have heard.

Ms. CONTRERAS-SWEET. Thank you, Senator.

Senator JOHANNS. Yes.

Let me turn to, if I might, Mr. Gerety.

ALLOCATION OF FUNDS TO RURAL AREAS

Since its creation in 1994, the CDFI Fund has awarded more than $1.9 billion to community development organizations, financial institutions. However, I would note that entities located in Nebraska have received grant awards totaling $5.8 million over 20 years, 2 decades. That is three-tenths of 1 percent of the total dollar amounts of awards.

By comparison, entities in New York have received awards totaling $250 million. California has received $225 million. Illinois has received $140 million.

It seems to me that the way the program is being implemented, it favors large population centers or States, and States like mine, Nebraska, kind of get what is left behind.

Tell me what is going on. Is this what you wanted to happen? Or is this an anomaly that you hope to fix?

Mr. GERETY. Senator, I think you raise a really important issue, which is the goal of the CDFI Fund is to provide access to capital, and to promote the capacity of lenders in underserved communities, wherever they are across the country.

One of the things that we have been the beneficiaries of from this subcommittee is a $1 million line item that is explicitly focused on improving the CDFI Fund's ability to target, identify, and build capacity for underserved communities, both urban and rural.

And that is beyond just the natural mission of the CDFI Fund, which is to serve underserved communities who are underserved by mainstream financial lenders, but this is explicitly to target communities that are underserved by CDFIs.

I think one of the things that we have seen is that, and particularly in rural communities, there are real opportunities to do outreach, to build capacity, to strengthen those programs.

For example, I know working with Senator Moran, we were able to do two explicit outreach programs in Kansas to try to build up the CDFI community in that State. And I know that there are six CDFIs located in Nebraska. And we, certainly, are always looking for opportunities to build the capacity of CDFIs across the country and, in particular, to do targeted outreach where there are areas that are underserved by the CDFI community.

This is an important part of our program and something that we continue to try to prioritize.

Senator JOHANNS. I would offer this, if you could take out the Nebraska file, and I hate to sound so parochial, but my office would be more than willing to work with you to see how we can make this program more relevant for our State. Obviously, it is not connecting much.

I don't know if that is something happening on our end of the equation or your end of the equation. That doesn't really matter to me so much as how do we fix it? How do we boost this effort? Because our natural tendency is to look at a program like this and say, gosh, it is hard to get capital in rural States. On your best day, you are competing with States that are much more populated and have greater advantages et cetera.

So we want to support these, but then 20 years into it, we look back and we say, gosh, it is doing some things for urban areas. It

is not doing much for our State. We have to rethink what we are doing here. We want to be helpful in trying to do that.

If you could do that and have somebody reach back to my office, that would be appreciated.

Mr. GERETY. Certainly, Senator, we will be glad to reach out and to continue to work with you to strengthen the CDFI programs in areas that are underserved.

Senator JOHANNS. Mr. Chairman, I took a little liberty with my time there, but what I was thinking is maybe I would ask each witness questions and then I know we are called to a vote, maybe we submit questions in writing. It is up to you, but I would be willing to do that.

Senator UDALL. I think we should probably do that. I think we can leave here in the next 10 minutes, if we wanted to do just a short 5-minute round. That is my understanding.

Let me do one quick question, and then if you would like to.

STATE TRADE AND EXPORT PROMOTION

I just want an explanation on the State Trade and Export Promotion Program. You know the President's goal of doubling exports and all of that. This has created some real opportunity out there.

We have seen $29 million in STEP funds, responsible for $300 million in export. And I am just really wondering, Administrator Contreras-Sweet, what is in the budget for them to look in other places, and why has the decision been made to eliminate the program?

Ms. CONTRERAS-SWEET. Thank you so much for the excellent question, and I am delighted to speak to it.

As a former banker and now the head of the SBA, I think that one of the most important things that we should be considering is how we help our small businesses compete in an international economy. We know that 95 percent of our customers are outside of our country. And with the technological advancements, we have lowered the threshold of being able to enter international markets.

So we want to make sure that small businesses have a level playing field to get outside and to compete in those markets.

