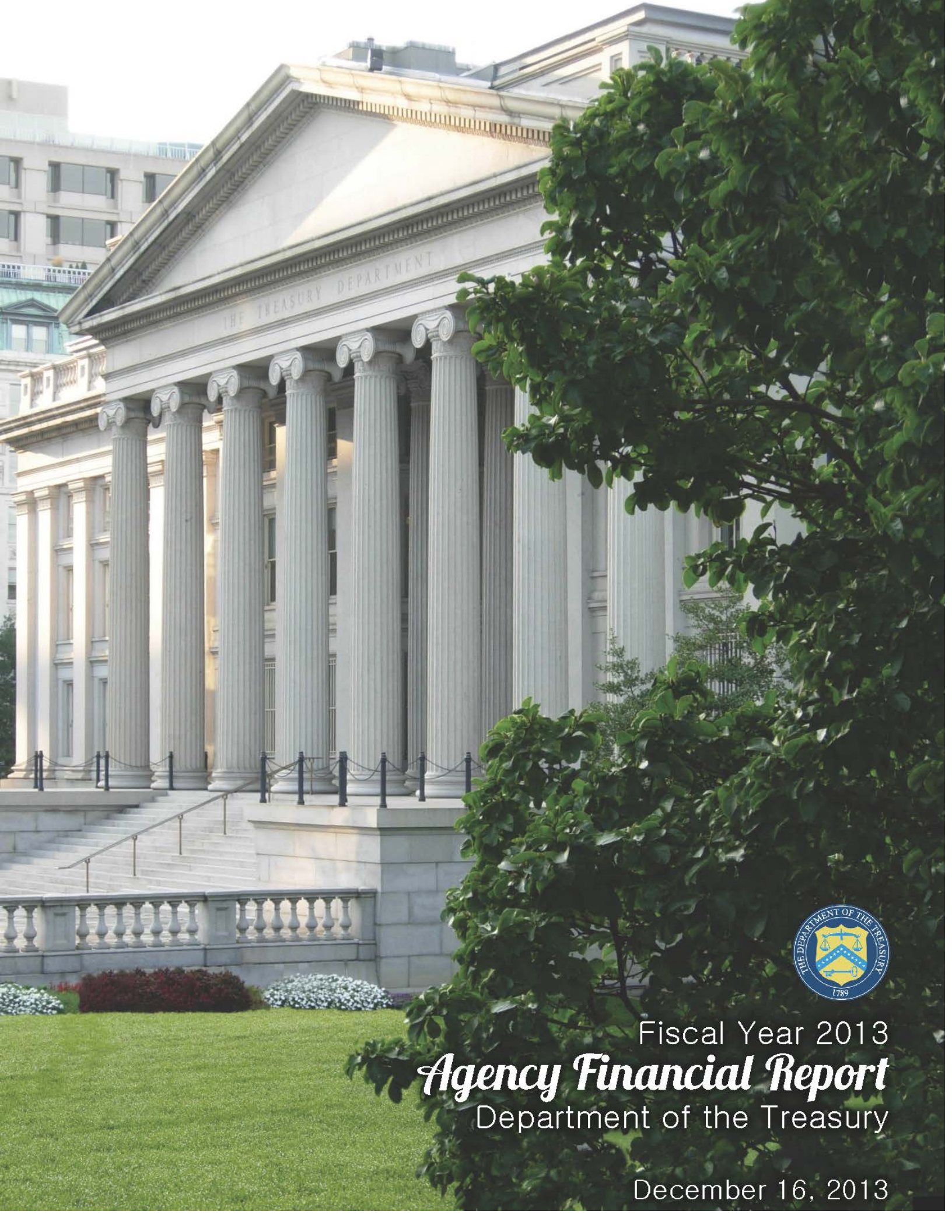



Fiscal Year 2013

# Agency Financial Report

Department of the Treasury

December 16, 2013

# The United States Department of the Treasury

## Our Mission

*Maintain a strong economy and create economic and job opportunities by promoting conditions that:*

*enable economic growth and stability at home and abroad,*

*strengthen national security by combating threats and protecting the integrity of the financial system, and*

*manage the U.S. Government's finances and resources.*

## Strategic Goals

### Goal 1

*Repair and reform the financial system and support the recovery of the housing market*

### Goal 2

*Enhance U.S. competitiveness and promote international financial stability and balanced global growth*

### Goal 3

*Protect our national security through targeted financial actions*

### Goal 4

*Pursue comprehensive tax and fiscal reform*

### Goal 5

*Manage the government's finances in a fiscally responsible manner*

## Priority Goals

*Increase voluntary tax compliance*

*Increase electronic transactions with the public to improve service, prevent fraud, and reduce costs*

THE DEPARTMENT OF THE TREASURY

# Agency Financial Report

Fiscal Year 2013

For the online version of this report, please see:
http://www.treasury.gov
and search for "2013 AFR"

# TABLE OF CONTENTS

Message from the Secretary of the Treasury..... iv

Part 1: Management's Discussion and Analysis (Unaudited)

Introduction..... 3

Organization..... 3

Treasury's Fiscal Year 2012-2015 Strategic Framework and Key Performance Indicators..... 6

Fiscal Year 2013 Performance by Strategic Goal..... 8

Performance by Agency Priority Goal..... 22

Highlights of Management and Performance Challenges ..... 24

Financial Highlights..... 25

Management Assurances ..... 30

Part 2: Annual Financial Report

Message from the Assistant Secretary for Management and Deputy Chief Financial Officer ..... 38

Inspector General's Transmittal Letter ..... 39

Independent Auditors' Report on the Department's Financial Statements..... 41

Management's Response to Independent Auditors' Report..... 48

Financial Statements..... 49

Notes to the Financial Statements..... 56

Required Supplemental Information (Unaudited) ..... 135

Part 3: Other Information (Unaudited)

Section A: Schedule of Spending ..... 143

Section B: Tax Gap and Tax Burden..... 144

Section C: Management and Performance Challenges Identified by the Inspectors General and the Secretary's Responses..... 146

Section D: Summary of Financial Statement Audit and Management Assurances ..... 203

Section E: IPIA (as amended by IPERA) Reporting Details ..... 204

Section F: Material Weaknesses and Audit Follow up ..... 215

Appendix: Glossary of Acronyms ..... 223

# MESSAGE FROM THE SECRETARY OF THE TREASURY

Five years ago, our economy faced challenges on a scale not seen since the Great Depression. In the span of a few weeks, many of our nation's largest financial institutions failed or were forced to merge to avoid insolvency. Capital markets – essential for helping families and businesses meet their everyday financing needs – were freezing up, dramatically reducing the availability of credit, such as student, auto, and small business loans. Market participants, consumers, and investors were rapidly losing trust in the stability of America's financial system. Our economy was shedding hundreds of thousands of jobs each month.

Since then, thanks to the tenacity of the American people and the bold, decisive, and bipartisan actions taken across the U.S. government, the U.S. economy has returned to a path of stability and steady growth. We have added more than 2 million jobs in the past year alone and our deficits are half of what they were when President Obama took office in 2009. And the end of this year and beginning of next year show signs of further progress.

As we continue on this path to recovery, I am proud of what the Treasury Department has achieved during the past fiscal year. Treasury made significant progress toward achieving its five strategic goals. As demonstrated in this report and by the following highlights, we have effectively pursued policies that will build a strong foundation for future growth and prepare for the challenges ahead – both at home and abroad.

- **To meet our goal of repairing and reforming the financial system,** we have worked diligently with federal regulators, as chair of the Financial Stability Oversight Council, to implement historic reforms designed to make the financial system safe, stronger, and more resilient;
- **To pursue our goal of enhancing U.S. competitiveness and promoting international financial stability,** we have successfully promoted free trade and open markets. Negotiating with the European Union to successfully launch a Transatlantic Trade and Investment Partnership, committing China to undertake future bi-lateral negotiations, and supporting development programs in the Middle East and Northern Africa;
- **To protect our national security,** we have helped to combat and prevent financial crimes and terrorist financing by conducting evaluations of various countries' compliance with international standards and providing training to international counterparts and we have made great strides to bolster cyber security in the public and private sectors alike;
- **To pursue comprehensive tax and fiscal reform,** we have worked tirelessly to increase international cooperation in implementing the Foreign Account Tax Compliance Act by signing intergovernmental agreements with eight countries, which will bolster our efforts to combat offshore tax evasion; and
- **To manage the government's finances in a fiscally responsible manner,** in fiscal year 2013, the Fiscal Service collected over $7.02 billion of delinquent debt, an increase of more than 13 percent over fiscal year 2012 and its highest annual collection to date.

While these accomplishments are worth noting, we cannot afford to be complacent. In fiscal year 2014, Treasury staff will continue to implement reforms and lay the foundation for stable economic growth both at home and abroad. Within the Department, we will continue to focus on a comprehensive set of management priorities, including recruiting and retaining outstanding employees, increasing shared services, using data to make better decisions, and

improving customer service, which will better enable us to lead and support government-wide financial management efforts to increase productivity, reduce waste and non-essential expenses, and modernize processes and systems.

As evidenced in this report, and for the fourteenth consecutive year, the Treasury Department received an unmodified opinion on its consolidated financial statements and, for the fifth consecutive year, on the financial statements of the Office of Financial Stability/Troubled Asset Relief Program. Treasury also made progress in reducing management control weaknesses and in achieving U.S. financial systems and control objectives. The financial and performance data in this report have been validated as accurate, complete, and reliable. To streamline the Department's reporting efforts, we are not providing a single Performance and Accountability Report for Fiscal Year 2013. The Annual Performance Report will be included in the Congressional Budget Justification in February 2014.

I look forward to building on the accomplishments contained in this year's Agency Financial Report, and leading the Treasury Department as it pursues policies to fuel our economy into the future and chart a course to expand opportunities for the next generation.

Jacob J. Lew
Secretary of the Treasury
December 16, 2013

PART 1:

# Management's Discussion and Analysis

(UNAUDITED)

# INTRODUCTION

In fiscal year 2013, the Department of the Treasury (Treasury) took a number of actions to strengthen the United States (U.S.) economy and job creation, help struggling homeowners, monitor risks to the financial system, encourage small business lending, protect taxpayers, fight financial crimes, reinforce the international competitiveness of the U.S., and responsibly manage the U.S. government's financial resources, among other duties. Treasury performed these functions in pursuit of achieving its vital mission: maintaining a strong economy and promoting conditions that enable economic growth and stability at home and abroad, strengthening national security by combating threats and protecting the integrity of the financial system, and managing the U.S. government's finances and resources effectively.

This Agency Financial Report documents Treasury's operational and financial performance during fiscal year 2013. This report also demonstrates Treasury's steady progress on the five Strategic Goals and two Agency Priority Goals outlined in the Department's Fiscal Year 2012 - 2015 Strategic Plan[1].

# ORGANIZATION

Treasury is organized into the Departmental Offices, seven operating bureaus, and three inspectors general. The Departmental Offices are primarily responsible for policy formulation, while the bureaus are primarily the operating units of the organization.

### DEPARTMENTAL OFFICES

**Domestic Finance** works to preserve confidence in the U.S. Treasury market, effectively manage federal fiscal operations, strengthen financial institutions and markets, promote access to credit, and improve financial access and education in service of America's long-term economic strength and stability.

**International Affairs** protects and supports U.S. economic prosperity and national security by working to help ensure the most favorable external environment for sustained jobs and economic growth in the U.S Through bilateral and multilateral engagement, the office promotes global economic and financial stability, encourages market-determined foreign exchange rates, leverages leadership positions in the international financial institutions to advance U.S. policy priorities, and pursues free trade, open markets, and level playing fields for U.S. financial institutions doing business abroad.

**Terrorism and Financial Intelligence (TFI)** marshals the Department's intelligence and enforcement functions with the twin aims of safeguarding the financial system against illicit use and combating rogue nations, terrorist facilitators, weapons of mass destruction (WMD) proliferators, money launderers, drug kingpins, and other national security threats.

**Economic Policy** reports on current and prospective economic developments and assists in the determination of appropriate economic policies. The office is responsible for the review and analysis of domestic economic issues and developments in the financial markets.

**Tax Policy** develops and implements tax policies and programs, reviews regulations and rulings to administer the Internal Revenue Code, negotiates tax treaties, and provides economic and legal policy analysis for domestic and international tax policy decisions. Tax Policy also provides revenue estimates for the President's Budget.

[1] Treasury 2012-2015 Strategic Plan: http://www.treasury.gov/about/budget-performance/strategic-plan/Documents/strategic-plan2012-2015.pdf

**Treasurer of the United States** has direct oversight over the U.S. Mint and the Bureau of Engraving and Printing. The Treasurer also chairs the Advanced Counterfeit Deterrence Steering Committee and is a key liaison with the Federal Reserve. In addition, the Treasurer serves as a senior advisor to the Secretary in the areas of community development and public engagement.

### Other Offices

Internally, the Departmental Offices are responsible for overall management of Treasury. The Office of Management and the Chief Financial Officer are responsible for managing the Department's financial resources and oversees Treasury-wide programs, including human capital, information and technology, acquisition, and diversity issues.

Other offices include General Counsel, Legislative Affairs, and Public Affairs. Three inspectors general—the Office of the Inspector General (OIG), the Treasury Inspector General for Tax Administration (TIGTA), and the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) — provide independent audits, investigations, and oversight of the Department of the Treasury and its programs.

## BUREAUS

Bureaus employ approximately 96 percent of Treasury's workforce and are responsible for carrying out specific operations assigned to the Department.

**The Alcohol and Tobacco Tax and Trade Bureau (TTB)** collects federal excise taxes on alcohol, tobacco, firearms, and ammunition; and is responsible for enforcing and administering laws covering the production, use, and distribution of alcohol and tobacco products.

**The Bureau of Engraving and Printing (BEP)** develops and produces U.S. currency notes trusted worldwide.

**The Financial Crimes Enforcement Network (FinCEN)** safeguards the financial system from illicit use and combats money laundering and promotes national security through the collection, analysis, and dissemination of financial intelligence and strategic use of financial authorities.

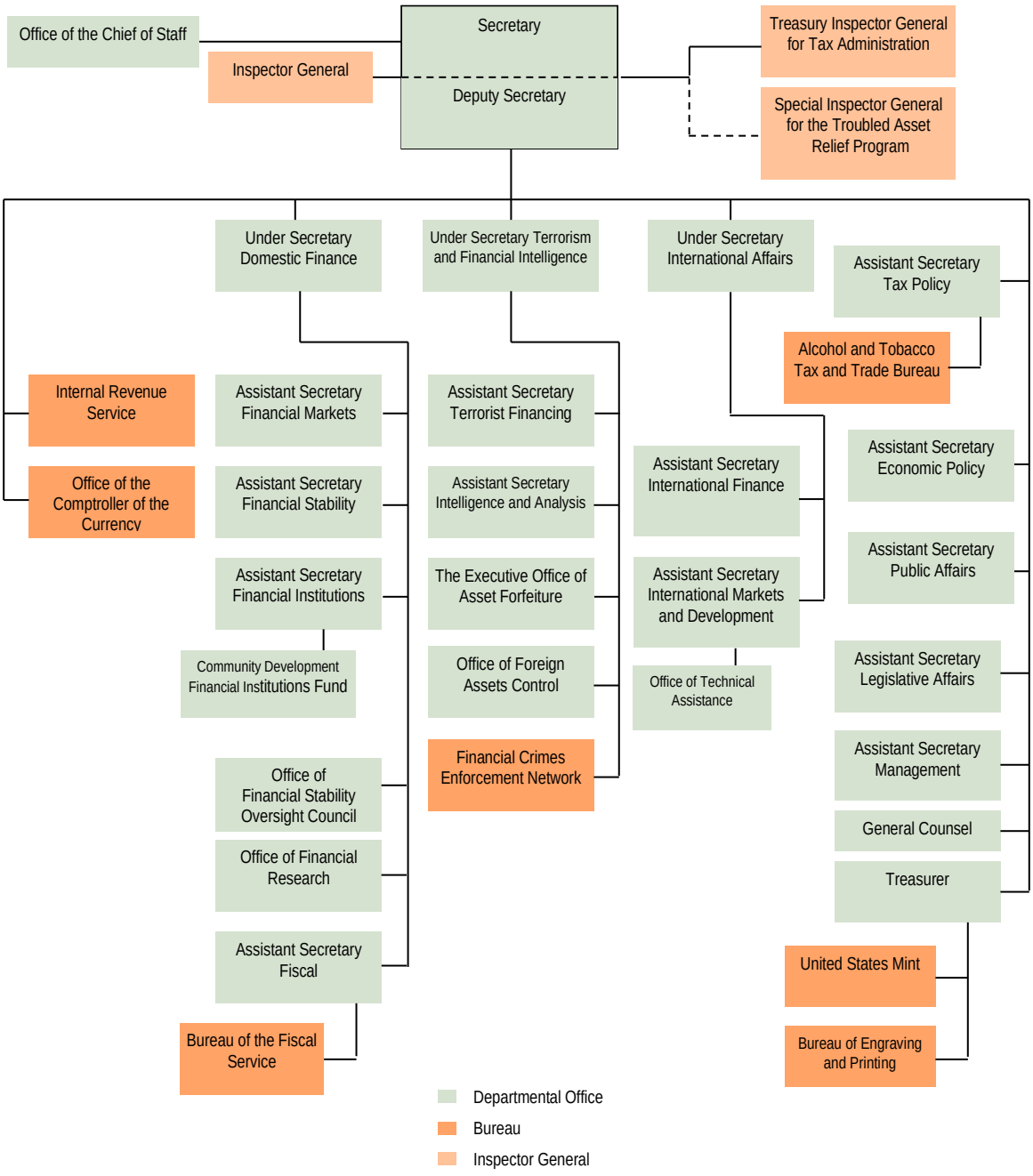
**The Bureau of the Fiscal Service (Fiscal Service)** provides central payment services to federal program agencies, operates the U.S. government's collections and deposit systems, provides government-wide accounting and reporting services, and manages the collection of delinquent debt owed to the U.S. government. In addition, Fiscal Service borrows the money needed to operate the U.S. government through the sale of marketable, savings, and special purpose U.S. Treasury securities and accounts for and services the public debt.

