



Audit Report



OIG-08-031

FOREIGN INVESTMENTS: Review of Treasury's Failure to Provide Congress Required Quadrennial Reports in 1998 and 2002 on Foreign Acquisitions and Industrial Espionage Activity Involving U.S. Critical Technology Companies

April 21, 2008

Office of
Inspector General

Department of the Treasury

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Abbreviations

CFIUS	Committee on Foreign Investments in the United States
CIA	Central Intelligence Agency
CFR	Code of Federal Regulations
DPA	Defense Production Act of 1950
EO	Executive Order
FINSA	Foreign Investment and National Security Act of 2007
GAO	Government Accountability Office
NEC	National Economic Council
NSC	National Security Council
OIG	Treasury Office of Inspector General
Pub. L. No.	Public Law number
U.S.C.	United States Code

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*The Department of the Treasury
Office of Inspector General*

April 21, 2008

Mr. David H. McCormick
Under Secretary for International Affairs

This report presents information we obtained concerning why the Department of the Treasury did not provide quadrennial reports to Congress in 1998 and 2002 in accordance with section 721(k) of the Defense Production Act of 1950, as amended. The quadrennial reports were intended to evaluate whether (1) there is credible evidence of a coordinated strategy by one or more countries or companies to acquire U.S. companies involved in research, development, or production of critical technologies for which the United States is a leading producer; and (2) there are industrial espionage activities directed or directly assisted by foreign governments against private U.S. companies aimed at obtaining commercial secrets related to critical technologies. In 1994, a Presidential Executive Order (EO) assigned responsibility to prepare these reports to the Secretary of the Treasury, in cooperation with other Executive branch agencies.

We were required by the Foreign Investment and National Security Act of 2007¹ (FINSAs) to determine the facts and circumstances concerning each failure of the Department of the Treasury to make any report to Congress that was required under section 721(k) of the Defense Production Act of 1950, as in effect on the day before the enactment of FINSAs. We performed our fieldwork from November 2007 to March 2008 in accordance with generally

¹ 50 U.S.C. app. § 2061. Pub. L. No. 110-049. The act also required that we submit the report on our review to the appropriate committees by April 21, 2008.

accepted government auditing standards. Appendix 1 contains a description of our audit objective, scope, and methodology.

Results in Brief

Section 721(k) of the Defense Production Act of 1950, which was enacted on October 28, 1992, required that quadrennial reports on foreign acquisition strategies and industrial espionage activities be provided to Congress beginning not later than one year after the date of enactment of this section. Since the mandate's establishment, however, only two reports have been produced—one in 1994 and one in 2006. The 1994 report was prepared by an interagency working group under the auspices of Treasury. It was transmitted to Congress by the National Economic Council (NEC), even though the President had assigned reporting responsibility to Treasury 2 months earlier. The report relied heavily on a commercial database on foreign investment to which the Central Intelligence Agency (CIA) had subscribed. The 2006 report, which covered the 12-year period from 1994-2006, was also prepared by an interagency group under Treasury's direction, and transmitted by Treasury to Congress. Once again, the CIA's subscription to a commercial database was a critical source of the needed information. The reporting lapse was raised during congressional hearings on foreign investment in the United States held in 2005, following inquiries from the Congressional Research Service and Government Accountability Office (GAO) which disclosed Treasury's failure to file reports in 1998 and 2002.²

Treasury officials from the Office of International Affairs, who were assigned the quadrennial reporting responsibility, said they were unaware that the President had transferred these reporting responsibilities to Treasury in 1994. The officials explained that they had attempted to obtain information for a second report in 1998, even though they did not believe that Treasury had any formal responsibility to prepare the report. However, Treasury officials learned that the CIA no longer subscribed to the

² *Defense Trade: National Security Reviews of Foreign Acquisitions of U.S. Companies Could Be Improved*, GAO-07-661T (Mar. 23, 2007).

commercial database that had been used for the 1994 report. Moreover, the espionage section of the quadrennial report was already being supplied to Congress in a report provided by the National Counterintelligence Executive's Office.

These findings were contained in a draft memorandum from Treasury to the National Security Council/National Economic Council (NSC/NEC) [since we only could locate a draft, we could not verify whether this memorandum was actually sent to the NSC/NEC]. The draft memorandum also listed potential options for meeting the reporting requirement, including requesting that Congress waive the requirement in view of not having access to the foreign acquisition data and the existing reporting on industrial espionage.

Treasury did not pursue the reporting matter in 2002. In July 2007, the President signed FINSA into law, which requires annual reporting by Treasury on foreign investment in the United States and related national security concerns.

We found that controls did not exist within Treasury to ensure that officials were aware of the 1994 EO that assigned the quadrennial reporting requirement to Treasury. As a result of the absence of such controls, Treasury did not exercise appropriate oversight of their respective offices to ensure compliance with the reporting requirement. In late fiscal year 2007, to ensure that Treasury meets its mandates, Treasury's Executive Secretary began maintaining a master list of all departmental-mandated tasks, including the requirement to report information annually on foreign investments in the United States.

We are recommending that the Under Secretary for International Affairs ensures that (1) internal guidance for implementing FINSA is established and includes procedures for preparing and issuing the now annual report to Congress and (2) Treasury, consistent with the Secretary of the Treasury's authority under the EO that implements FINSA, designates participating agencies and specifies their responsibilities in preparing the annual report.