To that extent, we are now ready almost imminently, to release the Request for Proposal (RFP) for the State Trade and Export Promotion (STEP) program for this year. And so I feel a duty to assess a program than be knee-jerk and just respond and say we are going to do it again. So since it is a new program, I felt it was important to assess its efficaciousness, to examine what worked, what didn't work, and to refine it, and then come back with something that was really supportive and successful and effective for small businesses in the next budget ground.

Senator UDALL. Thank you very much for that.

Senator JOHANNS. I will submit my questions.

Senator UDALL. Okay, we will both submit additional questions for the record.

Let me just thank you for participating today. Today's discussion has provided, I think, very helpful insights on both of your budgets for the CDFI and the SBA.

ADDITIONAL COMMITTEE QUESTIONS

The hearing record will remain open until next Wednesday, May 28, at noon, for subcommittee members to submit statements and questions to be submitted to the witnesses for the record.

[The following questions were not asked at the hearing, but were submitted to the Department and the Agency for response subsequent to the hearing:]

QUESTIONS SUBMITTED TO MARIA CONTRERAS-SWEET

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

MICROLOANS

Question. While SBA is well-known for guaranteeing the 7a and 504 loans that support numerous small businesses across the country, the SBA also provides $25 million in microloans and $20 million for technical assistance to microloan recipients. These loans, which average $13,000, help support the needs of very small businesses, including working capital, inventory or supplies, and equipment. The budget proposes to maintain the same lending level as fiscal year 2014, at a reduced cost, because the rate of default for these loans is decreasing. The SBA is currently developing a proposed rule to modernize the program.

How will the microloan program be updated to improve access to credit for America's smallest businesses?

Answer. The SBA is exploring a number of avenues for improvement of the Microloan Program and increased access to credit for our smallest businesses. We are currently working with, industry representatives, congressional representatives, and practitioners to gather appropriate ideas and build them into a strategic approach for program improvement and increased access to capital. In addition, we are moving forward with finalizing a rule that was proposed last March; with updating the Standard Operating Procedures (SOP) manual; and with exploring avenues to increase private sector involvement.

FUNDING FOR NEW INITIATIVES

Question. The SBA provides funding for many entrepreneurial development programs, such as the Small Business Development Centers and SCORE, which provide training and mentorship opportunities for small business owners across the country. These programs have proven results—they help businesses start up, prosper and grow. Yet the fiscal year 2015 budget request keeps funding for these critical programs flat, while including significant increases two new initiatives that have not yet had any results.

Why does the budget request significant increases for the new growth accelerators and entrepreneurial education programs, while keeping funding for successful programs flat?

How do these new initiatives differ from existing programs provided through entrepreneurial development? Could these activities not be provided by existing programs?

Answer. In today's economy, it is critical that we continue to support job creation wherever there's an opportunity among our Nation's 28 million small businesses. The President's fiscal year 2015 budget proposal for SBA ensures that small businesses have the tools and resources they need to start and expand their operations and create good jobs that support a growing economy and a strong middle class. The Small Business Development Centers, Women's Business Centers, SCORE chapters, and Veteran's Business Outreach Centers—also known collectively as our resource partner network—are essential to the agency's ability to achieve these goals. As a result, we are pleased to be able to request full funding for these programs for fiscal year 2015.

As an agency, we strive to be as innovative and entrepreneurial as the small businesses we serve. Moreover, we strive to maximize our value to small businesses and ensure that we make efficient use of taxpayer dollars. Currently, millions of existing small business owners plan to grow their businesses, but they lack sufficient training in areas like accounting, market analysis, and finance. They have the will to succeed but require access to quality, targeted education and mentorship to help them create and implement strong growth plans, access capital, increase revenue, and ultimately create new jobs. Many of these businesses are located in underserved communities, where there is much need and opportunity.

The fiscal year 2015 budget request seeks to address existing gaps in assisting small businesses. For example, the initiatives supported under Entrepreneurship Education differ from the services commonly offered by our resource partners, by their intensity and the time devoted to individual businesses coupled with training and complexity and level of expertise of the management support provided. There is an expressed need to offer intensive support that focuses on the unique challenges that growing firms face, which look very different from the needs of startups. A large number of SBA's existing resource partners have built up and concentrated their expertise in training and counseling for start-up businesses, and are limited in the amount of time they are able to devote to each business. The funding for Entrepreneurship Education programs allows us to address that gap.