**The Internal Revenue Service (IRS)** is the largest of the Department's bureaus and determines, assesses, and collects the tax revenue in the United States.

**The United States Mint (U.S. Mint)** designs, mints, and issues U.S. circulating and bullion coins; prepares and distributes numismatic coins and other items; and strikes Congressional Gold Medals and other medals of national significance. The Mint maintains physical custody and protection of most of the Nation's gold and all of its silver assets.

**The Office of the Comptroller of the Currency (OCC)** charters, regulates, and supervises national banks and federal savings associations to ensure a safe, sound, and competitive banking system that supports the citizens, communities, and economy of the United States. The OCC also supervises federal branches and agencies of foreign banks. Effective July 21, 2011, Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act, transferred to the OCC responsibility for the supervision of federal savings associations (thrifts) and rule making authority for all savings associations.

# THE DEPARTMENT OF THE TREASURY ORGANIZATIONAL CHART



# TREASURY FISCAL YEAR 2012-2015 STRATEGIC FRAMEWORK AND KEY PERFORMANCE INDICATORS

The strategic framework comprises the Department's goals and objectives and forms the basis for performance management within the agency.

| | Strategic Goals | Strategic Objectives | Select Performance Indicators[2] |
|---|---|---|---|
| Financial | Goal 1<br>Repair and Reform the Financial System and Support the Recovery of the Housing Market | • Lead the Administration's efforts to continue to implement comprehensive regulatory reform to increase stability and strengthen accountability in the financial system<br>• Effectively manage and exit emergency programs<br>• Reform and strengthen the housing finance system<br>• Help prevent avoidable foreclosures and support the availability of affordable mortgage credit | • Clean audit opinion on TARP financial statements (OFS)<br>• Percentage of SIGTARP and GAO oversight recommendations responded to on time (OFS) |
| Economic | Goal 2<br>Enhance U.S. Competitiveness and Promote International Financial Stability and Balanced Global Growth | • Protect global economic and financial stability and encourage market-determined exchange rates<br>• Promote strong international financial standards and a level playing field for U.S. financial institutions<br>• Pursue free trade and open markets<br>• Encourage foreign investment in the U.S. economy while ensuring national security<br>• Enter into bilateral and multilateral tax agreements that encourage cross-border trade and investment, and promote the exchange of tax information to combat offshore tax evasion<br>• Use leadership positions in the multilateral development banks and the International Monetary Fund to advance U.S. national security and economic interests<br>• Provide direct assistance to developing countries working to improve public financial management, and strengthen their financial systems | • Percentage of Multilateral Development Bank grant and loan proposals containing satisfactory framework for results measurement (IA)<br>• Average number of days to process an original permit application for a new alcohol or tobacco business (TTB) |

[2]Example performance measures are provided in this table to illustrate how performance against these goals can be quantified. A full discussion of all performance measures that are reported under each goal will be provided in the "Performance by Goal" sections of this report.

| | Strategic Goals | Strategic Objectives | Select Performance Indicators |
|---|---|---|---|
| Security | Goal 3<br>Protect our National Security through Targeted Financial Actions | • Collect, analyze, and disseminate financial and other information concerning illicit financing and national security threats<br>• Disrupt and dismantle the financial networks of those who threaten national security or engage in illicit financing<br>• Shape policy, laws, and regulations to safeguard the U.S. and international financial systems<br>• Coordinate with partners, both at home and abroad, including the foreign policy, law enforcement, and intelligence communities, to combat illicit finance<br>• Assist partner countries in developing and implementing anti-money laundering and counter terrorist financing regimes compliant with international standards | • Impact of TFI programs and activities (TFI)<br>• Percentage of domestic law enforcement finding FinCEN's analytic reports contribute to the detection and deterrence of financial crime (FinCEN) |
| Management | Goal 4<br>Pursue Comprehensive Tax and Fiscal Reform | • Develop comprehensive proposals to reform and simplify the tax code<br>• Increase voluntary tax compliance<br>• Promote policies to ensure a sound fiscal footing over the medium term | • Customer service representative level of service (%, IRS)<br>• Percent of individual returns processed electronically (IRS) |
| | Goal 5<br>Manage the Government's Finances in a Fiscally Responsible Manner | • Optimize the cash and debt portfolio to manage the Government's borrowing costs effectively<br>• Expand the use of electronic transactions<br>• Modernize financial systems and standardize accounting practices<br>• Continuously improve our operations and processes to generate efficiency savings<br>• Attract and retain an exceptional workforce | • Percentage collected electronically of total dollar amount of U.S. government receipts (Fiscal Service)<br>• Amount of delinquent debt collected through all available tools ($ billions, Fiscal Service) |

# FISCAL YEAR 2013 PERFORMANCE BY STRATEGIC GOAL

## GOAL #1: REPAIR AND REFORM THE FINANCIAL SYSTEM AND SUPPORT THE RECOVERY OF THE HOUSING MARKET

In late 2008 and early 2009, the Department of the Treasury put in place a set of emergency programs to help recover from a historic financial crisis, restore confidence, and restart economic growth.

In 2010, Congress passed and the President signed into law comprehensive financial regulatory reform: the Dodd-Frank Wall Street Reform and Consumer Protection Act. Treasury has worked with the financial regulatory agencies to implement these reforms, which are helping to protect the economy and financial system by addressing key gaps and weaknesses in the pre-crisis regulatory system. These reforms will also help to protect consumers against fraud and abuse that in part contributed to the financial crisis.

Treasury has also worked to support efforts to reform the housing market. Treasury has taken leadership roles in the development of loan modification and refinancing programs designed to help prevent avoidable foreclosures and reduce mortgage costs for homeowners. At the same time, Treasury has been involved in an ongoing conversation about a path forward for the nation's housing finance system and has responsibly managed the government's investments in Fannie Mae and Freddie Mac.

### SIGNIFICANT ACHIEVEMENTS

Treasury's Office of Financial Stability (OFS) has continued to make progress in winding down the Troubled Asset Relief Program (TARP)[3] and the emergency assistance for the financial system has primarily been replaced with private capital. OFS, on behalf of taxpayers, has now recovered far more of its TARP investments than most people expected when the program began. As of September 30, 2013, OFS had collected 96.2 percent of the $421.6 billion in program funds that were disbursed under TARP.

As OFS carefully winds down the investment programs under TARP, it continues to implement programs to help struggling homeowners avoid foreclosure, primarily through mortgage modifications under the Treasury housing programs. In addition to providing assistance to 1.8 million homeowners directly, these programs have set new standards and encouraged positive changes throughout the mortgage servicing industry. On May 30, 2013, the Obama Administration extended the application deadline for the Making Home Affordable Program through December 2015 in part to provide struggling homeowners additional time to access sustainable mortgage relief.

### PERFORMANCE AND FACTORS AFFECTING RESULTS

For a full discussion of Treasury's efforts to repair and reform the financial system and support the recovery of the housing market, please view the Agency Financial Report for OFS available at:

http://www.treasury.gov/initiatives/financial-stability/reports/Pages/Annual-Agency-Financial-Reports.aspx

### EMERGING ISSUES

For a full discussion of the emerging issues facing Treasury's efforts to repair and reform the financial system and support the recovery of the housing market, please view the Agency Financial Report for OFS available at the URL referenced above.

[3] Troubled Asset Relief Program: http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/Pages/default.aspx

# GOAL #2: ENHANCE U.S. COMPETITIVENESS AND PROMOTE INTERNATIONAL FINANCIAL STABILITY AND BALANCED GLOBAL GROWTH

Treasury works bilaterally and multilaterally to foster strong and balanced global growth, promote stable international financial markets, encourage foreign investment in the United States while protecting national security, promote a level playing field for U.S. financial institutions internationally, and enhance U.S. competitiveness. This goal is supported through the operations of the Office of International Affairs, the Office of Tax Policy, and the TTB. Promoting international growth and stability also includes Treasury's efforts to enable domestic growth and U.S. financial stability, which is supported through the efforts of the CDFI Fund, the U.S. Mint, and the BEP.

## SIGNIFICANT ACHIEVEMENTS

This year Treasury's Office of International Affairs made significant progress promoting free trade, open markets, and global financial stability:

- As co-lead on financial services negotiations, Treasury continued to support the Administration in negotiating the Transatlantic Trade and Investment Partnership agreement with the European Union and a Trade in Services Agreement with 23 other like-minded countries to liberalize services trade;
- At the U.S.-China Strategic and Economic Dialogue, China committed to undertake negotiations for a high-standard U.S.-China Bilateral Investment Treaty that would aim to cover all phases of investment and all sectors. China also reaffirmed its commitment to move to a more market-determined exchange rate and; between June 2010 and October 2013, the Chinese currency appreciated by over 17 percent against the dollar on a real, inflation-adjusted basis;
- As part of its efforts to prevent financial instability in the Eurozone from spreading to the U.S. economy, Treasury encouraged European countries to implement a robust policy framework to promote economic growth and restore confidence in the European banking system. Over the period, Treasury saw a significant reduction in interest rates facing Europe's most vulnerable economies;
- As chair of the G-8 Deauville Partnership, Treasury helped lead an effort to launch a transition fund to support projects contributing to economic growth and stability, trade and investment integration, and inclusive development and job creation in the Middle East and North Africa. In fiscal year 2013, the fund approved $100 million for 28 projects in Jordan, Egypt, Libya, Morocco, Tunisia and Yemen, helping to directly support U.S. development and national security priorities in the region; and
- In fiscal year 2013, TTB worked with the Office of the U.S. Trade Representative to promote U.S. exports by working with foreign regulators to address barriers that block market access for U.S. products. For example, many major markets abroad require export certifications to accompany shipments of alcohol beverages before a product may enter foreign commerce. In fiscal year 2013, TTB issued more than 12,000 export certificates for beer, wine, and distilled spirits. TTB also continued its work to open burgeoning markets to U.S. producers, including member economies of the Asia-Pacific Economic Cooperation forum, by educating their regulators about the U.S. system to help prevent those countries from issuing technical barriers to U.S. exports.

Also in 2013, Treasury made progress in implementing the Foreign Account Tax Compliance Act (FATCA)[4] and tax treaty negotiations:

[4] Foreign Account Tax Compliance Act: http://www.irs.gov/Businesses/Corporations/Foreign-Account-Tax-Compliance-Act-(FATCA)

- The Office of Tax Policy signed eight intergovernmental agreements under FATCA, concluded negotiations with another 15 countries, and began discussions with at numerous other countries; and
- In fiscal year 2013, Treasury signed three significant tax treaties: a protocol to the U.S.-Japan tax treaty, a protocol to the U.S.-Spain tax treaty, and a new tax treaty with Poland. Treasury also concluded negotiations on a new tax treaty with Romania and continued negotiations with Austria and Vietnam.

Treasury's achievements in supporting economic growth within the U.S. include:

- The Community Development Financial Institutions (CDFI) Fund's core program (the CDFI Program) awarded $146.7 million in funding to 148 CDFIs to provide loans, investments, financial services, and technical assistance to underserved populations and low-income communities. The CDFI Program awardees helped provide funds for projects that created or maintained 35,000 jobs; and
- The CDFI Fund completed the first round of the Bond Guarantee Program for $325 million in bonds with maturities up to 29.5 years that, when issued, are guaranteed by Treasury for community and economic development financing through. The CDFI Bond Guarantee Program was enacted through the Small Business Jobs Act of 2010, in order to provide eligible CDFIs with access to long-term capital by providing guarantees of bonds. As the administrator of the CDFI Bond Guarantee Program, the Fund completed final bond closings and issuance of guarantees during the final quarter of fiscal year 2013.

Treasury also achieved progress in managing the demand for U.S. currency, thus helping to improve financial stability through:

- The BEP produced sufficient quantities of the next generation $100 note needed to support the note's initial release into worldwide circulation;
- The U.S. Mint met an 18 percent increase in demand for circulating coinage in fiscal year 2013 over an initial forecast of 9.0 billion coins; and
- In fiscal year 2013, the U.S. Mint returned $350 million to the General Fund.

## PERFORMANCE AND FACTORS AFFECTING RESULTS

| International Affairs Measures | FY 10 | FY 11 | FY 12 | FY 13 | FY 13 Target | FY 13 Results |
|---|---|---|---|---|---|---|
| Timely review of CFIUS[5] cases | N/A | N/A | N/A | 100.00 | 100.00 | Met |
| Monitor quality and enhance effectiveness of International Monetary Fund (IMF) lending through review of IMF country programs | 97.00 | 100.00 | 100.00 | 100.00 | 100.00 | Met |
| Percentage of Multilateral Development Bank grant and loan proposals containing satisfactory framework for results measurement | 92.50 | 94.00 | 94.00 | 92.00 | 92.00 | Met |
| Changes that result from project engagement (Impact) (Office of Technical Assistance Programs)[6] | 3.00 | 3.20 | 3.10 | 3.00 | 3.10 | Unmet |
| Scope and intensity of engagement (Traction) (Office of Technical Assistance Programs)[7] | 3.50 | 3.70 | 3.90 | 3.8 | 3.60 | Met |

For both CFIUS (Treasury is the statutory Chair of the interagency committee) and IMF measures, the prioritize engagement and support of Treasury leadership contributed positively to the results. Several factors contributed to the Office of Technical Assistance Programs not realizing their fiscal year 2013 performance target for changes that result from project engagement, including: increased instability overseas; increased cost of overseas operations; increased cost of domestic operations; and funding reductions.

| Alcohol Tobacco Tax and Trade Bureau (TTB) Measures | FY 10 | FY 11 | FY 12 | FY 13 | FY 13 Target | FY 13 Results |
|---|---|---|---|---|---|---|
| Average number of days to process an original permit application for a new alcohol or tobacco business | 65.00 | 74.00 | 67.00 | 81.00 | 65.00 | Unmet |
| Percentage of electronically filed Certificate of Label Approval applications | 79.00 | 88.00 | 91.00 | 92.00 | 92.00 | Met |

TTB monitors its timeliness in processing permit applications through its measure of the average number of days to process an original permit application for a new alcohol or tobacco business. Undue delays in permit application processing impede economic growth, primarily in the small business sector, since taxable commodities, such as finished wine, beer, or spirits products, cannot

[5] Committee for Foreign Investment in the United States (CFIUS)
[6] Office of Technical Assistance measures are scored on a five-point scale and are averaged across all projects to provide one overall measure of OTA's performance in the categories of traction and impact.
[7] *Ibid*

be lawfully produced without a federal permit from TTB. In fiscal year 2013, TTB targeted a 65-day turnaround time for original permit applications; however, given increased demand for service from a growing industry and reduced resources, TTB averaged 81 days to process these applications. Even with greater than anticipated adoption rates for the Permits Online system, TTB does not anticipate achieving sustained reductions to its permit application turnaround time until the latter quarters of fiscal year 2015.

TTB protects U.S. consumers by ensuring that the alcohol beverage products offered at retail outlets are properly labeled and comply with federal production standards. In furtherance of Treasury's Agency Priority Goal of increasing paperless transactions, TTB met its performance level of 92 percent electronic filing for Certificates of Label Approval (COLA) applications. The ongoing rise in electronic filing is due to system improvements that track with customer feedback and which simplify the filing process for industry members.

| **CDFI Fund Measures** | **FY 10** | **FY 11** | **FY 12** | **FY 13** | **FY 13 Target** | **FY 13 Results** |
|---|---|---|---|---|---|---|
| Awardees' portfolio amount of CDFI loans/investments originated ($ millions) | NA | 1,228 | 1,298 | 1,978 | 1,200 | Met |
| Number of jobs created/maintained by all CDFI fund programs (as reported by CDFIs) | NA | 55,274 | 57,023 | 50,353 | 50,000 | Met |
| Percentage of New Markets Tax Credit (NMTC) loans and investments that went to severely distressed communities | 73.40 | 72.40 | 70.40 | 78.50 | 70.00 | Met |

A key factor that contributed to an increase in the number and amount of loans reported by CDFI awardees' portfolios was that reporting awardees had a significantly larger asset base (30 percent larger) than the prior year awardees, leading to increased lending over the projected target. Total jobs associated with lending and investing activities as reported by both CDFI and NMTC Program awardees (not including construction jobs) met the performance target, largely reflecting improved data quality for reporting project-level job outcomes for NMTC investments (due to improvement in linking multiple investments in the same project). The percentage of NMTC investments made in severely distressed communities exceeded the target largely as a result of better targeting by Community Development Entities (and it may also reflect improved targeting using new census data).

| **BEP and U.S. Mint Measures** | **FY 10** | **FY 11** | **FY 12** | **FY 13** | **FY 13 Target** | **FY 13 Results** |
|---|---|---|---|---|---|---|
| Manufacturing costs for currency (Dollar costs per thousand notes produced) (BEP) | 44.90 | 34.60 | 43.30 | 50.45 | 55.00 | Met |
| Customer satisfaction index (MINT) | 86.1 | 91.7 | 90.0 | 92.6 | 90.0 | Met |
| Numismatic sales units (Million Units) (MINT) | NA | 7.3 | 5.6 | 5.5 | 5.2 | Met |
| Seigniorage per dollar issued (MINT) | 0.49 | 0.45 | 0.21 | 0.24 | 0.17 | Met |

Manufacturing costs for currency notes (dollar costs per 1,000 notes) is an indicator of currency manufacturing efficiency and the effectiveness of program management. This standard is developed annually based on the past year's performance, contracted price factors, and anticipated productivity improvements. Actual performance against the standard depends on BEP's ability to meet

annual spoilage, efficiency, and capacity utilization goals established for a particular product line. In fiscal year 2013, the favorable results for this metric were driven primarily by more efficient use of currency inks in the manufacturing process and improved productivity in the Bureau's currency overprinting function.