Treasury concurred with our recommendations. The Assistant Secretary for International Affairs said that Treasury is taking the necessary steps to make the recommendations effective. Treasury has begun preparation of the 2008 annual report, and the procedures established for this first annual report will guide the development of internal Committee on Foreign Investments in the United States guidelines for implementing FINSA, which Treasury intends to develop in consultation with other agencies following the publication of final regulations that implement FINSA. The Assistant Secretary also said that in accordance with the EO that implements FINSA dated January 23, 2008, Treasury will designate the agencies that will participate in the preparation of the annual report and work closely with them to define their responsibilities to ensure timely submission of the 2008 annual report. Treasury did not provide estimated completion dates for developing internal guidance that implements FINSA and for designating agencies and defining their responsibilities for the annual report. The Office of International Affairs will need to establish these dates in the Department's Joint Audit Management Enterprise System so that the status of these corrective actions can be monitored.

In accordance with FINSA, we are providing copies of this report to the Committee on Foreign Relations, the Committee on Banking, Housing, and Urban Affairs, the Committee on Commerce, Science, and Transportation, and Committee on Finance of the Senate; and the Committee on Foreign Affairs, the Committee on Financial Services, and the Committee on Energy and Commerce of the House of Representatives.

Background

Quadrennial Reporting Requirements

The Committee on Foreign Investments in the United States (CFIUS), established in 1975 by a Presidential EO and by statute under FINSA, is an interagency committee chaired by the Secretary

of the Treasury.³ Through the Director of Investment Security in its Office of International Affairs, Treasury serves as secretariat for CFIUS, receiving and circulating notices to CFIUS agencies and coordinating reviews.⁴

CFIUS conducts national security reviews of foreign acquisitions of U.S. companies pursuant to section 721 of the Defense Production Act of 1950.⁵ Section 721 authorizes the President to investigate the impact of foreign acquisitions of U.S. companies on national security and, if necessary, to suspend or prohibit acquisitions that might threaten national security. The President, through an EO, assigned the review and investigation authorities to CFIUS.⁶ Pursuant to the EO, CFIUS receives notices of transactions potentially subject to section 721 and conducts interagency reviews and investigations to identify potential national security issues.

As part of the 1992 amendments to section 721, Congress added subsection (k) to assist with its oversight responsibilities.⁷ The subsection requires that the President and any agencies that the President designates complete and furnish to Congress, not later than 1 year after the date of enactment of the subsection and every 4 years thereafter, a report which evaluates the following:

1. Whether there is credible evidence of a coordinated strategy by one or more countries or companies to acquire U.S. companies

³ EO No. 11,858, 40 Federal Register 20,263 (May 7, 1975). On January 23, 2008, this EO was amended to implement FINSA.

⁴ Treasury's Office of International Affairs protects and supports U.S. economic prosperity by encouraging financial stability and sound economic policies abroad. International Affairs performs surveillance and conducts analysis of global economic and financial developments. In addition, it engages with financial market participants, foreign governments, and international financial institutions and participates in multilateral fora to develop and promote good policies.

⁵ 50 U.S.C. app. § 2170 (amended) (Pub. L. No. 100-418).

⁶ EO 12,661, amending EO 11,858, 54 CFR 779 (Dec. 27, 1988).

⁷ This provision was formerly codified at 50 U.S.C. app. § 2170(k) (Pub. L. No. 102-558). The requirement to submit annual reports to Congress is now at 50 U.S.C. app. § 2170(m)(3).

involved in research, development, or production of critical technologies⁸ for which the United States is a leading producer

2. Whether there are industrial espionage activities directed or directly assisted by foreign governments against private U.S. companies aimed at obtaining commercial secrets related to critical technologies

This report was known as the quadrennial report.

On July 26, 2007, FINSA was enacted, strengthening the process by which CFIUS reviews foreign acquisitions of U.S. companies for national security concerns.⁹ The Act, in part, increased oversight by Congress by requiring CFIUS to provide an annual report to Congress. It also requires that the former quadrennial report be incorporated into this annual report.

Finding and Recommendations

Finding

Treasury Officials Were Not Aware of the Assigned Responsibility to File the Required Reports

Treasury did not produce quadrennial reports in 1998 and 2002 on foreign acquisition strategies that could harm national security and industrial espionage activities directed against U.S. companies, as required under section 721(k) of the Defense Production Act of 1950, as amended. Since the 1992 reporting mandate, only two reports, in 1994 and in 2006, have been provided to Congress. Treasury officials said they were unaware of the 1994 EO that assigned the reporting authority and responsibility to the Department. In addition, Treasury officials said that intelligence data needed for each report were not available from the CIA in 1998 and 2002. The 1994 report was prepared by an interagency

⁸ For the purposes of former subsection (k), the term “critical technologies” was defined as technologies identified under title VI of the National Science and Technology Policy, Organization, and Priorities Act of 1976 or other critical technology, critical components, or critical technology items essential to national defense identified pursuant to this section. 50 U.S.C. app. § 2170(k)(2).

⁹ 50 U.S.C. app. § 2061. Pub. L. No. 110-049.

working group under Treasury auspices, and was transmitted to Congress by NEC, 2 months after the EO assigned responsibility to Treasury.