For example, the Entrepreneurship Education request will allow SBA to expand Emerging Leaders, which provides an intensive curriculum to existing small businesses and has a proven track record of helping these businesses grow and create jobs. Our Emerging Leaders initiative, now in its seventh consecutive year since starting in late 2007, was launched by SBA to assist existing small businesses possessing a high growth potential who are located in historically underserved communities across the United States.

Participants receive over 100 hours of in-person and out of classroom training. Through our Emerging Leaders Program we try to make use of all our assets. Our District Offices facilitate hosting the classes, and our resource partners still play a key role, which may include hosting classes, teaching sessions, identifying participants, and providing ongoing technical assistance at the conclusion of the course.

504 REFINANCING

Question. From 2010 to 2012, the 504 program allowed small businesses to use loans to refinance their commercial mortgages. This helped many small businesses in the same way that refinancing a home mortgage helped homeowners—it helped keep the doors open for many small businesses across the country. The budget requests the extension of this program which ended when the authorization lapsed in 2012. The budget proposes to reauthorize the program at $7.5 billion per year.

What was the impact of the program while it was authorized? What are some of the success stories?

Answer. The President's budget request supports reauthorizing the 504 Refinance program, which was part of the Small Business Jobs Act of 2010 and expired at the end of September 2012. Through this successful program, 200 SBA lending partners made over 2,700 loans valuing more than $2.5 billion. On the last day of the program in 2012, SBA had over 400 projects pending work and almost $500 million that did not get funded. Demand still exists in the marketplace, as commercial real estate values are still depressed. By refinancing their debt to take advantage of historically low interest rates, businesses improve their cash flow, and access equity in their properties to inject into their businesses. This allows companies to retain jobs and expand by offering a favorable long-term fixed rate. The budget requests a 1 year reauthorization of the program. Since SBA is allowed under the 504 Refi program to charge an adjusted fee to cover the projected costs, this request does not require an appropriation from Congress for subsidy.

Proceeds from the 504 Refinance program assisted businesses in all ten SBA regions:

—*Region I:* A grocery store was able to restructure debt and provide business expenses of $670,000.
—*Region II:* A water bottling company experienced $1.2 million in growth due to available working capital.
—*Region III:* An assisted living facility restructured debt and refinanced business expenses for three facilities.
—*Region IV:* A concrete foundation company was able to purchase a new pump to improve operations.
—*Region V:* A gas station finance eligible business expenses saving $43,000 annually.
—*Region VI:* A steel company financed their A/P and inventory worth almost $1.25 million.
—*Region VII:* A telecommunications firm secured a $1.6 million 504 Refi loan for equipment modernization.
—*Region VIII:* A restaurant had a balloon payment upcoming but was able to refinance to continue operations.
—*Region IX:* A medical equipment supplier refinanced balloon payments due in less than 1 year.

—*Region X:* A hotel was able to secure a $2 million loan for working capital under eligible business expenses.

Question. How would this loan compare to credit options that are available on the private market?

Answer. The 504 Refinance program provides excellent terms compared to what is available on the private market. For example, 504 Refi is unique in that it provides a fixed rate for 20 years (10 years for equipment). The private market generally won't do fixed rates for a 20 year term, but will either have variable rates or terms for a shorter period. The long-term fixed rate allows small businesses to better manage their debt, creating more stability and opportunity for job retention and creation.

LENDER OVERSIGHT

Question. Through the SBA's flagship 7a loan program and the 504 program, SBA will guarantee approximately $36 billion in fiscal year 15. In fiscal year 2011, approximately two-thirds of the SBA guaranteed loans were made using delegated authority with limited oversight. Both the SBA Inspector General and the GAO have identified weaknesses in SBA's oversight of these lending programs and provided recommendations to create an effective oversight program.

What steps has SBA taken to improve oversight of these lending programs and implement the recommendations?