Mint sold more than 5.5 million numismatic (or collectors') units, a 5.8 percent increase above the fiscal year 2013 target of 5.2 million units. The increase mainly resulted from strong Presidential $1 Coin product sales (above forecast by 23 percent); silver coin product sales (above forecast by 26 percent); and gold and platinum coin product sales (78 percent above forecast).

In fiscal year 2013, seigniorage per dollar coin issued was $0.24, which is above the fiscal year 2013 performance target of $0.17. Performance results exceeded the target mainly due to increased Federal Reserve Bank demand for quarter dollars and dimes; lower input costs than forecast for copper, nickel, and zinc; and reduced general and administrative expenses.

## EMERGING ISSUES

As Treasury strives to achieve its goals of enhanced U.S. competitiveness, balanced global growth, and international financial stability, its policy offices and bureaus face a variety of emerging issues that are environmental, operational, and managerial in nature.

Security conditions complicated ongoing work in North Africa and the increasing cost of overseas operations and budget uncertainty has the potential to reduce the effectiveness of Treasury personnel who are assigned overseas and hamper Treasury's ability to undertake international travel for critical activities like trade negotiations.

The Office of Tax Policy spends a significant amount of time and resources implementing FATCA. From a technical perspective, the U.S. government cannot offer full reciprocity under the FATCA agreements, which complicates the law's implementation.

The TTB has seen sharp increases in turnaround times for permit, label, and formula applications. Even as electronic filing rates for applications increase, TTB cannot meet the increasing demand for TTB service given the dramatic rise in small, craft alcohol producers in recent years.

The BEP faces significant manufacturing challenges caused by the complex new design of the $100 note (next generation), which have led to increased spoilage and quality issues. This has prompted BEP to partner with the Federal Reserve Board to develop a more robust quality assurance program based on best industry practices.

Finally, the U.S. Mint is facing increasing demand for circulating coinage, which required bringing on temporary workers and finding raw materials and supplies to meet delivery requirements. In circulating coinage, higher metal costs of one-cent and five-cent coins have raised production costs above the coins' face value for the eighth consecutive fiscal year. Also, the decision to cease minting and issuing $1 coins for circulation in December 2011 created challenges to circulating financial results because of reduced overall seigniorage generated by circulating coinage. Despite these challenges in circulating coinage operations, the seigniorage increased in fiscal year 2013 compared to last year, mainly due to increased demand for quarter-dollar coins and reduced general and administrative expenses.

Numismatic operations have faced a trend of declining sales for some products, such as recurring annual coin sets. The Mint's order management system is outdated, which creates challenges to the Mint's ability to meet numismatic customers' expectations for ordering Mint products online.

# GOAL #3: PROTECT OUR NATIONAL SECURITY THROUGH TARGETED FINANCIAL ACTIONS

Treasury is devoted to using financial measures to track, degrade, and disrupt threats to national security from state and non-state actors, including terrorists, WMD proliferators, drug traffickers, rogue regimes, and transnational criminal organizations.

As the Department works to enhance the accessibility of the financial system to legitimate users, it also works to prevent its exploitation by illicit actors. Financial intelligence information can help identify the infrastructure of terrorist and other illicit organizations that threaten U.S. national security. It is uniquely reliable and allows Treasury to track, deter, and disrupt threats.

## SIGNIFICANT ACHIEVEMENTS

The Office of Terrorism and Financial Intelligence (TFI), through its various components, supported Treasury's strategic and priority goals by implementing sanctions (via Executive Order and legislation) and by conducting other enforcement, analytic, and capacity-building work vital to protecting our national security.

In fiscal year 2013, TFI's Office of Foreign Assets Control (OFAC) tallied over 500 designations under its sanctions authorities in its efforts against weapons of mass destruction proliferators, terrorists, narcotics traffickers, transnational organized crime, persons contributing to regional violence in Africa and those who support these individuals and groups. In particular, OFAC conducted a sustained sanctions campaign against Iran, its agents, and its front companies in response to Iran's continued defiance of various United Nations Security Council resolutions. 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.

Since fiscal year 2010, OFAC has undertaken the task of implementing 16 new executive orders and a number of new laws, while continuing the ongoing work of administering existing programs. OFAC puts great effort into working to ensure that the public has clear and accurate information on its evolving sanctions programs through a robust website, telephone, and e-hotlines, and regular public outreach conferences and events with various sectors.

In fiscal year 2013, OFAC also implemented a new online application system made available to the public for all licensing situations (this application has been very well received by the regulated public), settled several significant enforcement cases, and published an unprecedented number of guidance documents on OFAC sanctions, including implementation guidance, fact sheets, FAQs, and website brochures. The office also released a public search tool for its Specially Designated Nationals and Blocked Persons List that allows the public faster and more simplified access to this list. This tool has become one of the most popular applications on the Treasury.gov domain.

TFI's Office of Terrorist Financing and Financial Crimes (TFFC) worked to strengthen global standards to combat and prevent financial crimes and terrorist financing. TFFC participated in or reviewed 18 mutual evaluations of various countries' compliance with international anti-money laundering (AML), terrorist financing, and counter-terrorist financing (AML/CFT) standards. TFFC also worked with its counterparts abroad, focusing on creating effective AML/CFT frameworks and financial regulations capable of combating terrorist financing.

Finally, the Financial Criminal Enforcement Network (FinCEN) issued interpretive guidance to clarify applicability of the Bank Secrecy Act (BSA) to administrators and exchangers of convertible currency and provided reference information to partners on emerging payment systems; implemented new processes to identify and deter money laundering through targeted enforcement actions; joined other federal and state agencies in imposing a $1.9 billion enforcement action against HSBC, the largest combined BSA and AML penalty ever imposed against any financial institution; and continued support of high priority health and tax fraud investigations, including identification of key links to third-party money launderers.

## PERFORMANCE AND FACTORS AFFECTING RESULTS

| TFI and FinCEN Measures | FY 10 | FY 11 | FY 12 | FY 13 | FY 13 Target | FY 13 Results |
|---|---|---|---|---|---|---|
| Impact of TFI programs and activities (TFI)[8] | 7.4 | 7.6 | 8.1 | 8.3[9] | 8.3 | Met |
| Percentage of domestic law enforcement finding that FinCEN's analytic reports contribute to the detection and deterrence of financial crime (FinCEN) | 80 | 86 | 83 | 81 | 83 | Unmet |
| Percentage of regulatory helpline customers understanding BSA guidance (FinCEN) | 92 | 92 | 89 | 92 | 90 | Met |

During fiscal year 2013, TFI estimates that it has met its performance target of 8.3 (on a scale of 10) on its composite measure, "Impact of TFI Programs and Activities." TFI will continue to achieve future performance level goals by continuing customer outreach, increasing production of intelligence products, and implementing IT modernization projects.

In fiscal year 2013, TFI continued to conduct effective AML/CFT actions to protect the integrity of markets and of the global financial framework as they help mitigate the factors that facilitate financial abuse. TFI provided AML/CFT policy development, coordination, and coalition-building and worked to ensure unique access to valuable financial information and conducted all-source analysis on financial and other illicit support.

Each of these actions was supported by critical analysis of intelligence by Treasury's Office of Intelligence and Analysis (OIA). In fiscal year 2013, OIA provided intelligence analysis of regional and specific country economies, the impact of U.S. and multilateral sanctions, and targeted organizations and individuals that would threaten the U.S. Further, OIA focused upon enhancing Intelligence Community (IC) efforts to address the impact of targeted financial measures, threats to the international financial system, and efforts to diminish the potential to be a target for internal and external threats to national security.

In the customer liaison area, FinCEN measures the percentage of regulatory helpline customers who understand Bank Secrecy Act (BSA) guidance. In fiscal year 2013, FinCEN exceeded its target by 2 percent with a 92 percent satisfaction level, continuing to provide timely and valuable guidance to the financial industry. Also, modernized information technology brought opportunities to generate efficiencies and improve effectiveness through increased use of the FinCEN website and delivery channels such as webinars that also positively impacted performance.

In the intelligence area, FinCEN supports domestic law enforcement by providing analyses of BSA information. In fiscal year 2013, 81 percent of domestic law enforcement, when surveyed, indicated that FinCEN's analytic reports contribute to the detection and deterrence of financial crime, narrowly missing the 83 percent target. FinCEN attributes this missed target to decline in satisfaction with proactive products, likely resulting from its focus on other mission related priorities and types of products. FinCEN created an analyst working group to review its customers and product types and make recommendations for

[8] This composite measure consists of three program office focus areas related to its mission and strategic goals. The composite measure consists of customer surveys, the impact of designations and identifications, compliance with and implementation of sanctions, evaluation of demonstrated action in key regions against threats and vulnerabilities to the financial system, evaluation of the development of timely and relevant US financial and economic initiatives to advance efforts to combat national security threats, and review of the private sector response in taking voluntary action to identify and safeguard against terrorist financing and money laundering threats.

[9] Value for this measure is estimated. Actual data will be available and reported in the Citizen's Report in February.

enhancements and broader dissemination for greater impact. FinCEN has also increased its emphasis on production of proactive products and believes it will be able to increase the percentage of customers who find its analytical products valuable with more focused products and targeted dissemination in the future.

### EMERGING ISSUES

TFI has been increasingly tasked with addressing the most pressing and emerging national security issues. These up-and-coming issues have levied many additional tasks and requirements upon Treasury. To meet these challenges, TFI has worked towards recruiting and retaining a flexible, multi-skill set workforce capable of meeting and addressing the quickly changing nature of threats in the national security arena. This effort has resulted in a workforce with the ability to quickly change focus and positively address new and rising key issues and the ever shifting complexities of combating illicit finance, disrupting and dismantling the financial infrastructure of terrorists, and isolating their support networks.

A more tactical emerging issue related to this goal involves FinCEN's efforts to modernize technology to better support its mission. In the first quarter of fiscal year 2013, FinCEN incrementally rolled out new technology to nearly 8,000 users to include a new portal to access BSA tools, including the new FinCEN Query system. The new Query tool has much more powerful capabilities than the legacy system. As such, it introduced a significant change and learning curve for users, especially those who do not use it regularly. Users currently have access to web-based training, along with other support materials. FinCEN is also developing a comprehensive, sustainable training plan that targets external users.

## GOAL #4: PURSUE COMPREHENSIVE TAX AND FISCAL REFORM

The Treasury Department leads the Administration's efforts to create and implement a tax system that is simple, fair, and fiscally responsible. Treasury is committed to comprehensive reform of the tax laws, which lowers tax rates while broadening the tax base, makes the system fairer, improves incentives for investment and production in the U.S., and helps contribute to a balanced deficit reduction plan over the medium-term.

Addressing the Nation's fiscal challenges requires reforms and fiscal policies that go beyond streamlining the corporate tax code. The Obama Administration has committed to pursuing a balanced approach to deficit reduction that strengthens our fiscal position and helps ensure that America has room to invest in education, infrastructure, and other areas critical to long term economic growth.

### SIGNIFICANT ACHIEVEMENTS

Treasury's Office of Tax Policy (OTP) continued implementation of the Foreign Account Tax Compliance Act (FATCA), which aims to combat offshore tax evasion. In fiscal year 2013, OTP worked to achieve the signing of eight intergovernmental agreements, concluded negotiations on another 15, and began discussions with at least 70 other countries.

In fiscal year 2013, the Internal Revenue Service (IRS) processed more than 240 million individual and business tax returns. In addition, after 18 years, in February 2013, the Government Accountability Office (GAO) removed the IRS Business Systems Modernization program from its High-Risk List. GAO concluded that the IRS had made substantial progress in addressing security material weaknesses over the past several years and demonstrated a commitment to sustained progress.

Additionally, the IRS has made progress in the implementation of the Affordable Care Act by proposing regulations on insurance provider fees, additional Medicare tax, net investment income tax, employer responsibility provision, small business health care tax credit (2014 phase), and information reporting regulations for Marketplaces, insurers and employers. The IRS also issued final regulations on disclosure of tax data to Marketplaces, the individual responsibility provision, the patient centered outcome excise tax, and the medical device excise tax.

TTB collected more than $22 billion in excise taxes and other revenues from over 9,000 taxpayers in the alcohol, tobacco, firearms, and ammunition industries. The return on investment for TTB's Collect the Revenue program consistently exceeds 400:1 and, in fiscal year 2013, reached 457:1. Additionally, TTB has developed an effective criminal enforcement program that draws on forensic auditing and advanced investigative techniques to be responsive to diversion schemes, which vary widely and change in response to targeted enforcement efforts. In less than three years, TTB's criminal enforcement program has initiated 63 cases and identified approximately $378 million in excise tax liabilities on diverted tobacco products, as well as $116 million in seizures. TTB has successfully referred each of these cases for prosecution to the U.S. Attorney's Office.

## PERFORMANCE AND FACTORS AFFECTING RESULTS

| Internal Revenue Service Measures | FY 10 | FY 11 | FY 12 | FY 13 | FY 13 Target | FY 13 Result |
|---|---|---|---|---|---|---|
| Customer service representative level of service (IRS) | 74.0 | 70.1 | 67.6 | 60.5 | 70.0 | Unmet |
| Percentage of individual returns processed electronically (IRS) | 69.3 | 76.9 | 80.5 | 82.5 | 80.0 | Met |

The customer service representative level of service target for fiscal year 2013 (70 percent) was established prior to sequestration. When sequestration took effect, the required funding adjustment severely hampered the IRS's ability to meet the original target. In addition, demand for toll-free service increased over the prior year by 7 percent, further straining reduced resources.

IRS met its fiscal year 2013 target for processing individual returns electronically; 82.5 percent of returns were processed electronically (2 percent above the target). This is in large part due to IRS's efforts to achieve Treasury's Agency Priority Goal of Increasing Voluntary Tax Compliance, which is discussed in detail later in this report.

## EMERGING ISSUES

Since fiscal year 2010, IRS's appropriated funding has been reduced by almost $1 billion. In fiscal year 2011 and fiscal year 2012, the IRS budget allocation decreased by 0.2 percent and 2.5 percent, respectively. During fiscal year 2012, the IRS collected $2.9 trillion, using a budget of $11.2 billion, accounting for 91 percent of the total revenue that the U.S. government received that year. This substantial return on investment provides the funds that allow the U.S. government to operate. In fiscal year 2013, sequestration and an across the board rescission combined to further reduce the IRS budget by $618 million. This resulted in the IRS re-evaluating its operating levels to ensure critical programs continued to be delivered. The effects of sequestration have created significant impediments to the ability of the IRS to achieve all taxpayer service goals. The challenges created by the current budget climate will continue to impact the IRS's ability to meet performance targets, including level of service..

For the TTB, a new law introducing large federal excise tax disparities among tobacco products, combined with higher prices on tobacco products, could result in decreased consumption of tobacco increased illicit trade, and tax avoidance schemes by manufacturers. This could indicate declining TTB tax revenues in the out years and GAO has recommended that Congress, in consultation with the Department of the Treasury, consider options for reducing tax avoidance due to tax differentials between small and large cigars.

# GOAL #5: MANAGE THE GOVERNMENT'S FINANCES IN A FISCALLY RESPONSIBLE MANNER

The Treasury Department is responsible for managing the finances of the U.S. government and maintaining public trust and confidence in U.S. and international economic and financial systems. Ensuring the Department is efficient, effective, accountable, and transparent enables the smooth, continuous operation of essential government services and enables the government to meet its financial obligations. To that end—and while supporting and maintaining governmental operations—during fiscal year 2013, Treasury focused on achieving greater cost savings for the American public, modernizing operations, and increasing productivity, effectiveness, and efficiency. Treasury has done this by developing systems, tools, and a culture of governing strategically, working smarter, and leveraging technologies.

## SIGNIFICANT ACHIEVEMENTS

The Collections and Cash Management Modernization Initiative has allowed Treasury to meet its target of receiving 97 percent of its collections electronically. This initiative, which involved reengineering the processes that have been built over decades, allows the Fiscal Service to be more efficient and cost-effective in processing collections for hundreds of agency cash flows with over 400 million transactions per year worth over $3 trillion.

A significant management achievement includes Treasury's Quarterly Performance Review process, which entails quarterly review sessions conducted with bureaus and policy offices by the Deputy Secretary, serving as the Chief Operating Officer, and the Assistant Secretary for Management, serving as the Performance Improvement Officer. These sessions bring key leaders together for regular discussions focused on management challenges and priority projects, driving accountability to make and sustain improvements, align expectations and priorities across the agency, and encourage data-driven decision-making. These quarterly reviews have been recognized by OMB and GAO as a best practice.

In addition to the quarterly performance reviews, Treasury's "shared services first" approach to managing across organizational boundaries has helped improve operation effectiveness and coordination across Treasury. The Treasury Shared Services Council provides a portfolio-wide approach to shared services, providing additional transparency and accountability for cost and performance issues and a common governance structure for Treasury's multiple shared services programs.

Finally, the Department continued multiple initiatives to broaden efficiency within its procurement operations to include acquisition-related savings and high risk reduction. In fiscal year 2013, the Department exceeded its internal savings goal of $97 million by achieving more than $340 million in acquisition-related savings. Treasury also exceeded its goal of reducing high-risk contracting obligations by five percent.