In 2007, Treasury strengthened controls over the filing of the reports to Congress. Treasury's Executive Secretary, who reports to the Chief of Staff, now tracks all department-mandated tasks, including CFIUS reporting.

Quadrennial Report Was Produced in 1994 but Not in 1998 and 2002

The President initially assigned the preparation of the first quadrennial report to the NEC in 1994. The NEC in turn asked Treasury to chair a working group to oversee preparation of the report. The working group consisted of representatives from the Departments of State, Defense, Commerce, and Justice; the Office of Management and Budget; the Office of the U.S. Trade Representative; the Council of Economic Advisors; the Office of Science and Technology Policy; the CIA; the Federal Bureau of Investigation; NSC; and NEC. NEC transmitted the report to Congress in August 1994.

Just 2 months before NEC transmitted the 1994 report, the President issued a comprehensive EO on the Defense Production Act, which assigned to Treasury, in cooperation with several others, responsibility for completing and furnishing quadrennial reports¹⁰ in 1994 and every 4 years thereafter. Treasury, however, did not produce the required reports in either 1998 or 2002.

Officials in Treasury's Office of Investment Security, within the Office of International Affairs, offered explanations for why reports were not produced for those years.

¹⁰ EO 12,919, 59 CFR 108 (June 3, 1994). The others identified in the EO who were to cooperate with Treasury were the Department of State, the Department of Defense, the Department of Commerce, the Department of Energy, the Department of Agriculture, the Attorney General, and the Director of Central Intelligence.

Treasury Officials Were Not Aware of the Delegated Reporting Responsibility

The Deputy Assistant Secretary for Investment Security explained that Treasury was unaware that the President had assigned to Treasury responsibility for completing and furnishing quadrennial reports. He also said that other Executive branch agencies with consultative responsibilities were similarly not aware of this delegation.¹¹

A staff attorney in the Office of the Assistant General Counsel for International Affairs, who was present during the 1998 and 2002 reporting periods, told us that Treasury knew about the reporting requirement but was not aware of the 1994 designation making Treasury responsible.

The reporting lapse became evident in 2005, when GAO issued a report concerning CFIUS, and when congressional hearings were held that discussed the lack of reports. Unaware of the designation, Treasury's Office of the General Counsel drafted a memorandum for the President to sign, to assign responsibility for the 2006 report to the Secretary of the Treasury.¹² The President signed the memorandum on December 29, 2006. This memorandum, however, was not necessary because the assignment had already been accomplished via the 1994 EO.

Data on Foreign Investments Were No Longer Available

The methodology employed to prepare the 1994 report involved an analysis of foreign acquisitions of U.S. companies to determine whether any patterns of activity might suggest the

¹¹ The Deputy Assistant Secretary for Investment Security has held the position since June 2006; accordingly, he was not with Treasury during the 1998 and 2002 reporting periods. The Deputy Assistant Secretary told us that he relied on the Office of International Affairs' Senior General Counsel, International Economist, and Director of Investment Security, all of whom were with Treasury during the aforementioned reporting periods, to provide all pertinent documentation.

¹² *Memorandum of December 29, 2006—Assignment of Function Under Section 721(k) of the Defense Production Act of 1950*, 58 Federal Register No. 172 (Jan. 5, 2007).

existence of a strategy. Treasury attempted to obtain information for the report in 1998.

Treasury's Assistant Secretary for International Affairs drafted a memorandum to a former Special Assistant to the President and Senior Director for International Trade and Investment, NSC/NEC, on the preparation of the second quadrennial report. In the memorandum, the Assistant Secretary notified the Special Assistant that the quadrennial report was due in 1998 and that the President, not Treasury, was assigned the responsibility for quadrennial reporting. We could not determine if this memorandum was actually transmitted, as only a draft was provided to us. We discussed the memorandum with the former Special Assistant to the President, who had no recollection of the memorandum, of any direction provided to Treasury regarding preparation of the quadrennial report, or of why it was allowed to go unfiled.

Officials in the Office of Investment Security explained, however, that the merger and acquisition data used for the 1994 report was no longer available because the CIA did not renew its contract for the commercial database that had been used for the prior report. The Office of Investment Security did provide some documentation indicating that Treasury tried to collect information from the CIA. In July 1998, an international economist from Treasury's Office of International Affairs wrote to the CIA asking the agency to provide information that could be made available to Treasury for the quadrennial report and to identify individuals who could participate in drafting the report.¹³ Treasury's files provided for our review did not contain a reply from the CIA. We discussed the Treasury request with the official at the CIA to whom the letter was addressed. The official stated that a colleague drafted a memorandum in response to Treasury stating that the CIA could not help because it no longer subscribed to the database on foreign mergers and acquisitions. The official stated that he had forwarded the written response to his supervisor but was not

¹³ We were provided an unsigned copy of this memorandum.

sure if it was ultimately sent to Treasury. The memorandum that the CIA provided to us was a copy of a draft, and Treasury officials could not recall whether they had received this correspondence.