Answer. SBA understands the importance of lender oversight in administering an effective 7(a) program. SBA has made significant progress in instituting a comprehensive credit risk management program for its business loan programs. All lenders participating in the 7(a) program are continually assessed and risk rated to ensure that those considered to represent highest risk receive greatest Agency attention. In fiscal year 2013, SBA undertook approximately 24 lender supervision and enforcement actions. SBA has also suspended or debarred approximately 27 parties, including but not limited to, actions against loan agents and borrowers. SBA has developed and implemented a regulatory framework to support credit risk management, including the promulgation of lender oversight/enforcement regulations that establish the grounds and procedures for lender supervision and enforcement, lender oversight Delegations of Authority, Lender Risk Rating Standards, and Standard Operating Procedures for lender supervision/enforcement and reviews/examinations. SBA conducts lender supervision and enforcement through a separate Office of Credit Risk Management and a Lender Oversight Committee (LOC) comprised of senior Agency officials representing fiscal, credit risk, operations and legal areas.

7(a) TOTAL LOAN LIMIT

Question. SBA's flagship 7(a) loan program is one of the Federal Government's primary business loan program. Through these guaranteed loans, SBA provides up to $5 million for up to 25 years to small businesses. Funds can be used for a variety of purposes to develop and expand small businesses. In 2013, the program supported over 483,000 jobs and 40,000 small businesses. The total loan level is currently capped at $17.5 billion in loan authority per year. But in 2013, the SBA reached this limit.

What are your projections for the total 7(a) lending level in fiscal year 2015? Do you believe the cap on the 7(a) loan should be increased?

Answer. SBA is supportive of both the Senate Committee on Appropriations and the House Committee on Appropriations plans through their fiscal year 2015 bills to increase the 7(a) loan authorization level. Based on prior year lending trends, when SBA formulated the fiscal year 2015 budget, we estimated that a $17.5 billion 7(a) authorization level would be sufficient to meet market demand for fiscal year 2015. However, in light of trends on fiscal year 2014 volume, SBA does believe it is prudent to increase the authorization level for fiscal year 2015. As stated at the hearing, we would like to emphasize that an increase in the authorization level would not have any subsidy cost for the taxpayer.

DISASTER ASSISTANCE (SBA)

Question. SBA provides direct loans to small businesses that are affected by natural disasters. These long-term, low-interest loans allow small businesses to repair or replace damaged property to limit the economic impact of natural disasters. The budget request for the administrative costs of these loans is decreasing by $5 million.

How do you determine what will be needed to administer disaster assistance?

Answer. The SBA reviews historical spending trends, expected carryover balances and staffing forecasts to determine what level of funding to request for disaster assistance. The SBA continually reviews processes and implements improvements in order to enhance program delivery and achieve greater efficiency. The $5 million reduction in the disaster administration request reflects cost reductions SBA expects to achieve through more efficient operations.

Question. Do you believe the fiscal year 2015 request is sufficient?

Answer. Absent a catastrophic disaster event or multiple major events in 2015, the fiscal year 2015 request should be sufficient.

Question. What are your balances for disaster assistance, and how long will they last?

Answer. As of May 31, the disaster administrative funding balance was $238 million and the disaster subsidy balance was $736 million. It is nearly impossible to predict the timing and severity of disasters, and therefore difficult to estimate how long these balances will last.

Question. How do you determine the portion of disaster funding that will be for Stafford Act disasters?

Answer. Previously, the SBA derived the Stafford Act allocation from a three-year average of loan applications processed by the Office of Disaster Assistance according to presidential and non-presidential disaster declarations. In 2014, the SBA conducted a cost study to determine the portion of overall disaster administration spending on Stafford Act disasters. The result of the study is a cost allocation model the SBA can update annually with actual spending to estimate the administrative funding needs of Stafford and non-Stafford disaster loans.

QUESTIONS SUBMITTED TO AMIAS GERETY

QUESTIONS SUBMITTED BY SENATOR TOM UDALL

CDFI BOND PROGRAM

Question. The CDFI bond program provides 30 year bonds to CDFI organizations to support additional lending for a variety of economic development efforts including—job creation, community revitalization and affordable housing. In fiscal year 2013, Congress provided $500 million for the bond program, and then in fiscal year 2014 we provided another $750 million. The fiscal year 2015 budget proposes to increase it again, to the authorized level of $1 billion.