## PERFORMANCE AND FACTORS AFFECTING RESULTS

| Bureau of the Fiscal Service Measures | FY10 | FY11 | FY12 | FY13 | FY13 Target | FY 13 Result |
|---|---|---|---|---|---|---|
| Percentage collected electronically of total dollar amount of U.S. government receipts | 85.0 | 96.0 | 97.0 | 97.0 | 97.0 | Met |
| Amount ($ billions) of delinquent debt collected through all available tools | 5.45 | 6.17 | 6.17 | 7.02 | 6.67 | Met |
| Percentage of Treasury payments and associated information made electronically | 82.2 | 84.3 | 88.3 | 92.5 | 91.0 | Met |
| Percentage of respondents selecting the highest rating of customer satisfaction with Government Agency Investment Services | 5.5 | 60.0 | 60.0 | 61.0 | 61.0 | Met |

In fiscal year 2013, the Fiscal Service met its target for the percentage collected electronically of total dollar amount of U.S. government receipts. On December 7, 2010, Treasury published a regulation that required businesses with an annual tax liability of at least $10,000 to pay their taxes electronically. The new requirement, combined with the Fiscal Service's efforts to transition taxpayers to electronic payments, resulted in the Fiscal Service processing approximately 138.5 million Electronic Federal Tax Payment System transactions during fiscal year 2013, sustaining the improved performance first reported three years ago, when the percentage of receipts collected electronically increased more than ten percent. With continued emphasis on the All Electronic Treasury initiative, the Fiscal Service has undertaken the Non-Tax Paperless Initiative, which is aimed at electronically processing collections and associated remittances. By processing these transactions electronically, the Fiscal Service and its agency partners will achieve greater efficiencies and afford the public more convenient methods for making their payments.

The Fiscal Service collects delinquent debt owed to the U.S. government and states, including child support debt, by providing centralized debt collection, oversight, and operational services pursuant to the Debt Collection Improvement Act of 1996 and related legislation[10]. The Fiscal Service uses two debt collection programs: Treasury Offset Program and Cross Servicing. In fiscal year 2013, the Fiscal Service collected over $7.02 billion of delinquent debt, an increase of more than 13 percent over fiscal year 2012, its highest annual collection to date. Since 1997, the Fiscal Service has collected over $62 billion in delinquent debt. Following are some accomplishments that supported the increase in delinquent debt collections:

- In 2013, the Fiscal Service continued to expand participation in state programs: 37 states including the District of Columbia now participate in the Unemployment Insurance Compensation (UIC) program, 19 more states than fiscal year 2012. UIC collected over $326 million (an increase of more than $194 million compared to fiscal year 2012). The Fiscal Service's goal is to serve all 50 states and territories participating in the state programs. To realize this goal requires states to pass legislation and prioritize funding;
- In fiscal year 2013, the Fiscal Service increased the number of administrative wage garnishments, with initiated garnishment orders up 73 percent compared to fiscal year 2012;
- In 2013, through improved partial matching, the Fiscal Service collected over $220 million. Since the program began in 2010, the Fiscal Service has collected over $267 million; and

[10] Debt Collection Improvement Act of 1996: http://www.fms.treas.gov/debt/dmdcia.txt

- In 2013, the Fiscal Service improved call center operations – all collector agents went through a training/certification program and became certified collectors

In fiscal year 2013, the Fiscal Service implemented a Centralized Receivables Service (CRS) pilot – six agency programs implemented CRS with additional agency programs expected. In fiscal year 2013, CRS invoiced over $11.2 million in receivables and collected over $9.8 million in current receivables.

In support of the All Electronic Treasury initiative, the Fiscal Service continued to expand and market the use of electronic funds transfer to deliver federal payments, improve service to payment recipients, and reduce government program costs. In fiscal year 2013, the Fiscal Service made over 92 percent of its payments electronically, exceeding its performance goal of 91 percent. The Fiscal Service attributes the performance outcome to considerable success in implementing its nationwide Go Direct® campaign to encourage current check recipients to switch to direct deposit. As a result, paper checks have declined from 10.3 million per month in January 2011 to 1.97 million as of September 2013, saving millions of taxpayer dollars in the years to come.

The GAIS Program strives to provide high-quality customer service, reliable transaction processing, and accurate and timely payment distribution. In fiscal year 2013, GAIS distributed 99 percent of its principal and interest payments accurately and timely. The basis for the consistent results achieved by GAIS is the commitment to maintaining strong internal controls, effective procedures, and a well-trained staff. These effective business practices are exhibited by routinely receiving clean audit opinions with no findings or material weaknesses. In fiscal year 2013, the targeted program initiatives to support the effective management of investments and borrowings activity consisted of enhancing case management functionality for federal investments customers, presenting at federal and state conferences, and conducting customer outreach through visits to various agencies and the distribution of a customer satisfaction survey.

| **Office of Management (ASM) Measures** | **FY 10** | **FY 11** | **FY 12** | **FY 13** | **FY 13 Target** | **FY 13 Result** |
|---|---|---|---|---|---|---|
| Treasury-wide footprint (Square Footage/Thousands) | 37,088 | 37,596 | 37,998 | 37,320 | n/a | n/a |
| Treasury-wide percentage of procurement dollars spent on small business | 29.62 | 34.51 | 38.52 | 38.54[11] | 32.00 | TBD[12] |

The Treasury-wide footprint is a measure of the total square footage occupied by Treasury's owned and leased buildings. Management's goal is to generally reduce total square footage over the course of several years, using space more efficiently and consuming fewer resources. Key strategies to reduce Treasury's footprint include an increased adoption of telework, hoteling, and work-space sharing in addition to improved work-station standards and office design.

The Treasury-wide percentage of procurement dollars spent on small businesses measures the percentage of total dollars obligated to small businesses and highlights Treasury's strong efforts to ensure that small businesses have the maximum practicable opportunity to provide goods and services to the U.S. government. In fiscal year 2013, according to preliminary results, Treasury spent 38.54 percent of its procurement dollars on small businesses, exceeding its target by more than six percentage

[11] Final data will not be available until early 2014. However, current numbers indicate that Treasury will meet the established target.
[12] The result for this measure is TBD; since final data will not be available until early 2014, the final result of this measure is unknown at the time this report was published.

points. Treasury will continue to employ proven past strategies in fiscal year 2014, including targeted small business outreach, enhanced leadership accountability, and increased intra-agency communication.

## EMERGING ISSUES

Fiscal year 2013 was a challenging year from a management and planning perspective. The uncertainty stemming from the year-long continuing resolution, implementation of sequestration, and continuity planning for the lapse in appropriations disrupted normal operations and hampered performance across the Department.

Sequestration was particularly difficult. The across-the-board spending cuts forced reductions across nearly all Treasury programs, harming both taxpayers and federal employees. The IRS was especially affected, with sequestration reducing the agency's ability to provide core taxpayer services and resulting in billions of dollars in lost revenue due to fewer tax return reviews and diminished fraud detection. For example, the IRS's customer level of service (i.e. the number of taxpayers receiving assistance at assistance centers and response letters) for fiscal year 2013 was 60.5 percent, down from the 67.6 percent in fiscal year 2012 and the fiscal year 2013 planned level of 70 percent prior to sequestration. Sequestration also forced Treasury to reduce direct payments to state and municipal bond issuers, decrease assistance for development of renewable energy, and grant fewer and smaller grants to low-income and disadvantaged communities.

Sequestration had a considerable impact on Treasury employees as well, compelling Treasury bureaus to institute hiring freezes and reduce training and travel budgets. The IRS furloughed all employees for three days in fiscal year 2013. These personnel impacts can be seen through the year over year decline in Treasury employee satisfaction and engagement scores as measured by OPM's Federal Employee Viewpoint Survey.

As the Department continues to work towards increasing the percentage of collections received electronically, Treasury will continue to pursue progress despite resource and budget constraints at federal agencies; and competing priorities that reduce the abilities of our federal agencies partners to focus on moving to an all-electronic Treasury.

# PERFORMANCE BY AGENCY PRIORITY GOAL

Treasury is pursuing two Agency Priority Goals for fiscal years 2012 and 2013. Performance data are available at the end of the calendar year in the Annual Performance Report, and reported quarterly on Performance.gov. A synopsis of these goals is provided below.

## INCREASE VOLUNTARY TAX COMPLIANCE

Helping taxpayers understand their obligations under the tax law is critical to improving compliance and addressing the tax gap. Therefore, the IRS is committed to making tax law easier to access and understand. The IRS remains committed to improving voluntary compliance and reducing the tax gap through both taxpayer service and enforcement programs. In fiscal year 2013, the IRS processed 147.6 million individual tax returns, of which more than 121 million were filed electronically. However, while improvements were made, sequestration limited the IRS's ability to provide service and enforcement to the level desired.

The IRS continued to increase the amount of tax information and services available to taxpayers through online and social media. IRS.gov provides alternative online and self-help service options. In fiscal year 2013, taxpayers viewed IRS.gov web pages approximately 1.9 billion times as they used the website to:

- **Get forms and publications.** More than 217.5 million tax products were downloaded;
- **Link to the Electronic Federal Tax Payment System (EFTPS).** EFTPS processed more than 145 million electronic tax payments totaling more than $2.3 trillion during fiscal year 2013;
- **Get answers.** More than 2.4 million visits to the Interactive Tax Assistant introduction page occurred where taxpayers can receive answers to tax law questions; and
- **Check on Refunds.** Taxpayers used "Where's My Refund?" more than 192.3 million times to check on the status of their tax refunds, an increase of 51.6 percent from 2012.

In addition, the IRS continued efforts in fiscal year 2013 to increase voluntary compliance in a variety of ways which include:

- Announced the release of an updated smartphone application "IRS2Go 3.0";
- Continued to expand the Virtual Service Delivery project, allowing assistors to interact with taxpayers virtually;
- Expanded its social media presence by adding Tumblr to its list of social media platforms;
- Deployed a web-based tool ("Where's my Amended Return?") to expand self-service features on the IRS website;
- Expanded the Law Enforcement Assistance Program, piloted in Florida in April 2012, to all 50 states and the District of Columbia to help law enforcement pursue identity thieves; and
- Announced a joint plan with the tax administrations from Australia and the United Kingdom to share tax information to pursue international tax evasion.

# Significantly Increase the Number of Electronic Transactions with the Public

The safety, security, efficiency, and reliability of Treasury transactions are paramount to maintaining public trust. Billions of transactions, including payments to benefits recipients, savings bonds purchases, and tax collections, are executed by Treasury each year. The paper processes associated with these transactions can be slow, insecure, inaccurate, and wasteful. In an effort to improve customer service, decrease the public's vulnerability to fraud, and efficiently manage resources, Treasury approved several initiatives to move towards electronic transactions including electronic savings bonds, electronic benefit payments, and electronic tax collection. Treasury has already discontinued the issuance of paper savings bonds. Treasury has achieved its goal for benefit payments as more than 97 percent are made electronically. Treasury will continue to have more businesses pay taxes electronically rather than by paper coupon. This priority goal is related to the strategic goal of "Manage the Government's Finances in a Fiscally Responsible Manner."

## Payments

In fiscal year 2013, 95.7 percent of benefit recipients were receiving their payments electronically. In support of the goal to increase electronic federal benefit payments, the Go Direct public education campaign conducted qualitative research with beneficiaries still receiving paper checks. The research was conducted to track awareness of the rule (31 CFR Part 208), which has helped to determine the likelihood that the remaining federal benefit check recipients would switch to an electronic payment method before the rule deadline of March 1, 2013.

## Collections

To achieve Treasury's goal of increasing electronic non-tax collections and remittances, the Fiscal Service embarked on the Non-Tax Paperless Initiative. The goal is to raise the electronic initiated revenue collection volume rate from the current 55-60 percent to 70 percent by 2017. This approach will involve efforts to increase awareness of available electronic options and their value, inform agencies about the need to transition their customers from paper to electronic, drive agency adoption of electronic collection processes and technologies, educate end users about the specific benefits of electronic transactions, and increase conversions from paper to electronic.

# HIGHLIGHTS OF MANAGEMENT AND PERFORMANCE CHALLENGES

Annually, in accordance with the Reports Consolidation Act of 2000, OIG and TIGTA identify the most significant management and performance challenges facing the Department. These challenges do not necessarily indicate deficiencies in performance; rather, some represent inherent risks that require continuous monitoring. Treasury made progress on these issues in fiscal year 2013, and will continue to focus on resolving them during fiscal year 2014 and beyond. Refer to Section C of Part 3, Other Accompanying Information, for a detailed discussion of these challenges, listed below.

Note: SIGTARP does not provide the Secretary with an annual report on management and performance challenges. SIGTARP provides oversight of the Troubled Asset Relief Program, a program that spans several federal agencies, only as a special inspector general while the OIG and TIGTA provide oversight of the Department and IRS, respectively, and report on its management and performance challenges under the Reports Consolidation Act of 2000.

## TREASURY-WIDE MANAGEMENT CHALLENGES – AS IDENTIFIED BY OIG

- Continued Implementation of Dodd-Frank
- Management of Treasury's Authorities Intended to Support and Improve the Economy
- Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement
- Gulf Coast Restoration Trust Fund Administration

## IRS MANAGEMENT CHALLENGES – AS IDENTIFIED BY TIGTA

- Security for Taxpayer Data and IRS Employees
- Implementing the Affordable Care Act and Other Tax Law Changes
- Tax Compliance Initiatives
- Modernization
- Fraudulent Claims and Improper Payments
- Providing Quality Taxpayer Service Operations
- Human Capital
- Globalization
- Taxpayer Protection and Rights
- Achieving Program Efficiencies and Cost Savings

# FINANCIAL HIGHLIGHTS

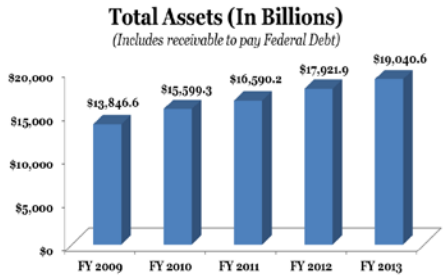



**Figure 1**

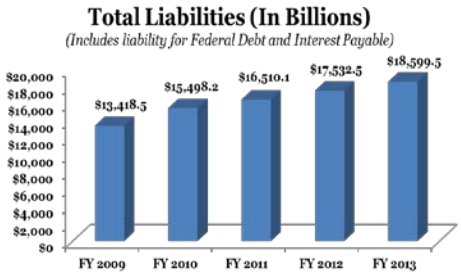



**Figure 2**

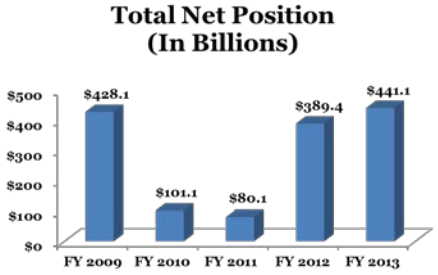



**Figure 3**

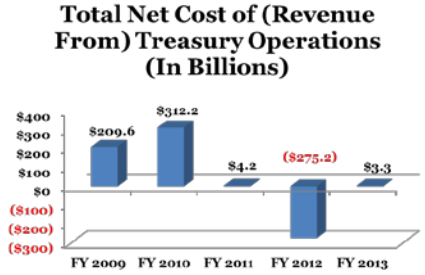



**Figure 4**

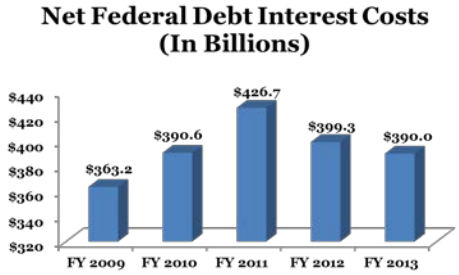



**Figure 5**

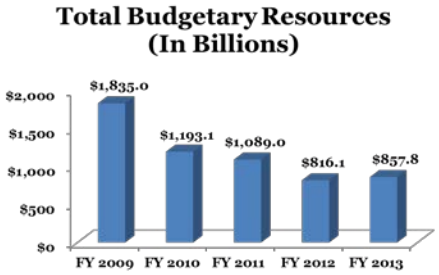



**Figure 6**

**Figure 7**

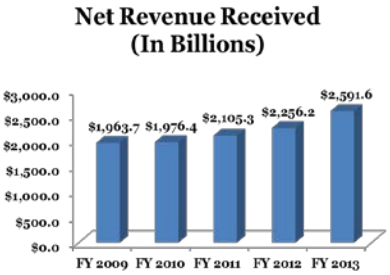



**Figure 8**

The financial highlights below are an analysis of the information included in the Department's consolidated financial statements that appear within the "Annual Financial Report" section of this report. The Department's principal financial statements have been prepared to report the agency's financial position and results of operations, pursuant to the requirements of 31 USC 3515(b). These consolidated financial statements have been prepared from the books and records of the Department in accordance with generally accepted accounting principles (GAAP) for federal entities and the formats prescribed by OMB. The consolidated financial statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The financial statements should be read with the realization that they are for a component of the U.S. government, a sovereign entity.

The chart below presents changes in key financial statement line items as of and for the fiscal year ended September 30, 2013 compared to September 30, 2012.