In the 1998 draft memorandum to the former Special Assistant to the President, Treasury's Assistant Secretary for International Affairs wrote that Treasury had surveyed the agencies that had contributed most of the information for the 1994 report (Commerce and the CIA) to assess the availability of information to update the quadrennial report in 1998 and had found that the information was no longer available for the report. According to the Assistant Secretary, the CIA database provided comprehensive data used to prepare the 1994 report. Well before 1998, however, the CIA had cancelled the database contract. According to the 1998 memorandum, Commerce had, to a lesser extent, supplied data for the report. However, those data were no longer available for this purpose because the program Commerce had used to collect publicly available information on particular foreign direct investments by industry sectors was discontinued in 1995.

Information on Foreign Industrial Espionage Was Provided to Congress in Other Reports

The second component of the report required under section 721(k) of the Defense Production Act concerns industrial espionage activities directed or directly assisted by foreign governments against private U.S. companies aimed at obtaining commercial secrets related to critical technologies. Regarding this component, the Deputy Assistant Secretary for Investment Security told us that the reporting requirement was satisfied through the *Foreign Economic Collection and Industrial Espionage* report. This report is submitted annually by the Office of the National Counterintelligence Executive, in compliance with the Intelligence Authorization Act for Fiscal Year 1995,¹⁴ which requires that the President provide Congress with updated information on the threat

¹⁴ 50 U.S.C. app. § 2170(b) (Pub. L. No. 103-359).

to U.S. industry from foreign economic collection and industrial espionage. We noted that the report for fiscal year 2005 issued in August 2006, the latest available on the Office of the National Counterintelligence Executive website, states that the information provided in the report also satisfies the requirements stipulated in the Defense Production Act of 1950, as amended, that the President provide quadrennial reports on whether foreign governments sponsor industrial espionage activities to obtain U.S. critical technology assets. Prior annual reports did not contain a similar statement that the reports satisfied this requirement in the act.

In the previously mentioned 1998 draft memorandum to the former Special Assistant to the President, the Assistant Secretary for International Affairs wrote that the information in the 1994 report was already being provided to Congress in the espionage reports prepared by the Office of the National Counterintelligence Executive. As we discussed earlier, the former Special Assistant to the President had no recollection of this memorandum.

Although annual espionage reports were prepared by Office of the National Counterintelligence Executive since 1995, in 1998 and 2002, Treasury was not relieved of the section 721(k) reporting requirement. It was still incumbent upon Treasury to report such information to Congress or, at a minimum, inform the Congress that the information was provided in other reports. As mentioned previously, this issue was discussed in the draft 1998 memorandum from Treasury to the NSC/NEC.

Renewed Attention to CFIUS in 2005 Led to Production of 2006 Report

Inquiries from GAO and the Congressional Research Service, congressional hearings, and publicity concerning the foreign acquisition of a U.S. company in 2005 appears to have renewed interest in the report required under section 721(k) of the Defense Production Act and led to Treasury's 2006 filing. During that time, a Chinese government owned company was trying to acquire a U.S. oil company, and the United States–China Economic and

Security Review Commission¹⁵ raised the issue of the missing reports.

In June 2005, the China National Offshore Oil Corporation announced its intentions to acquire U.S. energy company Unocal. Although the bid by the China National Offshore Oil Corporation was eventually withdrawn, it resulted in renewed focus on the federal government's review process for acquisitions of U.S. companies by foreign countries or companies, especially foreign companies located within or controlled by countries whose governments might not be sympathetic to U.S. security interests.

The Senate Committee on Banking, Housing, and Urban Affairs held a hearing starting on October 6 and continuing on October 20, 2005, on the implementation of section 721 by CFIUS. At the time, there was a great deal of congressional interest because of a GAO report that found the government's process for reviewing foreign investments could be improved.¹⁶ The United States-China Economic and Security Review Commission raised the issue of the missing reports in the hearing. Treasury's Deputy Secretary confirmed in his written testimony that the Administration failed to produce quadrennial reports and that the Administration was working toward producing a report in 2006.

In January 2006, Dubai Ports World, a port operator owned by the government of the Emirate of Dubai, announced plans to acquire P&O Ports, a United Kingdom global port terminal operator with operations at a number of U.S. maritime ports. Following the acquisition, Dubai Port World later divested its interest in U.S. port terminal operations. This acquisition, however, brought additional attention to the federal government's national security review process for acquisitions of U.S. companies by foreign government owned companies.

¹⁵The United States-China Economic and Security Review Commission was established in October 2000 to monitor, investigate, and submit to Congress an annual report on the national security implications of the trade and economic relationship between the United States and the Peoples' Republic of China, and to provide recommendations to Congress for legislative and administrative action.

¹⁶ GAO, *Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness*, GAO-05-686 (Sept. 28, 2005).

The Administration became aware of the long lapse in producing the quadrennial report in 2005 and worked to produce an in-depth report for Congress in 2006. On January 25, 2006, Treasury's Deputy Secretary wrote to the Director of National Intelligence that the quadrennial report had not been prepared since 1994, and requested assistance in preparing the 2006 report. We asked the Office of Investment Security what prompted this letter. Treasury's Senior General Counsel for International Affairs told us that that a September 2005 GAO report and October 2005 GAO testimony related to implementation of Exon-Florio,¹⁷ including the role of CFIUS, brought Treasury's failure to produce the quadrennial report to the attention of Congress.¹⁸ The Senior General Counsel told us that 2005 was the first time anyone had asked about the missing quadrennial reports.