Please explain how this program is using the funds provided in 2013 and 2014, and why the budget proposes to continue and expand the program.

Answer. The Administration continues to support and expand the CDFI Bond Guarantee Program (CDFI BG Program) because it addresses a fundamental challenge in revitalizing communities, creating jobs, and expanding economic opportunity: many low-income and underserved communities require long-term, fixed-rate financing that the private market does not generally offer. According to the Carsey Institute, CDFI loan funds do not have access to long-term debt to meet market needs for longer-term financing.[1] The CDFI BG Program provides a long-term, fixed-rate source of capital so CDFIs can provide the financing communities need.

CDFIs may use bond proceeds to finance: charter schools; commercial real estate; daycare centers; healthcare facilities; rental housing; rural infrastructure; owner-occupied homes; licensed senior living and long-term care facilities; small businesses; not-for-profit organizations; and other CDFIs and similar financing entities.

In the first two rounds of the CDFI BG Program in fiscal year 2013 and fiscal year 2014, Treasury approved term sheets and executed agreements to guarantee a combined total of $525 million. Bond proceeds are expected to finance affordable housing, charter schools, healthcare facilities, commercial real estate, and lending to not-for-profit organizations. Financing of community development projects has recently begun.

Question. Do you believe there is sufficient demand from CDFIs to support the $1 billion level?

Answer. We believe that $1 billion is an appropriate cap for fiscal year 2015. Congress set the $1 billion level when it authorized the program. This level indicates to CDFIs that significant resources will be available if they make a commitment to participate in the program.

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[1] Carsey Institute, "CDFI Industry Analysis Summary Report", Spring 2012, pg 12. Accessed at: http://www.cdfifund.gov/docs/CBI/2012/Carsey%20Report%20PR%20042512.pdf.

The $525 million committed in the first 2 years of the program marks an encouraging start to a new and complex program. There is a promising initial level of interest and capacity, as evidenced by the four CDFIs that submitted high quality plans within a very short application period in fiscal year 2013 and the four additional CDFIs that received bond loans in fiscal year 2014.

After completing two funding rounds for the Bond Guarantee Program, we have begun to explore ways to improve administration of the program, including opportunities to address any perceived impediments for program applicants.

HEALTHY FOODS

Question. Obesity and malnutrition are widespread in this country and have been linked to major health problems, such as diabetes and heart disease. In many low-income neighborhoods across the country, there are no healthy food options nearby, making it much more difficult to adopt a healthy lifestyle. CDFI's Healthy Foods Financing program provides assistance to CDFIs to finance grocery stores, farmers markets and other healthy food options in these low-income neighborhoods. The budget proposes to increase this program to $35 million, $13 million more than last year.

Why does the budget propose such a significant increase for this program?

Answer. The Healthy Foods Financing Initiative (HFFI) expanded healthy food options necessary to address obesity and malnutrition. It achieved this through improved access to affordable food outlets in areas where there has been a chronic absence of such alternatives. Continued support from Congress will enable CDFIs to expand access to healthy food options in low-income communities. To date, all 12 of the first-round HFFI awardees reported on the impacts of their first year of investments. The 12 HFFI awardees initiated 43 projects totaling $29,035,079 in HFFI eligible activities. Of these projects, 30 were retail HFFI projects with 339,226 square feet of new retail space developed from small green grocers to large supermarkets serving low income, low-access census tracts. Another 13 non-retail projects, such as production and distribution, resulted in the development of 5,073 square feet of space for eligible healthy food activities.

Question. How would the requested funds help address this national epidemic?

Answer. The Healthy Foods Financing Initiative (HFFI) is dedicated to increasing access to healthy food options in low-income urban and rural communities. Through HFFI, the CDFI Fund provides competitive awards to CDFIs that finance healthy food retail outlets in underserved communities.

CDFIs have a wealth of experience in financing grocery stores, local food processors and distributors, farmers' markets, and food co-ops. As with other CDFI Fund programs, the HFFI-Financial Assistance award is designed to help CDFIs respond to local economic market conditions in the low-income communities they serve. CDFIs may use up to 25 percent of the award to finance non-retail HFFI activities, an option especially responsive to rural areas in need of financing for food production.