**Summary Financial Information** *(dollars in billions)*

| | | **2013** | | 2012 | | $ Change | % Change |
|---|---|---|---|---|---|---|---|
| Total Assets | $ | **19,040.6** | $ | 17,921.9 | $ | 1,118.7 | 6.2% |
| Total Liabilities | $ | **18,599.5** | $ | 17,532.5 | $ | 1,067.0 | 6.1% |
| Total Net Position | $ | **441.1** | $ | 389.4 | $ | 51.7 | 13.3% |
| Total Net Cost of (Revenue From) Treasury Operations | $ | **3.3** | $ | (275.2) | $ | 278.5 | (101.2)% |
| Net Federal Debt Interest Costs | $ | **390.0** | $ | 399.3 | $ | (9.3) | (2.3)% |
| GSEs Non-Entity Costs (Revenue) | $ | **(126.6)** | $ | 5.3 | $ | (131.9) | (2488.7)% |
| Total Budgetary Resources | $ | **857.8** | $ | 816.1 | $ | 41.7 | 5.1% |
| Agency Outlays, Net | $ | **286.9** | $ | 241.3 | $ | 45.6 | 18.9% |
| Net Revenue Received (Custodial) | $ | **2,591.6** | $ | 2,256.2 | $ | 335.4 | 14.9% |

**Financial Overview.** The Department's financial performance as of and for the fiscal year ended September 30, 2013, reflects several major trends. Most significantly, the outstanding federal debt, including interest, rose by $671.9 billion to finance the U.S. government's operations. The Department also incurred a liability at September 30, 2013, totaling $248.6 billion in connection with extraordinary debt management measures undertaken by the Department during a debt issuance suspension period (DISP) to prevent outstanding Treasury debt from exceeding the statutory debt limit. Specifically, these measures included, among other things: *(i)* suspending investments in Treasury debt securities by the Government Securities Investment Fund of the Federal Employees' Retirement System Thrift Savings Plan (TSP), Civil Service Retirement and Disability Trust Fund (Civil Service Fund), and the Postal Service Retiree Health Benefits Fund (Postal Benefits Fund); and *(ii)* redeeming early a certain amount of Treasury debt securities held by the Civil Service Fund. The $248.6 billion liability reflects the Department's obligation by statute as of September 30, 2013, to restore to the three funds the accumulated principal balance of Treasury debt securities bearing the same interest rates and maturity dates that would have been invested by these funds had the DISP not occurred (uninvested principal), as well as pay these funds the related lost interest on the uninvested principal.

Additionally, the Department amended its Senior Preferred Stock Purchase Agreements (SPSPAs) with Fannie Mae and Freddie Mac - two Government-Sponsored Enterprises (GSEs) - in 2012, which changed, among other things, the basis for determining quarterly dividends that are paid by the GSEs to the U.S. government commencing with the quarter ending March 31, 2013. As a result of the amended SPSPAs, coupled with the GSEs' long-term financial forecasts within a specific time horizon, the Department reduced its contingent liability associated with the GSE program by $9.0 billion and $288.7 billion at the end of fiscal year 2013 and 2012, respectively, via a reduction in expense.

The Department's 2013 financial performance also reflects the ongoing wind-down of the TARP programs, principally through sales of securities and principal repayments of loans made under these programs. TARP's wind-down activity included, among other things, sales of its remaining equity investments in the AIG Investment Program, Public-Private Investment Program, and Capital Purchase Program. In December 2013, the Department completed the disposition of the remaining shares of General Motors common stock held under the Automotive Industry Financing Program. The continued wind-down of the TARP programs in fiscal year 2013 drove significant fluctuations in the subsidy costs associated with these programs. Subsidy costs recorded in connection with each credit program represent the difference between the projected costs of the program and the future cash flows anticipated to be generated by the program.

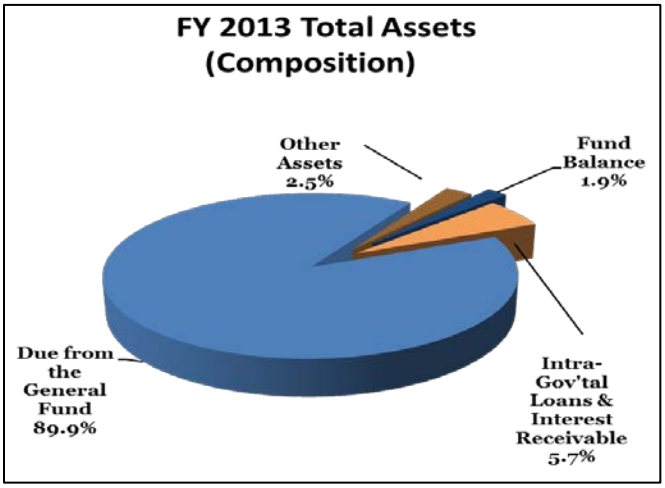



**Figure 9**

**Total Assets** of $19.0 trillion at September 30, 2013 consist of a receivable due from the General Fund of the U.S. government of $17.1 trillion, intra-governmental loans and interest receivable of $1.1 trillion, and fund balance and various other assets which totaled $823.7 billion (Figure 9). The $1.1 trillion (or 6.2 percent) increase in total assets at the end of fiscal year 2013 over the prior year is primarily due to an increase in the "Due from the General Fund of the U.S. Government" account, corresponding to increases in the following liabilities: *(i)* a $671.9 billion increase in federal debt and related interest payable and *(ii)* a $248.6 billion additional liability for the restoration of federal debt principal and interest in connection with the DISP. These additions to Treasury liabilities at the end of 2013 caused a corresponding rise in the "Due from the General Fund of the U.S. Government" asset account which represents future funds required from the General Fund of the U.S. Government to pay borrowings from the public and other federal agencies.

Intra-governmental loans and interest receivable represent loans issued primarily by the Fiscal Service to other federal agencies for their own use or for the agencies to loan to private sector borrowers whose loans are guaranteed by the federal agencies. This receivable grew by $179.3 billion (or 19.6 percent) to $1.1 trillion at the end of fiscal year 2013 due to increased borrowings by various federal agencies – such as the Departments of Education, Agriculture, and Housing and Urban Development – to fund their existing programs.

Other assets include, among other things, TARP and non-TARP credit program receivables due from, and other investments in certain financial institutions for which the Department provides financial assistance in an effort to stabilize financial markets. Other assets decreased by almost $5.1 billion primarily due to, among other things, the ongoing wind-down of the TARP programs through sales of securities or principal repayments of loans made under these programs. Offsetting this decrease was an increase in the fair value of the GSE investments, which primarily reflects the improved financial performance of the GSEs.

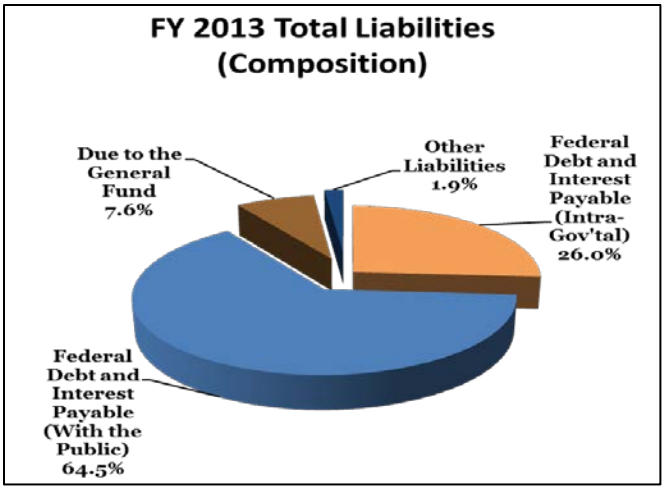



**Figure 10**

**Total Liabilities** of $18.6 trillion at September 30, 2013 principally consist of the federal debt held by the public, including interest, of $12.0 trillion, which were mainly issued as Treasury Notes and Bills (Figure 10). Liabilities also include intra-governmental liabilities totaling $6.4 trillion (of which $4.8 trillion represent principal and interest of federal debt in the form of Treasury securities held by federal agencies), and various other liabilities totaling $0.2 trillion. The $1.1 trillion (or 6.1 percent) increase in total liabilities at the end of fiscal year 2013 over the prior year is attributable to a $671.9 billion increase in federal debt, including interest, held by the public and federal agencies that was needed to finance the U.S. government's budget deficits. An additional $248.6 billion of the increase is attributable to a liability for restoration of federal debt principal and interest as of September 30, 2013. This liability relates to uninvested principal and interest owed to funds due to extraordinary measures taken by the Department during the DISP. The increase in total liabilities is also attributable to a $159.7 billion increase in the "Due to the General Fund of the U.S. Government" account, primarily as a result of an increase in intra-governmental loans and interest receivable. The Department, through the Fiscal Service, accounts for and reports on the principal borrowings from and repayments to the General Fund, as well as the related interest due to the General Fund.

**Total Net Position** of $441.1 billion at September 30, 2013 represents the combined total of the Department's cumulative results of operations and unexpended appropriations at the end of the fiscal year. The $51.7 billion (13.3 percent) increase in the net position at the end of fiscal year 2013 was principally attributable to a $69.3 billion increase in budgetary financing sources driven by increased appropriations primarily to fund the Department's Economic programs.

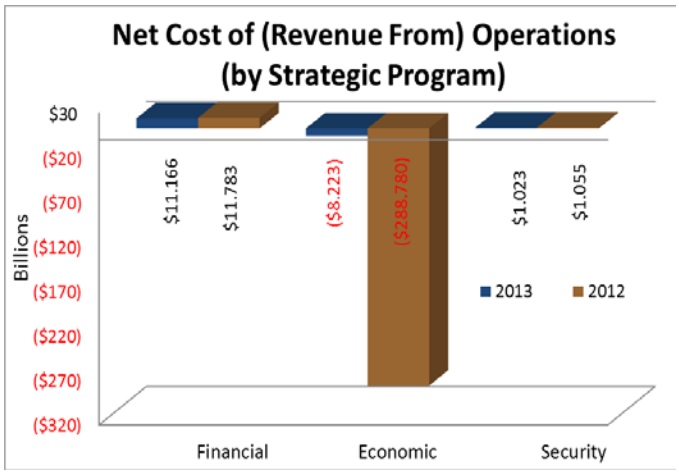



**Figure 11**

**Net Cost of (Revenue From) Treasury Operations**, as presented on the Department's Consolidated Statements of Net Cost, presents the Department's gross and net costs by strategic program. There are three main categories of strategic programs: financial, economic, and security. The Department's net cost of operations totaled $3.3 billion for 2013 compared to total net revenue from its operations of $275.2 billion for 2012. The year-over-year combined change of $278.5 billion in cost of operations is primarily driven by net revenue in fiscal 2012 associated with the Department's economic programs, as described below.

Economic programs generated net revenue of $8.2 billion in 2013 compared to $288.8 billion in 2012 (Figure 11). The $288.8 billion in economic programs net revenue in fiscal year 2012 was driven by a $288.7 billion reduction in the Department's estimated future liability to the GSEs in 2012, via a reduction in expense, down to $9.0 billion at the end of 2012. As a result of the new dividend payment requirement under the amended SPSPAs that commenced with the quarter ended March 31, 2013, coupled with GSEs' long-term financial forecasts within a specific time horizon, the Department reduced by $9.0 billion its estimated future liability to the GSEs in 2013, via a reduction in expense.

**Net Federal Debt Interest Costs** primarily reflect interest expense on the federal debt. Federal interest costs declined by $9.3 billion (or 2.3 percent) in fiscal year 2013 (Figure 5) despite the rise in the overall federal debt. The decrease in cost is primarily attributable to a decline in the intra-governmental federal debt outstanding balance, coupled with a decline in the average interest rate on intra-governmental federal debt. This decrease was slightly offset by increased expense associated with the growth in the outstanding balance of federal debt held by the public.

**GSE Non-Entity Revenue** totaled $126.6 billion for 2013 compared to net cost of $5.3 billion for 2012. The revenue in 2013 was primarily driven by a $77.3 billion increase in preferred stock dividends, coupled with a $30.9 billion valuation gain on GSE investments in 2013 compared to a $42.3 billion loss in 2012. These increases primarily stemmed from federal income tax benefits and other improvements in the GSEs' financial performance in 2013.

**Total Budgetary Resources** of $857.8 billion were higher in fiscal year 2013 (Figure 6) by $41.7 billion (or 5.1 percent) primarily due to an increase in appropriations, offset by decreases in other changes in unobligated balances, borrowing authority, and spending authority from offsetting collections. Appropriations increased $75.2 billion primarily due to increased funding needed in fiscal year 2013 to service the federal debt. Partially offsetting the increase in appropriations were reduced borrowing authority, spending authority from offsetting collections, and other changes in unobligated balances by a combined total of $34.7 billion principally due to the ongoing wind-down of the TARP programs.

**Agency Outlays, Net** of $286.9 billion were higher in fiscal year 2013 (Figure 7) by $45.6 billion (or 18.9 percent) primarily due to fewer collections in fiscal year 2013 from the wind-down of the TARP programs, partially offset by increased receipts of preferred stock dividends from the GSE SPSPA program.

**Net Revenue Received (Custodial),** representing net revenue collected by Treasury on behalf of the U.S. government, includes various taxes, primarily income taxes, as well as user fees, fines and penalties, and other revenue. Over 90 percent of these revenues are related to income and social security taxes. Net revenue received was $2.6 trillion for fiscal year 2013, an increase of $335.4 billion (or 14.9 percent) over the prior fiscal year. This increase is attributed mainly to an increase in ordinary, capital gains, and dividend income tax rates for individuals, coupled with an increase in corporate income tax collections and a reduction in tax refunds.

# MANAGEMENT ASSURANCES

## The Secretary's Assurance Statement

The Department of the Treasury's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the *Federal Managers' Financial Integrity Act* (FMFIA). Treasury has evaluated its management controls, internal controls over financial reporting, and compliance with federal financial systems standards. As part of the evaluation process, Treasury considered results of extensive testing and assessment across the Department and independent audits.

Treasury provides assurance that the objectives of Section 2 of the FMFIA (Financial Reporting and Operations) have been achieved, except for the material weaknesses noted below. Treasury is in substantial conformance with Section 4 (Financial Management Systems) of the FMFIA. Also, in accordance with Office of Management and Budget Circular No. A-123, *Management's Responsibility for Internal Control, Appendix A, Internal Control over Financial Reporting*, Treasury provides qualified assurance that internal control over financial reporting was operating effectively based on the results of the assessment as of June 30, 2013. Treasury's financial management systems are not in substantial compliance with the *Federal Financial Management Improvement Act* (FFMIA) due to the Internal Revenue Service's (IRS's) material weakness related to unpaid tax assessments.

During fiscal year 2013 Treasury closed one material weakness: IRS – Computer Security. As of September 30, 2013, Treasury had two remaining FMFIA material weaknesses as follows (with origination/planned resolution timeframes indicated):

**Operations:**

- Bureau of the Fiscal Service (formerly Financial Management Service) – Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements (Fiscal Year 2001/2015)

**Financial Reporting:**

- IRS – Unpaid Tax Assessments (Fiscal Year 1995/2015)

Treasury management remains dedicated to the resolution of these remaining weaknesses. Overall, Treasury continues to make progress in reducing internal control weaknesses and in meeting federal financial management systems requirements.

Jacob J. Lew
Secretary of the Treasury
December 16, 2013

# FMFIA

The management control objectives under FMFIA are to reasonably ensure that:

- Obligations and costs are in compliance with applicable law
- Funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation
- Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets

FMFIA requires agencies to evaluate and report on the effectiveness of controls over operations and financial reporting (FMFIA Section 2), and conformance with financial management systems requirements (FMFIA Section 4 and FFMIA) that protect the integrity of federal programs. Deficiencies that seriously affect an agency's ability to meet these objectives are deemed "material weaknesses."

In fiscal year 2013, Treasury continued to make progress on closing its three material weaknesses, as listed in the Secretary's assurance statement. Treasury includes resolution of material weaknesses as a performance requirement for every executive, manager, and supervisor. Treasury closed the IRS Computer Security material weakness during fiscal year 2013. Additional information on Treasury's material weaknesses and progress can be found in Section F of Part 3, Other Accompanying Information.

# FFMIA and Financial Management Systems

### FFMIA

FFMIA mandates that agencies "... implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Government Standard General Ledger (USSGL) at the transaction level." FFMIA also requires the development of remediation plans by any entity unable to report substantial compliance with these requirements.

During fiscal year 2013, Treasury bureaus and offices used a risk-based approach to assess their financial management systems' compliance with FFMIA, as required by OMB. The bureaus and offices conducted self-assessments to determine their risk levels. All Treasury bureau and office financial management systems are in compliance with FFMIA, with the exception of IRS that did not comply with federal financial management systems requirements or applicable federal accounting standards. As required, the IRS has a remediation plan in place to correct the identified deficiencies. IRS management updates this plan quarterly and Treasury management reviews it. In addition, TIGTA audits IRS's remediation progress annually.

To address the Unpaid Tax Assessments material weakness, the IRS implemented programming changes in the Custodial Detail Data Base to improve the financial classification in situations where:

- There are unpaid tax assessments requiring amounts to be accurately reported on single Business Master File modules with a partial collection statute-expired assessment
- A taxpayer is ordered to make restitution on criminal activity
- A taxpayer has become a victim of identity theft and his/her account has been compromised; the taxpayer's account will be restored to its accurate balance

In addition, the IRS continues to update the Automated Trust Fund Recovery system to increase the number of Trust Fund Recovery Penalty (TFRP) cases that can be worked without user intervention and to eliminate errors. The IRS will continue to perform internal control testing to ensure the accuracy of these accounts.

### FINANCIAL MANAGEMENT SYSTEMS FRAMEWORK

The Department of the Treasury's financial management systems framework consists of two fundamental components: (1) core financial and mixed systems maintained by the Treasury bureaus, and (2) the Department-wide Financial Analysis and Reporting System (FARS). The bureau systems process and record detailed financial transactions and submit summary-level data to FARS, which maintains the key financial data necessary for Treasury-wide consolidated financial reporting. This framework satisfies the bureaus' diverse financial operational and reporting needs as well as the Department's internal and external reporting requirements. The FARS framework provides essential support each year to Treasury's efforts to obtain an unqualified audit opinion.