Documentation provided to us by the Office of Investment Security revealed that the Congressional Research Service¹⁹ also started to inquire about CFIUS reporting during mid-2005. In a July 11, 2005, e-mail, the Director of Investment Security sent the Congressional Research Service background information on the quadrennial report. We discussed the e-mail with a Congressional Research Service specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division, who told us that questions for the Director of Investment Security were likely based on requests from a Congressional committee or member of Congress.

¹⁷ The Exon-Florio amendment to the DPA of 1950 added Section 721, which authorized the President to investigate the impact of foreign acquisitions of U.S. companies on national security and to suspend or prohibit acquisitions that might threaten national security. 50 U.S.C. app. § 2170 (amended) (Pub. L. No. 100-418). In 2007, FINSAs amended Section 721 to formally establish CFIUS and its membership by statutory authority. FINSAs also added new requirements to Section 721 to strengthen the process by which acquisitions are reviewed and investigated for national security concerns, and increasing congressional oversight of CFIUS activities. 50 U.S.C. app. § 2061 (Pub. L. No. 110-049).

¹⁸ GAO, *Defense Trade: Implementation of Exon-Florio*, GAO-06-135T, (Oct. 6, 2005).

¹⁹ The Congressional Research Service serves congressional committees and members of Congress, and assists at every stage of the legislative process — from the early considerations that precede bill drafting, through committee hearings and floor debate, to the oversight of enacted laws and various agency activities.

On January 8, 2007, Treasury transmitted to Congress a report to fulfill the reporting requirements of section 721(k) of the Defense Production Act. The classified report was titled *Report on Whether Foreign Governments or Companies Have a Coordinated Strategy to Acquire U.S. Critical Technology Companies and Whether Foreign Governments Use Espionage Activities to Obtain Commercial U.S. Critical Technology Companies and Whether Foreign Governments Use Espionage Activities to Obtain Commercial U.S. Critical Technology Secrets*.

Treasury's Office of Investment Security provided us with the unclassified version of the report. The scope of the report covers the 12-year period from the end of the previous report, October 1, 1993, through December 31, 2005. The report states that a working group was established to assist with the report, consisting of officials from the Departments of the Treasury, Commerce, Defense, Justice, and State; Office of the Director of National Intelligence; and Executive Office of the President. According to the Deputy Assistant Secretary for Investment Security, the CIA helped prepare many parts of the report by contributing information about foreign mergers and acquisitions from a newly acquired data source.

Controls Have Been Strengthened to Ensure Completion of Congressionally Mandated Tasks

OMB Circular A-123 requires that general management control standards be established and followed to comply with applicable law and regulations.²⁰ Treasury did not have controls in place to ensure that mandated reports were produced, as evidenced by Treasury's failure to note that the President had assigned the quadrennial reporting requirement to Treasury in EO 12,919.

Treasury's Executive Secretary, who reports to the Secretary of the Treasury's Chief of Staff, told us that Treasury now maintains a master control list of all department-related congressionally mandated tasks. She said the control list has been in place since

²⁰ OMB Circular A-123, "Management's Responsibility for Internal Control" (revised Dec. 21, 2004).

late fiscal year 2007 and includes departmental CFIUS reporting requirements. The Executive Secretary provided us with a copy of the standard operating procedures and the master control list for the Office of International Affairs. As of January 25, 2008, the CFIUS reporting requirement was included on this master control list. According to Treasury's standard operating procedures, the Office of Legislative Affairs is responsible for maintaining the list.

In addition, the Deputy Assistant Secretary for Investment Security stated that the office was in the process of drafting regulations to implement FINSA, and that internal guidance based on those regulations would follow.²¹ The Deputy Assistant Secretary also said that establishment of memoranda of understanding would be considered between Treasury and the other agencies that contribute information for the report to clearly define the responsibilities of all parties.

Recommendations

We recommend that the Under Secretary of International Affairs do the following:

1. Ensure that internal CFIUS guidance for implementing FINSA is established and includes procedures for preparing and issuing the annual report to Congress on foreign investment in critical technology companies and industrial espionage activities.

Management Response

Treasury has begun preparation of the 2008 annual report, and the procedures established for this first annual report will guide the development of internal CFIUS guidelines for implementing FINSA, which Treasury intends to develop in consultation with other agencies following the publication of final regulations that implement FINSA.

²¹ FINSA required issuance of implementing regulations by April 2008. The October 2007 Federal Register (Vol. 72, No. 196) gave notice for written comments and a public meeting to obtain views on the regulatory development.

OIG Comments

Treasury's plan to develop internal CFIUS guidelines in consultation with other agencies, following the publication of final regulations that implement FINSA, satisfies the intent of our recommendation. Although the response lacks a completion date, management will need to establish a target date for completing this action in the Joint Audit Management Enterprise System.

2. Ensure that, consistent with the Secretary of the Treasury's responsibilities as Chairperson of CFIUS under the Executive Order that implements FINSA, Treasury designates participating agencies and specifies their responsibilities in preparing the annual report.

Management Response

In accordance with the January 23, 2008, EO that implements FINSA, Treasury will designate the agencies that will participate in the preparation of the annual report and work closely with them to define their responsibilities to ensure timely submission of the 2008 annual report.