BANK ENTERPRISE AWARD PROGRAM (BEA)

Question. The fiscal year 2015 budget eliminates an important CDFI Fund program, the Bank Enterprise Award program. Created in 1994, the program helps leverage CDFI dollars by supporting banks that provide lending, investment and service activities in economically distressed communities. Without the BEA program, many of these banks cannot compete for CDFI funds, and would be unable to finance development projects in low-income and distressed neighborhoods.

Why did the budget eliminate this critical program?

Answer. Treasury recognizes that the Bank Enterprise Award Program (BEA Program) provides important resources for FDIC-insured banks and thrifts to invest in underserved communities. However, in the current fiscal environment, difficult budget decisions have to be made.

The BEA Program isn't the only CDFI Fund grant program that supports FDIC-insured banks; depository institutions certified as CDFI's are also eligible to apply for the CDFI Fund's flagship CDFI Program, which will continue to provide financial and technical assistance to invest in and build the capacity of CDFI banks. This program empowers them to grow, achieve organizational sustainability, and contribute to the revitalization of their communities. In the fiscal year 2014 round of the CDFI Program, 9 percent of total applicants were CDFI-certified banks. Out of these 23 bank applicants 9 received financial assistance awards totaling $12.2 million.

The CDFI Fund's Capacity Building Initiative also recently launched a "Preserving and Expanding CDFI Minority Depository Institutions" series to address the

unique challenges facing CDFI MDIs. This program provides advanced training and technical assistance for CDFI MDIs to build their capacity to provide community development services to their underserved communities.

Question. How would this elimination impact overall lending?

Answer. The elimination of the BEA Program is not expected to have a material impact on overall lending to markets served by CDFIs. CDFI target markets are highly correlated with eligible areas under the Community Reinvestment Act (CRA), communities historically underserved by mainstream institutions. Banks eligible to apply to the BEA Program will continue to be incentivized by CRA to invest in these communities.

In addition, due to the higher poverty level eligibility criteria, areas eligible under the BEA Program are a subset of CDFI investments areas and target markets. The CDFI Program will continue to provide financial and technical assistance to invest in and build the capacity of CDFIs which will help to mitigate the impact of eliminating this program.

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. Section 1206 of the Dodd-Frank Wall Street Reform and Consumer Protection Act established a grant program within the CDFI Fund to encourage financial institutions to offer affordable small dollar loans through technical assistance and loan loss reserve funds. Affordable small dollar loans would help borrowers who may otherwise turn to predatory payday loans, and this grant program can help financial institutions overcome some of the challenges that come with offering these products.

To what extent have technical assistance and loan loss reserve funds under section 1206 been clearly included in the core program Notice of Funding Availability (NOFA) since authorization in 2009? If not, how can these be included in the core program NOFA in fiscal year 2015?

Answer. Since 2007, the CDFI Program NOFA has specified that eligible uses of Financial Assistance awards include loan loss reserves.to cover losses on loans made in their investment areas or target populations, which may include small dollar loans.[2] Since 2011, applicants are required to specify how much of their award request will be used for loan loss reserves. In fiscal year 2014, 126 applicants requested approximately $59 million (or 17.4 percent of the total amount requested) for loan loss reserves. It is important to note, this data is prospective, based-on an institution's intentions at the time of application. The CDFI Fund is unable to track at this time the amount of Financial Assistance awards received that were then used to fund loan loss reserves specifically for small dollar loans.

The Fund will explore including language in its NOFA concerning small dollar consumer lending and is open to establishing a new grant program as proposed in Section 1206 if, and when, funds are appropriated.

CONCLUSION OF HEARINGS

Senator UDALL. The subcommittee is hereby adjourned.

[Whereupon, at 2:23 p.m., Wednesday, May 21, the hearings were concluded, and the subcommittee was recessed, to reconvene subject to the call of the Chair.]

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[2] To carry out the purposes specified in the Technical Assistance application, funds may be expended for: compensation; professional services; travel; training and education; equipment; and supplies. Developing a small dollar loan program is an eligible purpose. However, data is not available on the number of applicants that request technical assistance awards to develop small dollar loan programs.

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