The FARS includes the following component applications:

- Treasury Information Executive Repository (TIER) – a financial data warehouse used to consolidate and validate bureau financial data
- CFO Vision (CFOV) – a tool used to produce monthly financial statements, notes, and other supporting reports, and also to perform financial analysis
- Joint Audit Management Enterprise System (JAMES) – tracks information on open audits and audit report findings, recommendations, and planned corrective actions

Bureaus submit summary-level financial data to TIER monthly. The CFOV application uses these data to produce financial statements and reports on both a Department-wide and bureau-level basis, including Treasury's audited annual financial statements and monthly management reports.

Fourteen Treasury bureaus and offices use centralized financial operations, budget execution services, or IT support provided by the Fiscal Service's Administrative Resource Center (ARC). This shared services approach enables these bureaus to have access to core financial systems without having to maintain the necessary technical and systems architectures. Fiscal Service/ARC also provides administrative services in the areas of accounting, travel, payroll, human resources, and procurement to Treasury bureaus and offices and to other federal entities to support core business activities. Using these services reduces the need for Treasury to maintain duplicative financial management systems; enhances the quality, timeliness, and accuracy of financial management processes; and provides a more efficient and cost-effective business model. In fiscal year 2013, Fiscal Service/ARC upgraded its core financial management system to adopt the Common Government-wide Accounting Classification (CGAC) structure and offer additional functionality to its customers. In fiscal years 2013 and 2014, the Department and Fiscal Service/ARC plan

to upgrade to the second instance of the core financial management system to meet compliance expectations. In addition, Fiscal Service/ARC will continue to expand its use of the Invoice Processing Platform (IPP), a secure, web-based service implemented in fiscal year 2012 that more efficiently manages government invoicing.

### GOALS AND THE SUPPORTING FINANCIAL SYSTEM STRATEGIES

Treasury's financial system goals and supporting strategies focus on improving and streamlining the current bureau core and mixed financial systems as well as the current FARS applications in order to support new financial requirements and continue to provide management with accurate and timely financial information.

Throughout fiscal year 2013, Treasury updated TIER and CFOV to meet new and evolving reporting requirements. These include updates to TIER to comply with the data standard reflected in Fiscal Service's planned Government-wide Treasury Account Symbol Adjusted Trial Balance System (GTAS). The TIER Focus Group, which serves as a forum for bureau feedback on TIER enhancements and issues, continued to meet to improve communication with the bureaus and coordinate changes impacting financial management systems and financial operations.

In fiscal year 2014, Treasury will replace two component FARS applications in order to reduce operating costs and increase the efficiency of Treasury staff through increased automation.

- The current CFOV application will be replaced as part of Treasury's effort to bring the FARS into compliance with Fiscal Service's new GTAS data standard. CFOV will be replaced by the TIER Financial Statements (TFS) application, which is expected to have lower operating costs.
- The current JAMES application will be replaced by a commercial off-the-shelf (COTS) governance, risk, and compliance (GRC) software product for managing audit follow-up and internal self-assessment activities. By automating certain operational functions, the new product will allow Treasury staff more time for analysis and oversight. The GRC product will improve the ability to document, track, and mitigate key risks across Treasury; facilitate collaboration with and across Treasury bureaus, third-party service providers, and oversight bodies; and enable users to manage issues centrally and leverage data over multiple years in the development of corrective action plans.

Customer Account Data Engine (CADE) 2 Transition State 1 daily processing is enhancing IRS tax administration and improving service to taxpayers by enabling faster refunds for taxpayers, more timely account updates, and faster issuance of taxpayer notices. In addition, Transition State 1 changes the underlying Information Technology infrastructure by allowing the IRS to store taxpayer data in a state-of-the-art database, which will position the IRS to implement new applications to access and analyze all of a taxpayer's data from one authoritative source.

In calendar year 2013, intense focus has been placed on optimizing performance of the CADE 2 database, ensuring the data are clean and ready for next filing season production deployment in 2014 and for the longer term. This effort includes database performance optimization, building and testing data validation and data recovery tools, addressing security and privacy requirements, changes to code base to reflect tax law changes, infrastructure upgrades, systems and integration testing, and organizational readiness activities to ensure support processes and monitoring are in place so the database can run successfully in production.

In fiscal year 2013, the IRS also began the next phase of CADE 2 Transition State 2, modernizing its 50-year old legacy core taxpayer account processing systems, which includes re-writing IRS's legacy core tax processing applications in modern programming language, resulting in increased flexibility, scalability, reliability and security;

and enhancing IRS's ability to leverage the new CADE 2 database, ensuring compliance with federal financial system requirements and addressing IRS's Financial Material Weakness for individual taxpayer accounts. The Penalty and Interest 2013 Mid-Year Release, part of the Transition State 2 score to insure that Penalty and Interest calculations are consistent across IRS, was successfully deployed on July 29, 2013. The Primary Penalty and Interest Project is on track for its scheduled Filing Season 2014 implementation.

In fiscal year 2013, BEP enhanced and refined its cloud-based, fully integrated enterprise resource planning system. This included the conversion of supply chain management, manufacturing management, project accounting, and contract lifecycle management modules. BEP plans to continually focus on improving automation and streamlining in a cost-efficient manner in fiscal year 2014.

The OCC upgraded its Management and Accountability Reporting Tools ($MART) financial system in order to retain access to vendor support for the underlying software in fiscal year 2013. The OCC plans to continue to integrate its applications with its customers and to provide innovative solutions for efficient reporting.

PART 2:

# Annual Financial Report

# PART II - TABLE OF CONTENTS

Message From The Assistant Secretary for Management and Deputy Chief Financial Officer ..... 38
Inspector General's Transmittal Letter ..... 39
Independent Auditors' Report on the Departments' Financial Statements ..... 41
Management's Response to Independent Auditors' Report ..... 48

**Financial Statements**

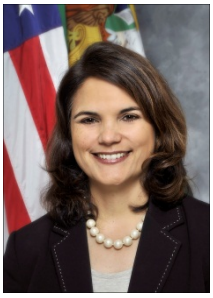
Consolidated Balance Sheets ..... 49
Consolidated Statements of Net Cost ..... 51
Consolidated Statements of Changes in Net Position ..... 52
Combined Statement of Budgetary Resources ..... 53
Statements of Custodial Activity ..... 55

**Notes to the Financial Statements**

1. Summary of Significant Accounting Policies ..... 56
2. Fund Balance ..... 72
3. Loans and Interest Receivable – Intra-Governmental ..... 74
4. Due From the General Fund and Due To the General Fund ..... 76
5. Cash, Foreign Currency, and Other Monetary Assets ..... 78
6. Gold and Silver Reserves, and Gold Certificates Issued to the Federal Reserve Banks ..... 80
7. Troubled Asset Relief Program – Credit Program Receivables, Net ..... 81
8. Investments in Government Sponsored Enterprises ..... 90
9. Investments in International Financial Institutions ..... 95
10. Other Investments and Related Interest ..... 95
11. Other Credit Program Receivables, Net ..... 96
12. Reserve Position in the International Monetary Fund and Related Loans and Interest Receivable ..... 101
13. Taxes, Interest, and Other Receivables, Net ..... 102
14. Property, Plant, and Equipment, Net ..... 103
15. Non-Entity vs. Entity Assets ..... 104
16. Federal Debt and Interest Payable and Related Liabilities ..... 105
17. Other Debt and Interest Payable ..... 109
18. D.C. Pensions and Judicial Retirement Actuarial Liability ..... 110
19. Liabilities ..... 112
20. Net Position ..... 113
21. Consolidated Statements of Net Cost and Net Costs of Treasury Sub-Organizations ..... 114
22. Additional Information Related to the Combined Statements of Budgetary Resources ..... 120
23. Collection and Disposition of Custodial Revenue ..... 123
24. Funds From Dedicated Collections ..... 125
25. Reconciliation of Net Cost of Treasury Operations and Non-Entity Costs to Budget ..... 129
26. Schedule of Fiduciary Activity ..... 130
27. Commitments and Contingencies ..... 131

Required Supplemental Information (Unaudited – See accompanying auditors' report) ..... 135

# MESSAGE FROM THE ASSISTANT SECRETARY FOR MANAGEMENT AND DEPUTY CHIEF FINANCIAL OFFICER



Nani A. Coloretti
Assistant Secretary
for Management

Dorrice C. Roth
Deputy Chief Financial
Officer

In fiscal year 2013, Treasury pursued an aggressive set of management programs and initiatives designed to manage the U.S. government's finances efficiently and responsibly. By focusing on a comprehensive set of management priorities, Treasury has led and supported government-wide financial management efforts to increase productivity, reduce waste and non-essential expenses, and modernize processes and systems. These priorities included the Department's two Agency Priority Goals "Increase Voluntary Tax Compliance" and "Significantly Increase the Number of Electronic Transactions with the Public."

In efforts to make doing business with the U.S. government as easy as possible, the Department is leading in implementing the use of electronic transactions with the public. In fiscal year 2013, 93 percent of Treasury payments and associated information was made electronically. As the number of Social Security recipients increases, the savings from electronic payments will also increase while providing beneficiaries a safer, more reliable, and convenient way to receive their payments.

In fiscal year 2013, Treasury demonstrated leadership in fiscal prudence and management excellence by:

- Advancing engagement of small businesses by exceeding all small business contracting goals for the third year in a row (based on preliminary results) to jump-start job creation and stimulate local economies;
- Further reducing administrative expenses as directed by the President's Executive Order to cut waste, in which we exceeded this year's goal by $153.5 million (saving a total of $394.5 million in fiscal year 2013);
- Advancing the Administration's goal of reducing the federal footprint by working to align space expenses with organizations that use the space, creating cost accountability and, consequently, incentives to use less space; and
- Enhancing technological modernization efforts, supporting federal data center consolidation, and increasing shared services through initiatives such as onboarding new customers to Treasury's Administrative Resource Center and HR Connect (Treasury's HR line of business).

The Department again received an unmodified audit opinion on both the Treasury-wide and Office of Financial Stability/TARP fiscal year 2013 financial statements. Treasury closed the material weakness on IRS – Computer Security and continued to make steady progress toward resolving the two Federal Managers' Financial Integrity Act material weaknesses remaining open as of September 30, 2013 (IRS – Unpaid Tax Assessments, and Bureau of the Fiscal Service – Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements). Despite the complexity of Treasury's financial systems contributing to these material weaknesses, we have made considerable progress toward resolving the issues.

Nani A. Coloretti
Assistant Secretary for Management
December 16, 2013

Dorrice C. Roth
Deputy Chief Financial Officer
December 16, 2013

# INSPECTOR GENERAL'S TRANSMITTAL LETTER

**DEPARTMENT OF THE TREASURY**
**WASHINGTON, D.C. 20220**

December 16, 2013

**OFFICE OF INSPECTOR GENERAL**

**INFORMATION MEMORANDUM FOR SECRETARY LEW**

**FROM:** Eric M. Thorson

**Inspector General**

**SUBJECT:** Audit of the Department of the Treasury's Financial Statements for Fiscal Years 2013 and 2012

## INTRODUCTION

I am pleased to transmit KPMG LLP's report on the Department of the Treasury's (the Department) financial statements as of and for the fiscal years (FY) ending September 30, 2013 and 2012.

The Chief Financial Officer's Act, as amended, requires the Department of the Treasury Office of Inspector General or an independent auditor, as determined by the Inspector General, to audit the Department's financial statements. Under a contract monitored by my office, KPMG LLP, an independent certified public accounting firm, performed an audit of the Department's FY 2013 and 2012 financial statements. The contract required that the audit be performed in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States and Office of Management and Budget Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements.*

## RESULTS OF INDEPENDENT AUDIT

In its audit of the Department, KPMG LLP reported the following:

- the financial statements were fairly presented, in all material respects, in accordance with U.S. generally accepted accounting principles;
- a material weakness related to unpaid tax assessments and a significant deficiency related to financial reporting systems identified by the auditor of the Internal Revenue Service collectively represent a material weakness for the Department as a whole;
- weaknesses related to information systems controls at the Bureau of the Fiscal Service represent a significant deficiency for the Department as a whole;
- the Department's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA)

related to Federal financial management systems requirements and applicable Federal accounting standards;

- no instances of reportable noncompliance with laws and regulations , exclusive of FFMIA, that are required to be reported under government auditing standards or Office of Management and Budget Bulletin No. 14-02; and

- an instance of a potential Anti-deficiency Act violation related to voluntary services provided to the Departmental Offices.

**EVALUATION OF AUDITORS' PERFORMANCE**

To ensure the quality of the audit work performed, we evaluated KPMG LLP's qualifications and independence, reviewed the approach and planning of the audit, monitored the progress of the audit at key points, reviewed and accepted KPMG LLP's audit report, and performed other procedures that we deemed necessary. Additionally, we provide oversight of the audits of financial statements and certain accounts and activities conducted at 10 component entities of the Department. Our review, as differentiated from an audit performed in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the financial statements or conclusions about the effectiveness of internal control or on whether the Department's financial management systems substantially complied with FFMIA or conclusions on compliance with laws and regulations. KPMG LLP is responsible for the attached auditors' report dated December 16, 2013, and the conclusions expressed in that report. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with generally accepted government auditing standards.

I appreciate the courtesies and cooperation extended to KPMG LLP and my staff during the audit. Should you or your staff have questions, you may contact me at (202) 622-1090 or Marla A. Freedman, Assistant Inspector General for Audit, at (202) 927-5400.

Attachment

cc: Nani A. Coloretti
Assistant Secretary for Management

Dorrice C. Roth
Deputy Chief Financial Officer

**KPMG LLP**
Suite 12000
1801 K Street, NW
Washington, DC 20006

# Independent Auditors' Report

Inspector General
U.S. Department of the Treasury:

## Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the U.S. Department of the Treasury (Department), which comprise the consolidated balance sheets as of September 30, 2013 and 2012, and the related consolidated statements of net cost, consolidated statements of changes in net position, combined statements of budgetary resources, and statements of custodial activity for the years then ended, and the related notes to the consolidated financial statements (hereinafter referred to as "consolidated financial statements").

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of the Internal Revenue Service (IRS), a component entity of the Department, which statements reflect total assets of $42.2 and $46.8 billion, net cost of operations of $12.3 and $12.8 billion before applicable eliminating entries, budgetary resources of $12.7 and $13.2 billion, and custodial activity of $2,851 and $2,528 billion, as of and for the years ended September 30, 2013 and September 30, 2012, respectively. Those statements were audited by another auditor, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for IRS, is based solely on the report of the other auditor.

We did not audit the financial statements of the Office of Financial Stability (OFS), a component entity of the Department, which statements reflect total assets of $71.2 and $116.7 billion, net income from operations of $7.7 and $7.7 billion before applicable eliminating entries, and budgetary resources of $37.9 and $67.8 billion, as of and for the years ended September 30, 2013 and September 30, 2012, respectively. Those statements were audited by another auditor, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for OFS, is based solely on the report of the other auditor.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 14-02, *Audit Requirements for Federal Financial Statements*. Those standards and OMB

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Bulletin No. 14-02 require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion on the Financial Statements***

In our opinion, based on our audits and the reports of the other auditor, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of the Treasury as of September 30, 2013 and 2012, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended in accordance with U.S. generally accepted accounting principles.

***Emphasis of Matter***

As discussed in Notes 7, 8, and 11, the Department is a participant in significant legislation and transactions whose purpose is to assist in stabilizing the financial markets. Also as discussed in note 1A, the consolidated financial statements do not include the assets, liabilities, or results of operations of commercial entities in which the Department has a significant equity interest as it has determined that none of these entities meet the criteria for inclusion as a federal entity and are therefore not included in the consolidated financial statements. Furthermore, as discussed in notes 1V, 7, 8, and 11, the value of certain investments, loans, commitments, and asset guarantees is based on estimates. These estimates are inherently subject to substantial uncertainty arising from the likelihood of future changes in general economic, regulatory, and market conditions. In addition, there are significant uncertainties related to the amounts that the Department will realize from its investments. As such, there will likely be differences between the estimated value of these investments, loans, commitments, and asset guarantees as of September 30, 2013 and 2012, and the amounts that may ultimately be realized from these assets or may be required to settle these commitments and asset guarantees. Such differences may be material and will also affect the ultimate cost of these programs. Our opinion is not modified with respect to these matters.

As discussed in Note 24 to the consolidated financial statements, in 2013 the Department adopted Statement of Federal Financial Accounting Standards No. 43, *Funds from Dedicated Collections: Amending Statement of Federal Financial Accounting Standards No. 27, Identifying and Reporting Earmarked Funds.* The 2012 consolidated financial statements have been adjusted for the retrospective application of the new accounting guidance. Our opinion is not modified with respect to this matter.

### *Other Matters*

*Required Supplementary Information*

U.S. generally accepted accounting principles require that the information in the Management's Discussion and Analysis and Required Supplemental Information sections be presented to supplement the basic consolidated financial statements. Such information, although not a part of the basic consolidated financial statements, is required by the Federal Accounting Standards Advisory Board who considers it to be an essential part of financial reporting for placing the basic consolidated financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic consolidated financial statements, and other knowledge we obtained during our audits of the basic consolidated financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Other Information*

Our audits were conducted for the purpose of forming an opinion on the basic consolidated financial statements as a whole. The *Message from the Secretary of the Treasury*, the *Message from the Assistant Secretary for Management and the Deputy Chief Financial Officer*, and the *Other Information* section are presented for purposes of additional analysis and are not a required part of the basic consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

## Other Reporting Required by *Government Auditing Standards*

### *Internal Control Over Financial Reporting*

In planning and performing our audit of the consolidated financial statements, we considered the Department's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control. We did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described below, the other auditor identified certain deficiencies in internal control that we consider to be a material weakness, and we identified certain deficiencies in internal control that we consider to be a significant deficiency.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a

combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described below to be a material weakness.