OIG Comments

Treasury's intention to designate the agencies that will participate in the preparation of the annual report, and to define their responsibilities to ensure timely submission of the report, satisfies the intent of our recommendation. Although the response lacks a completion date, management will need to establish a target date for completing this action in the Joint Audit Management Enterprise System.

* * * * *

We would like to extend our appreciation to Treasury personnel for the cooperation and courtesies extended to our staff during this review. If you have any questions, please contact me at (202) 927-5400 or Donald Benson, Audit Director, at (617) 223-8638.

/s/

Marla A. Freedman
Assistant Inspector General for Audit

The objective of our audit was to determine the facts and circumstances concerning the Department of the Treasury's failure to provide reports to Congress in accordance with section 721(k) of the Defense Production Act of 1950, as amended in 1988 and in 1992. Specifically, we (1) determined the roles of all parties involved in preparing and issuing the quadrennial reports to Congress; (2) determined the applicable due dates for the required periodic report filings; (3) identified all reports prepared and filed, including when the reports were filed and by whom; and (4) obtained and reviewed copies of unclassified versions of these reports with any applicable transmittals. To determine why the reports were not filed, we conducted interviews and reviewed office correspondence, e-mails, and all other documentation retained regarding the filing of the reports.

We reviewed background information including laws, regulations, and executive orders applicable to quadrennial report filings.

We requested from Treasury all documentation related to the quadrennial report filings from 1994 to 2006, and reviewed the documentation received from Treasury in response. These documents included the unclassified quadrennial reports prepared in 1994 and 2006 and office correspondence regarding the filing of reports.

We interviewed officials within Treasury's Office of International Affairs in Washington, D.C., because that office was responsible for providing the reports to Congress. We also interviewed Treasury officials within the Office of Performance Budgeting, Office of General Counsel, and Office of Executive Secretary regarding how Treasury ensures that regulatory requirements, such as mandated reporting, are met.

In addition to Treasury officials and staff, we interviewed (1) a former Special Assistant to the President and Senior Director for International Trade and Investment, National Security Council/National Economic Council, about communications with Treasury regarding the quadrennial report requirements and

direction provided to Treasury regarding preparation of the report; (2) a Central Intelligence Agency official with responsibility for helping Treasury prepare the quadrennial report, about his communication with Treasury and participation in drafting the quadrennial report; and (3) a Congressional Research Service official involved in requesting information about the quadrennial reports in 2005, regarding the reasons for the information requests.

We reviewed all information that Treasury provided and stated was available regarding the report filings. This documentation included e-mail correspondence, report filings, and various memoranda. With regard to the 1998 draft memorandum in which Treasury discussed preparation of the second quadrennial report with a former Special Assistant to the President, we requested but did not receive the transmittal letter evidencing that the memorandum had been issued.

Regarding the quadrennial report that Treasury was required to produce in 2002, officials in the Office of Investment Security informed us that there was no documentation to provide to us because they did not pursue the matter during that year.

All officials at the Office of International Affairs involved with the quadrennial filings represented to us in writing that they had provided all related materials for our review. There were no other audit procedures that we could perform to ensure that the documentation provided was complete.

Our conclusions as to the facts and circumstances surrounding the filing of the quadrennial reports were based on interviews with officials from Treasury and the Central Intelligence Agency, as well as on the limited documentation we received from these entities.

We performed our fieldwork from November 2007 to March 2008 in accordance with generally accepted government auditing standards.

Appendix 2
Timeline of Significant Events

Date	Event
September 8, 1950	The Defense Production Act (DPA) of 1950 is enacted. The act authorized governmental activities in various areas, including requisition of property for national defense, expansion of productive capacity, establishment of contract priorities, and materials allocation designed to aid the national defense. The authority to suspend or prohibit foreign acquisition that threatens national security was not added until the Omnibus Trade and Competitiveness Act was enacted in 1988.
May 7, 1975	Executive Order (EO) 11,858, Foreign Investment in United States is issued. This EO established the Committee on Foreign Investment in the United States (CFIUS), with the Secretary of the Treasury as chairman. The responsibility of CFIUS is to examine and monitor the impact of foreign investment in the United States.
Aug. 23, 1988	The Omnibus Trade and Competitiveness Act (section 5021) is enacted (Pub. L. No. 100-418). The act added section 721 (50 U.S.C. app. § 2170), also known as the Exon-Florio provision, to DPA, giving the President authority to suspend or prohibit any foreign acquisition, merger, or takeover of a U.S. corporation that is determined to threaten national security. If the President decides to suspend or prohibit a transaction, the President is required to provide Congress a written report of the action that the President intends to take, including a detailed explanation of the findings.
Dec. 27, 1988	EO 12,661, Implementing the Omnibus Trade and Competitiveness Act of 1988 and Related Internal Trade Matters, is issued. The President's responsibilities under section 721 of DPA are assigned to CFIUS, specifically, the duty to conduct reviews, undertake investigations, and make recommendations on foreign acquisition of U.S. companies. This order amended EO 11,858.
November 21, 1991	31 CFR Part 800 is promulgated. These regulations implement section 721 and inform CFIUS, the President, and parties regarding procedures for reviewing mergers, acquisitions, and takeovers by foreign entities.