***A. Material Weakness in Internal Control Over Financial Reporting at the IRS (Repeat Condition)***

IRS needs to establish internal control over financial reporting and systems in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control* to ensure reliable and timely financial information is obtained, maintained, and reported. IRS continued to make progress in addressing its deficiencies in internal control over financial reporting. However, a material weakness in internal control over unpaid tax assessments and significant deficiency in internal control over financial reporting systems continued to exist in fiscal year 2013 and are collectively considered a material weakness at the Department level. The other auditor performed an audit of IRS's internal control over financial reporting for the purpose of providing an opinion on the effectiveness of internal controls. Because of the material weakness, the other auditor's opinion on IRS's internal control over financial reporting stated that IRS did not maintain, in all material respects, effective internal control over financial reporting as of September 30, 2013, and thus did not provide reasonable assurance that losses and misstatements that were material in relation to the IRS's financial statements would be prevented or detected and corrected on a timely basis. The deficiencies are summarized as follows:

- Internal control deficiencies that affected IRS's management and reporting of unpaid tax assessments continued to exist. Specifically, the IRS was unable to: (1) use its general ledger system and underlying subsidiary records to classify and report federal taxes receivable, compliance assessments, and write-offs for tax transactions, in accordance with federal accounting standards without a labor-intensive manual compensating estimation process; (2) use its subsidiary ledger for unpaid tax assessments to prepare reliable, useful, and timely information to manage and report externally because IRS's classification program does not effectively sort through, identify, and analyze all the relevant transaction information required for proper classification, recording and reporting; and (3) effectively prevent or timely detect and correct errors in recording taxpayer information.

- Internal control deficiencies over financial reporting systems continued to exist that increase the risk that IRS financial and taxpayer data will remain vulnerable to inappropriate and undetected use, modification or disclosure. Specifically, the IRS did not: (1) install appropriate security updates on certain databases and servers, which increased the risk that known vulnerabilities could be exploited; (2) sufficiently monitor internal and external system control activities supporting financial reporting; (3) monitor internal controls of its service organizations; (4) prevent individuals from making changes to mainframe processing without following its established change control procedures to ensure changes were authorized; (5) include sufficient detail in its authorization process to ensure that access to systems was appropriate and configure certain applications to use strong encryption for authentication; and (6) fully implement its information security program and update key mainframe policies and procedures related to access.

Additional details related to the material weakness identified above have been provided separately to IRS management by the auditor of the IRS's financial statements.

***Recommendation***

The other auditor separately provided IRS management with recommendations to address the above material weakness. We recommend that the Assistant Secretary for Management (ASM) and Deputy Chief Financial Officer (DCFO) ensure that the IRS takes corrective action to improve controls over financial reporting.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described below to be a significant deficiency.

***B. Significant Deficiency in Internal Control in Information Systems Controls at the Bureau of the Fiscal Service (Repeat Condition)***

The Bureau of the Fiscal Service (Fiscal Service) relies on an extensive array of information technology systems to perform its primary mission. Effective information system controls and security programs over financial systems are essential to protecting information resources in accordance with OMB Circular No. A-130, *Management of Federal Information Resources*. Fiscal Service made progress in several areas in its efforts to address prior year deficiencies in its information systems controls. Despite these improvements, our tests revealed that the necessary policies and procedures to detect and correct control and functionality weaknesses have not been consistently documented, implemented, or enforced. Specifically, deficiencies continue to exist in the areas of: (1) security management; (2) access to computer resources, including data, equipment, and facilities; (3) changes to information system resources and system configurations; and (4) segregation of responsibilities. These deficiencies could compromise the Fiscal Service's ability to ensure security over sensitive financial data and reliability of the financial systems.

***Recommendation***

Recommendations to address the above significant deficiency have been provided to Fiscal Service management. We recommend that the ASM and DCFO ensure that the Fiscal Service takes corrective action to improve controls over its information systems.

***Compliance and Other Matter***

As part of obtaining reasonable assurance about whether the Department's consolidated financial statements are free from material misstatement, we, and the other auditor, performed tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 14-02. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our, and the other auditor's, tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 14-02. The results of our tests disclosed an other matter this is required to be reported under *Government Auditing Standards* or OMB Bulletin No. 14-02, and is described below.

### *C. Other Matter of Potential Violation of the Anti-Deficiency Act (Repeat Condition)*

As stated in our prior year auditors' report, the Department informed us of an instance of a potential violation of the *Anti-Deficiency Act* related to voluntary services provided to the Departmental Offices. This matter has been referred to the Government Accountability Office to determine whether the matter is a violation of the *Anti-Deficiency Act*.

We, and the other auditor, also performed tests of the Department's compliance with certain provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). Providing an opinion on compliance with FFMIA was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests of FFMIA disclosed instances, described below, in which the Department's financial management systems did not substantially comply with the (1) Federal financial management systems requirements, and (2) applicable Federal accounting standards. The results of our tests of FFMIA disclosed no instances in which the Department's financial management systems did not substantially comply with the United States Government Standard General Ledger at the transaction level.

### *D. Noncompliance with Federal Financial Management Improvement Act of 1996 (Repeat Condition)*

The Department's financial management systems did not substantially comply with the following FFMIA requirements:

1. Federal Financial Management Systems Requirements
As discussed in finding A. Material Weakness in Internal Control Over Financial Reporting at the IRS (Repeat Condition), the Department continues to have deficiencies in the IRS's financial management systems.

2. Federal Accounting Standards
As discussed in finding A. Material Weakness in Internal Control Over Financial Reporting at the IRS (Repeat Condition), the Department has a material weakness related to the IRS that affected the Department's ability to prepare its financial statements in accordance with the federal accounting standards. Specifically, IRS financial management systems were unable to support the taxes receivable amount on the consolidated balance sheet, and the compliance assessments and write-offs in the required supplementary information disclosures, in accordance with accounting standards.

### *Recommendation*

The other auditor separately provided IRS management with recommendations to address the above noncompliance with FFMIA. We recommend that the ASM and DCFO ensure that the IRS implements its remediation plan outlining actions to be taken to resolve noncompliance with the FFMIA requirements and the resources and responsible organizational units for such planned actions. Many of the IRS's planned actions are long term in nature and are tied to IRS's systems modernization efforts.

***Department's Response to Findings***

The Department indicated in a separate letter immediately following this report that it concurs with the findings and recommendations presented in our report. Further, the Department responded that it will take necessary corrective actions to address each of the matters presented. The Department's response was not subjected to the auditing procedures applied in the audit of the consolidated financial statements and, accordingly, we express no opinion on the response.

***Purpose of the Other Reporting Required by* Government Auditing Standards**

The purpose of the communication described in the Other Reporting Required by *Government Auditing Standards* section is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Department's internal control or compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

December 16, 2013

# MANAGEMENT'S RESPONSE TO INDEPENDENT AUDITORS' REPORT

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

December 16, 2013

KPMG LLP
1801 K Street, NW
Washington, DC 20006

Ladies and Gentlemen:

On behalf of Secretary Lew, we are responding to your draft audit report on the Department of the Treasury's fiscal year 2013 consolidated financial statements. Our bureaus and program offices are proud of the Department's success in achieving an unmodified audit opinion on the Department's financial statements for the fourteenth consecutive year.

The high level of professionalism, technical expertise, and partnership demonstrated by KPMG in conducting this year's audit contributed greatly to Treasury's successful fiscal year 2013 results. We also appreciate the expertise and commitment demonstrated by the other organizations involved in the audit process – the Office of the Inspector General, Government Accountability Office (GAO), and the firms that audited several of our bureaus.

We acknowledge the one material weakness and one significant deficiency at the Department level, and instances of noncompliance with laws and regulations described in your report. We agree with your recommendations, and will focus on necessary corrective actions to address each of the issues.

Overall, we have made substantial progress in enhancing our internal control environment. We are very proud of our progress, and remain committed to ensuring high standards of integrity and transparency in reporting our financial performance.

Nani A. Coloretti
Assistant Secretary for Management

Dorrice C. Roth
Deputy Chief Financial Officer

**Consolidated Balance Sheets**
**As of September 30, 2013 and 2012**
**(In Millions)**

| | 2013 | 2012 |
|---|---|---|
| **ASSETS** | | |
| **Intra-governmental Assets** | | |
| Fund Balance (Note 2) | **$ 367,820** | $ 344,346 |
| Loans and Interest Receivable (Note 3) | **1,093,559** | 914,304 |
| Advances to the Unemployment Trust Fund (Note 4) | **29,696** | 32,932 |
| Due From the General Fund (Note 4) | **17,123,357** | 16,202,179 |
| Other Intra-governmental Assets | **435** | 1,495 |
| **Total Intra-governmental Assets** | **18,614,867** | 17,495,256 |
| | | |
| Cash, Foreign Currency, and Other Monetary Assets (Note 5) | **148,506** | 145,551 |
| Gold and Silver Reserves (Note 6) | **11,062** | 11,062 |
| Troubled Asset Relief Program (TARP) - Credit Program Receivables, Net (Note 7) | **17,869** | 40,231 |
| Investments in Government Sponsored Enterprises (GSE) (Notes 4 and 8) | **140,221** | 109,342 |
| Investments in International Financial Institutions (Note 9) | **6,396** | 6,043 |
| Non-TARP Investments in American International Group, Inc. (Note 7) | **-** | 2,611 |
| Other Investments and Related Interest (Note 10) | **14,114** | 15,436 |
| Other Credit Program Receivables, Net (Note 11) | **17,628** | 19,888 |
| Loans and Interest Receivable (Note 12) | **10,042** | 10,334 |
| Reserve Position in the International Monetary Fund (Note 12) | **17,915** | 21,573 |
| Taxes, Interest and Other Receivables, Net (Note 13) | **38,602** | 41,463 |
| Property, Plant, and Equipment, Net (Note 14) | **2,646** | 2,435 |
| Other Assets | **756** | 637 |
| **Total Assets (Note 15)** | **$ 19,040,624** | $ 17,921,862 |

Heritage Assets (Note 14)

*The accompanying notes are an integral part of these financial statements.*

**Consolidated Balance Sheets**
**As of September 30, 2013 and 2012**
**(In Millions)**

| | 2013 | 2012 |
|---|---|---|
| **LIABILITIES** | | |
| **Intra-governmental Liabilities** | | |
| Federal Debt and Interest Payable (Notes 4 and 16) | **$ 4,837,436** | $ 4,861,005 |
| Liability for Restoration of Federal Debt Principal and Interest (Notes 4 and 16) | **128,272** | - |
| Other Debt and Interest Payable (Note 17) | **5,761** | 7,194 |
| Due To the General Fund (Note 4) | **1,417,423** | 1,257,752 |
| Other Intra-governmental Liabilities (Note 19) | **477** | 541 |
| **Total Intra-governmental Liabilities** | **6,389,369** | 6,126,492 |
| | | |
| Federal Debt and Interest Payable (Notes 4 and 16) | **12,003,030** | 11,307,583 |
| Liability for Restoration of Federal Debt Principal and Interest (Notes 4 and 16) | **120,356** | - |
| Certificates Issued to the Federal Reserve (Note 5) | **5,200** | 5,200 |
| Allocation of Special Drawing Rights (Note 5) | **54,177** | 54,463 |
| Gold Certificates Issued to the Federal Reserve (Note 6) | **11,037** | 11,037 |
| Refunds Payable (Notes 4 and 23) | **2,914** | 3,255 |
| D.C. Pensions and Judicial Retirement Actuarial Liability (Note 18) | **9,164** | 10,059 |
| Liability to Government Sponsored Enterprises (Note 8) | **-** | 9,003 |
| Other Liabilities (Note 19) | **4,234** | 5,374 |
| **Total Liabilities (Note 19)** | **18,599,481** | 17,532,466 |
| Commitments and Contingencies (Note 27) | | |
| | | |
| **NET POSITION** | | |
| Unexpended Appropriations: | | |
| Funds from Dedicated Collections (Note 24) | **200** | 200 |
| Other Funds | **361,095** | 317,309 |
| Subtotal | **361,295** | 317,509 |
| Cumulative Results of Operations: | | |
| Funds from Dedicated Collections (Note 24) | **48,477** | 49,047 |
| Other Funds | **31,371** | 22,840 |
| Subtotal | **79,848** | 71,887 |
| | | |
| **Total Net Position – Funds from Dedicated Collections (Note 24)** | **48,677** | 49,247 |
| **Total Net Position – Other Funds** | **392,466** | 340,149 |
| **Total Net Position (Note 20)** | **441,143** | 389,396 |
| **Total Liabilities and Net Position** | **$ 19,040,624** | $ 17,921,862 |

*The accompanying notes are an integral part of these financial statements.*

**Consolidated Statements of Net Cost**
**For the Fiscal Years Ended September 30, 2013 and 2012**
**(In Millions)**

| **Cost of Treasury Operations: (Note 21)** | **2013** | 2012 |
|---|---|---|
| **Financial Program** | | |
| Gross Cost | **$ 14,293** | $ 14,883 |
| Less Earned Revenue | **(3,127)** | (3,100) |
| Net Program Cost | **11,166** | 11,783 |
| **Economic Program** | | |
| Gross Cost (Revenue) (Note 8) | **(834)** | (280,045) |
| Less Earned Revenue | **(7,389)** | (8,735) |
| Net Program Cost (Revenue) | **(8,223)** | (288,780) |
| **Security Program** | | |
| Gross Cost | **1,030** | 1,059 |
| Less Earned Revenue | **(7)** | (4) |
| Net Program Cost | **1,023** | 1,055 |
| **Total Program Gross Costs (Revenue)** | **14,489** | (264,103) |
| **Total Program Gross Earned Revenues** | **(10,523)** | (11,839) |
| **Total Net Program Cost (Revenue) before Changes in Actuarial Assumptions** | **3,966** | (275,942) |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | **(684)** | 695 |
| **Total Net Cost of (Revenue From) Treasury Operations (Note 21)** | **3,282** | (275,247) |
| **Non-Entity Costs** | | |
| Federal Debt Interest | **425,081** | 432,265 |
| Restoration of Foregone Federal Debt Interest (Note 16) | **20** | 59 |
| Less Interest Revenue from Loans | **(35,132)** | (33,073) |
| Net Federal Debt Interest Costs | **389,969** | 399,251 |
| Accrued Restoration of Foregone Federal Debt Interest (Note 16) | **801** | - |
| Other Federal Costs (Note 21) | **17,006** | 16,290 |
| GSEs Non-Entity Cost (Revenue) (Note 8) | **(126,606)** | 5,322 |
| Other, net | **(828)** | (435) |
| **Total Net Non-Entity Costs** | **280,342** | 420,428 |
| **Total Net Cost of Treasury Operations and Non-Entity Costs** | **$ 283,624** | $ 145,181 |

*The accompanying notes are an integral part of these financial statements.*

**Consolidated Statements of Changes in Net Position**
**For the Fiscal Years Ended September 30, 2013 and 2012**
**(In Millions)**

| | 2013 | 2012 |
|---|---|---|
| **CUMULATIVE RESULTS OF OPERATIONS (Note 20)** | | |
| **Beginning Balance** | $ 71,887 | $ (262,840) |
| **Budgetary Financing Sources** | | |
| Appropriations Used | 455,216 | 428,479 |
| Non-Exchange Revenue | 695 | 620 |
| Donations and Forfeitures of Cash/Equivalent | 1,093 | 186 |
| Transfers In/Out Without Reimbursement | (30) | - |
| Other | 12 | 148 |
| **Other Financing Sources (Non-Exchange)** | | |
| Donation/Forfeiture of Property | 135 | 174 |
| Accrued Interest and Discount on Debt | 10,905 | 95,877 |
| Accrued Interest on Restoration of Federal Debt Principal (Note 16) | 801 | - |
| Transfers In/Out Without Reimbursement | (42) | (47) |
| Imputed Financing Sources (Note 21) | 776 | 812 |
| Transfers to the General Fund and Other (Note 20) | (177,976) | (46,341) |
| **Total Financing Sources** | 291,585 | 479,908 |
| Net Cost of Treasury Operations and Non-Entity Costs | (283,624) | (145,181) |
| Net Change | 7,961 | 334,727 |
| **Cumulative Results of Operations** | 79,848 | 71,887 |
| | | |
| **UNEXPENDED APPROPRIATIONS (Note 20)** | | |
| **Beginning Balance** | 317,509 | 342,978 |
| **Budgetary Financing Sources** | | |
| Appropriations Received (Note 20) | 508,448 | 419,130 |
| Appropriations Transferred In/Out | 25 | 142 |
| Other Adjustments | (9,471) | (16,262) |
| Appropriations Used | (455,216) | (428,479) |
| **Total Budgetary Financing Sources** | 43,786 | (25,469) |
| **Total Unexpended Appropriations** | 361,295 | 317,509 |
| **Net Position** | $ 441,143 | $ 389,396 |