Appendix 2
Timeline of Significant Events

Date	Event
Oct. 23, 1992	National Defense Authorization Act for FY 1993 (Pub. L. No. 102-484) is enacted amending DPA. The act requires the President to provide Congress a report of the President's decision to prohibit or not prohibit a foreign acquisition, merger, or takeover of a U.S. corporation. Prior to this act, the President only had to submit a report when deciding to prohibit such transactions. The act also required mandatory investigations of transactions that could result in a foreign government's gaining control of a U.S. company that could affect U.S. national security.
October 28, 1992	Defense Production Act Amendments of 1992 (Pub. L. No. 102-558) is enacted. Section 721 of DPA is amended by adding the following new subsection: (k) Quadrennial Report. "...President and such agencies as the President shall designate shall complete and furnish to Congress, not later than 1 year after date of enactment of the section and upon the expiration of every 4 years thereafter." The report is to evaluate whether foreign countries have concerted strategies to acquire U.S. companies in the area of critical technologies and to address the scope of industrial espionage activities in the country. Critical technologies are defined as "critical components or critical technology items essential to national defense."
September 3, 1993	EO 12,860, Adding Members to the Committee on Foreign Investment in the United States, is issued. Several members are added to CFIUS: the Director of the Office of Science and Technology Policy, the Assistant to the President for National Security Affairs, and the Assistant to the President for Economic Policy.
June 3, 1994	EO 12,919, National Defense Industrial Resources Preparedness, is issued. Among many delegations involving a number of agencies, the Secretary of the Treasury is assigned responsibility (in cooperation with several other Executive branch agencies) to complete and furnish a report to the President and Congress in accordance with the requirements of section 721(k) of DPA concerning foreign efforts to acquire U.S. companies involved in research, development, or production of critical technologies and industrial espionage activities directed by foreign governments against private U.S. companies.

Appendix 2
Timeline of Significant Events

Date	Event
August 30, 1994	The National Economic Council sends the first report (classified and unclassified) to Congress.
1998	Treasury's Assistant Secretary for International Affairs drafts a memorandum to the Special Assistant to the President and Senior Director for International Trade and Investment, National Security Council/National Economic Counsel, to explain that CIA and Commerce data were not available for the report. Treasury did not produce the required quadrennial report.
2002	This was the year that the next report to Congress was due; however, as Treasury officials recalled, again CIA and Commerce data were not available for the report. Treasury did not produce the required quadrennial report.
September 28, 2005	The Government Accountability Office (GAO) issues <i>Defense Trade: Enhancements to the Implementation of Exon-Florio Could Strengthen the Law's Effectiveness</i> , (GAO-05-686). GAO found the CFIUS process for reviewing foreign investments could be improved. To provide more transparency and congressional oversight, GAO said that Congress should revisit the criterion for reporting circumstances surrounding cases to Congress. For example, GAO said that Congress could require an annual report on all transactions that occurred during each year.
October 6, 2005, and continued on October 20, 2005	A hearing is held before the Senate Committee on Banking, Housing, and Urban Affairs to review the CFIUS process for implementing the Exon-Florio amendment. GAO testified that despite the 1992 requirement for a report on foreign acquisition strategies every 4 years, only one report was issued, in 1994. In response to a written question by the Committee member asking for an explanation of the failure of CFIUS to produce the quadrennial report after 1993, Treasury stated, in part, that one report was submitted in 1994 and other reports have not since been produced. Treasury also noted that the information required related to industrial espionage had been provided through annual reports prepared

Appendix 2
 Timeline of Significant Events

Date	Event
May 17, 2006	<p>by the Office of the National Counterintelligence Executive. Treasury further stated that the Administration planned to provide a comprehensive report in 2006. Treasury's response, however, did not identify the reasons why the quadrennial reports were not prepared.</p> <p>A hearing is held before the House Financial Services Subcommittee on Domestic and International Monetary Policy, Trade and Technology on H.R. 5337, the National Security Foreign Investment Reform and Strengthened Transparency Act of 2006. The Treasury Assistant Secretary for International Affairs testified on ways to improve the CFIUS process, particularly communication with Congress and political accountability. The Treasury official stated that Treasury is now promptly notifying Congress of every review upon its completion and has committed to conducting quarterly briefings for Congress on CFIUS matters. He said that the Administration was also preparing the 2006 quadrennial report and that Treasury regretted that a quadrennial report had not been prepared since 1994.</p>
Dec. 28, 2006	<p>Treasury/CFIUS completes <i>Report on Whether Foreign Governments or Companies Have a Coordinated Strategy to Acquire U.S. Critical Technology Companies and Whether Foreign Governments Use Espionage Activities to Obtain Commercial U.S. Critical Technology Companies and Whether Foreign Governments Use Espionage Activities to Obtain Commercial U.S. Critical Technology Secrets</i>. The report cites section 721(k) of DPA. According to Treasury officials, this classified report was transmitted to Congress in January 2007. Treasury transmitted the unclassified version to Congress in September 2007.</p>
Dec. 29, 2006	<p>Memorandum on the Assignment of Function Under Section 721(k) of the Defense Production Act of 1950 is signed by the President and issued. It appears in the Federal Register on Jan. 5, 2007. In the memorandum, the President assigned to the Secretary of the Treasury "the function of the President under section 721(k) of the Defense Production Act of 1950 (50 U.S.C. App. 2170(k)), for purposes of submitting such report by February 28, 2007." This memorandum was unnecessary</p>

Appendix 2
Timeline of Significant Events

Date	Event
	because Treasury was already assigned this responsibility in EO 12,919 dated June 3, 1994.
January 8, 2007	Treasury transmits the 2006 classified quadrennial report to Congress.
July 26, 2007	Foreign Investment and National Security Act of 2007 (Pub. L. No. 110-049) is enacted. This act made changes to the foreign investment review process contained in section 721 of DPA and provides for increased oversight by Congress. It requires CFIUS to submit annual reports to Congress before July 31 of each year on all of the reviews and investigations of covered transaction completed during the year. The Treasury Inspector General is required to investigate and submit a report to Congress concerning any failure of Treasury to comply with the reporting requirements of section 721(k) of DPA.
September 2007	Treasury transmits the 2006 unclassified quadrennial report to Congress.
January 23, 2008	Further Amendment of EO 11,858, Concerning Foreign Investment in United States is issued. This EO implemented FINSA.

Source: OIG analysis of Treasury data and applicable laws and regulation.

Appendix 3
Management Response



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

April 17, 2008

Ms. Marla A. Freedman
Assistant Inspector General
For Audit
U.S. Department of the Treasury
Washington, D.C. 20220

Dear Ms. Freedman:

This letter is in response to your April 3, 2008, transmittal of the Draft Audit Report: *Foreign Investments: Review of Treasury's Failure to Provide Congress Required Quadrennial Reports in 1998 and 2002 on Foreign Acquisitions and Industrial Espionage Activity Involving U.S. Critical Technology Companies*. The Foreign Investment and National Security Act of 2007 (FINSA) required that Treasury's Office of the Inspector General prepare this Report. Under Secretary McCormick has asked that I respond to your request for comments on the Report.

In general, we support the recommendations made by the OIG in the Report and are taking the necessary steps to make them effective. The recommendations and the actions being taken are as follows:

1. Recommendation: Ensure that internal CFIUS guidance for implementing FINSA is established and includes procedures for preparing and issuing the annual report to Congress on foreign investment in critical technology companies and industrial espionage activities.

Action: Treasury has begun the process of preparing the 2008 annual report. The procedures established for this first annual report will guide the preparation of future annual reports and guide the development of internal CFIUS Guidelines for implementing FINSA, which Treasury intends to develop in consultation with other CFIUS agencies following the publication of final regulations that implement FINSA.

As you may know, the reporting requirements imposed by FINSA have increased significantly. In response, Treasury has implemented procedures to provide Congress certified notices upon conclusion of each review or investigation of a covered transaction notified under FINSA. Since October 24, 2007, Treasury has provided over 50 such notices, which are approved by each member agency and signed at the Assistant Secretary level or higher. Also since then, Treasury coordinated the preparation of and sent to Congress the *Report to Congress on*

Appendix 3
Management Response

Foreign Direct Investment in the United States from Certain Countries as Required by the Foreign Investment and National Security Act of 2007.

2. Recommendation: Ensure that, consistent with the Secretary of the Treasury's responsibilities as Chairperson of CFIUS under the Executive Order that implements FINSA, Treasury designates participating agencies and specifies their responsibilities in preparing the annual report.

Action: On January 23, 2008, the White House issued an executive order substantially amending Executive Order 11858 regarding the implementation of section 721 of the Defense Production Act of 1950, as amended. Executive Order 11858, as amended, gives Treasury the authority to coordinate preparation of the annual report and transmit it to Congress. Treasury will accordingly designate the participating agencies and work closely with them in defining their responsibilities to ensure the timely submission of the 2008 annual report. Treasury took a similar approach in preparing the quadrennial report in 2006.

We appreciate that the Report describes the proactive actions that Treasury took to address the lack of previous quadrennial reports, including assuming the lead role in coordinating, preparing and submitting to Congress the 2006 report, which covered the 12-year period from the end of the 1994 report through 2005. We are also pleased that the Report notes that Treasury strengthened controls to ensure completion of congressionally mandated tasks and notes that our Executive Secretary now maintains a list of department-related congressionally mandated tasks to ensure that all offices within Treasury are adequately informed.

In conclusion, we appreciate the opportunity to respond to this Report and its recommendations.

Sincerely,


Clay Lowery
Assistant Secretary for International Affairs

Appendix 4
Major Contributors to This Report

Office of Inspector General

Sharon Torosian, Audit Manager

Mark Ossinger, Audit Manager

Jenny Hu, Auditor

Cynthia Milanez, Referencer

The Department of the Treasury

Under Secretary for International Affairs
Assistant Secretary, International Affairs
Deputy Assistant Secretary, Investment Security
Office of Strategic Planning and Performance Management
Office of Accounting and Internal Control

Office of Management and Budget

OIG Budget Examiner

United States Congress

Senate

Committee on Foreign Relations
Committee on Banking, Housing, and Urban Affairs
Committee on Commerce, Science, and Transportation
Committee on Finance

House of Representatives

Committee on Foreign Affairs
Committee on Financial Services
Committee on Energy and Commerce