*The accompanying notes are an integral part of these financial statements.*

**Combined Statement of Budgetary Resources**
**For the Fiscal Year Ended September 30, 2013**
**(In Millions)**

| | Budgetary | Non-Budgetary Financing | 2013 Total |
|---|---|---|---|
| **BUDGETARY RESOURCES** | | | |
| Unobligated balance brought forward, October 1 | $ 320,785 | $ 18,813 | $ 339,598 |
| Recoveries of prior year unpaid obligations | 7,876 | 7,608 | 15,484 |
| Other changes in unobligated balance | (3,366) | (23,430) | (26,796) |
| Unobligated balance from prior year budget authority, net | 325,295 | 2,991 | 328,286 |
| Appropriations (discretionary and mandatory) (Notes 20) | 504,687 | - | 504,687 |
| Borrowing authority (discretionary and mandatory) (Note 22) | - | 576 | 576 |
| Spending authority from offsetting collections (discretionary and mandatory) | 10,091 | 14,141 | 24,232 |
| **Total Budgetary Resources** | $ 840,073 | $ 17,708 | $ 857,781 |
| | | | |
| **STATUS OF BUDGETARY RESOURCES** | | | |
| Obligations incurred (Note 22) | $ 471,734 | $ 15,697 | $ 487,431 |
| Unobligated balance, end of year: | | | |
| Apportioned | 274,291 | 735 | 275,026 |
| Exempt from apportionment | 18,983 | - | 18,983 |
| Unapportioned | 75,065 | 1,276 | 76,341 |
| Total unobligated balance brought forward, end of year | 368,339 | 2,011 | 370,350 |
| **Total Status of Budgetary Resources** | $ 840,073 | $ 17,708 | $ 857,781 |
| | | | |
| **CHANGE IN OBLIGATED BALANCE** | | | |
| Unpaid obligations, gross, brought forward, October 1 | $ 142,307 | $ 110,866 | $ 253,173 |
| Obligations incurred (Note 22) | 471,734 | 15,697 | 487,431 |
| Outlays, gross | (473,187) | (17,521) | (490,708) |
| Recoveries of prior year unpaid obligations | (7,876) | (7,608) | (15,484) |
| Unpaid obligations, gross, end of year | 132,978 | 101,434 | 234,412 |
| Uncollected Payments: | | | |
| Uncollected payments from federal sources, brought forward, October 1 | (186) | (818) | (1,004) |
| Change in uncollected customer payments from federal sources | (59) | 88 | 29 |
| Uncollected customer payments from federal sources, end of year | (245) | (730) | (975) |
| **Obligated Balance, End of Year (Net)** | $ 132,733 | $ 100,704 | $ 233,437 |
| **Obligated balance, net, Start of Year** | $ 142,121 | $ 110,048 | $ 252,169 |
| | | | |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | |
| Budget authority, gross (discretionary and mandatory) | $ 514,778 | $ 14,717 | $ 529,495 |
| Actual offsetting collections (discretionary and mandatory) | (10,088) | (42,358) | (52,446) |
| Change in uncollected customer payments from federal sources (discretionary and mandatory) | (59) | 88 | 29 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ 504,631 | $ (27,553) | $ 477,078 |
| | | | |
| Outlays, gross (discretionary and mandatory) | $ 473,187 | $ 17,521 | $ 490,708 |
| Actual offsetting collections (discretionary and mandatory) | (10,088) | (42,358) | (52,446) |
| Outlays, net (discretionary and mandatory) | 463,099 | (24,837) | 438,262 |
| Distributed offsetting receipts | (151,404) | - | (151,404) |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ 311,695 | $ (24,837) | $ 286,858 |

*The accompanying notes are an integral part of these financial statements.*

**Combined Statement of Budgetary Resources**
**For the Fiscal Year Ended September 30, 2012**
**(In Millions)**

| **BUDGETARY RESOURCES** | **Budgetary** | **Non-Budgetary Financing** | **2012 Total** |
|---|---|---|---|
| Unobligated balance brought forward, October 1 | $ 340,384 | $ 28,570 | $ 368,954 |
| Recoveries of prior year unpaid obligations | 2,818 | 10,531 | 13,349 |
| Other changes in unobligated balance | (3,542) | (37,484) | (41,026) |
| Unobligated balance from prior year budget authority, net | 339,660 | 1,617 | 341,277 |
| Appropriations (discretionary and mandatory) (Note 20) | 429,535 | - | 429,535 |
| Borrowing authority (discretionary and mandatory) (Note 22) | - | 11,019 | 11,019 |
| Spending authority from offsetting collections (discretionary and mandatory) | 9,727 | 24,503 | 34,230 |
| **Total Budgetary Resources** | $ 778,922 | $ 37,139 | $ 816,061 |
| | | | |
| **STATUS OF BUDGETARY RESOURCES** | | | |
| Obligations incurred (Note 22) | $ 458,137 | $ 18,326 | $ 476,463 |
| Unobligated balance, end of year: | | | |
| Apportioned | 227,587 | 3,948 | 231,535 |
| Exempt from apportionment | 23,692 | - | 23,692 |
| Unapportioned | 69,506 | 14,865 | 84,371 |
| Total unobligated balance brought forward, end of year | 320,785 | 18,813 | 339,598 |
| **Total Status of Budgetary Resources** | $ 778,922 | $ 37,139 | $ 816,061 |
| | | | |
| **CHANGE IN OBLIGATED BALANCE** | | | |
| Unpaid obligations, gross, brought forward, October 1 | $ 148,351 | $ 123,802 | $ 272,153 |
| Obligations incurred (Note 22) | 458,137 | 18,326 | 476,463 |
| Outlays, gross | (461,363) | (20,731) | (482,094) |
| Recoveries of prior year unpaid obligations | (2,818) | (10,531) | (13,349) |
| Unpaid obligations, gross, end of year | 142,307 | 110,866 | 253,173 |
| Uncollected Payments: | | | |
| Uncollected payments from federal sources, brought forward, October 1 | (201) | (969) | (1,170) |
| Change in uncollected customer payments from federal sources | 15 | 151 | 166 |
| Uncollected customer payments from federal sources, end of year | (186) | (818) | (1,004) |
| **Obligated balance, End of Year (Net)** | $ 142,121 | $ 110,048 | $ 252,169 |
| **Obligated balance, net, Start of Year** | $ 148,150 | $ 122,833 | $ 270,983 |
| | | | |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | |
| Budget authority, gross (discretionary and mandatory) | $ 439,262 | $ 35,522 | $ 474,784 |
| Actual offsetting collections (discretionary and mandatory) | (9,743) | (157,152) | (166,895) |
| Change in uncollected customer payments from federal sources (discretionary and mandatory) | 15 | 151 | 166 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ 429,534 | $ (121,479) | $ 308,055 |
| | | | |
| Outlays, gross (discretionary and mandatory) | $ 461,363 | $ 20,731 | $ 482,094 |
| Actual offsetting collections (discretionary and mandatory) | (9,743) | (157,152) | (166,895) |
| Outlays, net (discretionary and mandatory) | 451,620 | (136,421) | 315,199 |
| Distributed offsetting receipts | (73,881) | - | (73,881) |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ 377,739 | $ (136,421) | $ 241,318 |

*The accompanying notes are an integral part of these financial statements.*

**Statements of Custodial Activity**
**For the Fiscal Years Ended September 30, 2013 and 2012**
**(In Millions)**

| | 2013 | 2012 |
|---|---|---|
| **Sources of Custodial Revenue (Note 23)** | | |
| Individual Income and FICA Taxes | $ **2,448,546** | $ 2,159,990 |
| Corporate Income Taxes | **311,994** | 281,462 |
| Estate and Gift Taxes | **19,830** | 14,450 |
| Excise Taxes | **83,970** | 79,554 |
| Railroad Retirement Taxes | **5,511** | 4,773 |
| Unemployment Taxes | **7,896** | 7,159 |
| Deposit of Earnings, Federal Reserve System | **75,767** | 81,957 |
| Fines, Penalties, Interest, and Other Revenue | **2,886** | 623 |
| **Total Revenue Received** | **2,956,400** | 2,629,968 |
| Less Refunds | **(364,788)** | (373,752) |
| **Net Revenue Received** | **2,591,612** | 2,256,216 |
| Non-Cash Accrual Adjustment | **(959)** | 5,543 |
| Non-TARP Investments in American International Group, Inc. (Note 7): | | |
| Cash Proceeds from Sale of Stock | **2,588** | 12,992 |
| Non-Cash Market Adjustments | **(2,611)** | (8,251) |
| **Total Custodial Revenue** | **2,590,630** | 2,266,500 |
| | | |
| **Disposition of Custodial Revenue (Note 23)** | | |
| Amounts Provided to Fund Non-Federal Entities | **358** | 386 |
| Amounts Provided to Fund the Federal Government | **2,591,254** | 2,255,830 |
| Non-Cash Accrual Adjustment: | | |
| Amounts to be Provided to the General Fund and Others | **(618)** | 4,000 |
| Accrual Adjustment | **(341)** | 1,543 |
| Non-TARP Investments in American International Group, Inc. (Note 7): | | |
| Cash Proceeds from Stock Sales Provided to Fund the Federal Government | **2,588** | 12,992 |
| Non-Cash Market Adjustment | **(2,611)** | (8,251) |
| **Total Disposition of Custodial Revenue** | **2,590,630** | 2,266,500 |
| **Net Custodial Revenue** | **$ -** | $ - |

*The accompanying notes are an integral part of these financial statements.*

# NOTES TO THE FINANCIAL STATEMENTS

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### A. REPORTING ENTITY

The accompanying financial statements include the operations of the U.S. Department of the Treasury (Department), one of 24 CFO Act agencies of the Executive Branch of the U.S. government, and certain custodial activities the Department manages on behalf of the entire U.S. government. The following paragraphs describe the activities of the reporting entity.

The Department was established by an Act of Congress approved on September 2, 1789. Many subsequent acts affected the development of the Department, delegating new duties to its charge and establishing the numerous bureaus and divisions that now comprise the Department. As a major policy advisor to the President, the Secretary of the Treasury (Secretary) has primary responsibility for formulating and managing the domestic and international tax and financial policies of the U.S. government.

Further, the Secretary is responsible for recommending and implementing U.S. domestic and international economic and fiscal policy; governing the fiscal operations of the U.S. government; maintaining foreign assets control; managing the federal debt; collecting income and excise taxes; representing the United States on international monetary, trade, and investment issues; overseeing Departmental overseas operations; and directing the manufacture of coins, currency, and other products for customer agencies and the public.

The Department's reporting entities include Departmental Offices (DO) and seven operating bureaus. For financial reporting purposes, DO is composed of: Community Development Financial Institutions (CDFI) Fund, Office of D.C. Pensions (ODCP), Exchange Stabilization Fund (ESF), Federal Financing Bank (FFB), Government Sponsored Enterprises (GSE) Program, International Assistance Programs (IAP), Office of Financial Research (OFR), Office of Financial Stability (OFS), Office of Inspector General (OIG), Small Business Lending Fund (SBLF), Special Office of Inspector General for the Troubled Asset Relief Program (SIGTARP), Treasury Forfeiture Fund (TFF), Treasury Inspector General for Tax Administration (TIGTA), and the DO policy offices.

As of September 30, 2013, the Department's seven operating bureaus were: Bureau of Engraving and Printing (BEP); Bureau of the Fiscal Service (Fiscal Service); Financial Crimes Enforcement Network (FinCEN); Internal Revenue Service (IRS); United States Mint (Mint); Office of the Comptroller of the Currency (OCC); and Alcohol and Tobacco Tax and Trade Bureau (TTB). Effective in October 2012, the Bureau of the Public Debt (BPD) and Financial Management Service (FMS) operating bureaus merged to form the new Fiscal Service operating bureau. Financial information of the legacy BPD and FMS operating bureaus were combined for purposes of disclosure within the notes to the financial statements. The administrative accounts of the legacy BPD and FMS bureaus will continue to be managed separately until Congress enacts legislation for a single appropriation to fund the newly consolidated Fiscal Service. The Department's financial statements reflect the reporting of its own entity activities comprising both the Department's operating bureaus and DO that are consolidated with the Department, which include appropriations received to conduct its operations and revenue generated from those operations. They also reflect the reporting of certain non-entity (custodial) functions it performs on behalf of the U.S. government and others. Non-entity activities include collecting certain federal revenue, servicing the federal debt, disbursing certain federal funds, and maintaining certain assets and liabilities for the U.S. government, as well as for other federal entities. The Department's reporting entity does not include the General Fund of the U.S. government (General Fund), which maintains receipt, disbursement, and appropriation accounts for all federal agencies.

Following generally accepted accounting principles (GAAP) for federal entities, the Department does not consolidate into its financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in

which it holds either a direct, indirect, or beneficial majority equity investment, unless they constitute a part of the reporting entity per GAAP. Even though some of the equity investments are significant, these entities meet the criteria of "bailed out" entities under paragraph 50 of Statement of Federal Financial Accounting Concepts (SFFAC) No. 2, *Entity and Display,* which directs that such "bailout" investments should not be consolidated into the Financial Report of the U.S. government, either in part or as a whole.

In addition, the Department made loans and investments in certain special purpose vehicles (SPV) under the American International Group, Inc. Investment Program, Public-Private Investment Program, and the Term Asset-Backed Securities Loan Facility. SFFAC No. 2, paragraphs 43 and 44, reference indicative criteria such as ownership and control over an SPV to carry out government powers and missions as criteria in the determination about whether the SPV should be classified as a federal entity. The Department has concluded that the lack of control over the SPVs is the primary basis for determining that none of the SPVs meet the criteria to be classified as a federal entity. As a result, the assets, liabilities, and results of operations of the SPVs are not included in the Department's financial statements. The Department has recorded the loans and investments in private entities and investments in SPVs in accordance with credit reform accounting, as discussed below. Additional disclosures regarding these SPV investments are included in Note 7.

### B. Basis of Accounting and Presentation

The financial statements have been prepared from the accounting records of the Department in conformity with accounting principles generally accepted in the United States for federal entities, and the Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements,* as revised. Accounting principles generally accepted for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB). FASAB is recognized by the American Institute of Certified Public Accountants as the official accounting standards-setting body for the U.S. government.

These financial statements consist of the Consolidated Balance Sheets, the Consolidated Statements of Net Cost, the Consolidated Statements of Changes in Net Position, the Combined Statements of Budgetary Resources, and the Statements of Custodial Activity. The statements and the related notes are prepared in a comparative form to present both fiscal years 2013 and 2012 information.

To provide additional clarity to its financial statements, the Department has presented more line items on the Consolidated Balance Sheets than are required by the guidance in OMB Circular No. A-136. The following summarizes what the Department's additional balance sheet line items represent in accordance with the financial statement guidelines of the OMB Circular No. A-136: (*i*) Advances to the Unemployment Trust Fund and Due From the General Fund represent other intra-governmental assets; *(ii*) Gold and Silver Reserves and the Reserve Position in the International Monetary Fund (IMF) represent other monetary assets; (*iii*) Loans and Interest Receivable represents other assets; (*iv*) Liability for Restoration of Federal Debt Principal and Interest and Due To the General Fund represent other intra-governmental liabilities; (*v*) Liability for Restoration of Federal Debt Principal and Interest, Certificates issued to the Federal Reserve, Allocation of Special Drawing Rights, Gold Certificates Issued to the Federal Reserve, Refunds Payable, Liability to Government Sponsored Enterprises, and the D.C. Pensions and Judicial Retirement Actuarial Liability represent other liabilities. For the Statement of Changes in Net Position, the following line items -- Accrued Interest and Discount on Debt, Accrued Interest on Restoration of Federal Debt Principal, and Transfers to the General Fund and Other -- represent other non-exchange financing sources per OMB Circular No. A-136 guidance.

Transactions and balances among the Department's entities have been eliminated from the Consolidated Balance Sheets, the Consolidated Statements of Net Cost, and the Consolidated Statements of Changes in Net Position. The Statements of Budgetary Resources are presented on a combined basis; therefore, intra-departmental transactions and balances have not been eliminated from these statements.

While these financial statements have been prepared from the accounting records of the Department in accordance with the formats prescribed by OMB, these financial statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same accounting records.

Intra-governmental assets and liabilities are those due from or to other federal entities. Intra-governmental earned revenues are collections or accruals of revenue from other federal entities, and intra-governmental costs are payments or accruals of expenditures to other federal entities.

The financial statements should be read with the realization that the Department is a component of the U.S. government, a sovereign entity and, accordingly, its liabilities not covered by budgetary resources cannot be liquidated without the legislative enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity. Liabilities represent the probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or funding is otherwise available to pay amounts due. Liabilities not covered by budgetary or other resources represent amounts owed in excess of available, congressionally appropriated funds or other amounts, and there is no certainty that the appropriations will be enacted.

Certain fiscal year 2012 activity and balances presented on the financial statements have been reclassified to conform to the presentation in the current year, the effects of which are immaterial.

There are numerous acronyms used throughout the notes herein as well as other sections of this Agency Financial Report (AFR). Refer to the *"Glossary of Acronyms"* located in the Appendix of this report for a complete listing of these acronyms and their definitions.

### C. Fund Balance

The Fund Balance is the aggregate amount of the Department's accounts with the U.S. government's central accounts from which the Department is authorized to make expenditures and pay liabilities. It is an asset because it represents the Department's claim to the U.S. government's resources. Fund balance is not equivalent to unexpended appropriations because it also includes non-appropriated revolving and enterprise funds, suspense accounts, and custodial funds such as deposit funds, special funds, and trust funds.

### D. Loans and Interest Receivable, Intra-Governmental

Intra-governmental entity loans and interest receivable from other federal agencies represent the principal and related interest receivable on loans issued by the Department, through FFB. No loan loss allowance or credit reform subsidy costs are recorded for loans purchased from federal agencies or for guaranteed loans made to non-federal borrowers because the outstanding balances (interest and principal) are guaranteed by those agencies.

Intra-governmental non-entity loans and interest receivable from other federal agencies represent the principal and related interest receivable on loans issued by the Department, through the Fiscal Service. The Department acts as an intermediary issuing these loans because the agencies receiving these loans lend these funds to third parties to carry out various programs of the U.S. government. Because of the Department's intermediary role in issuing these loans, the Department does not record a loan loss allowance related to these non-entity intra-governmental loans. Instead, loan loss allowances and subsidy costs are recognized by the ultimate lender, the federal agency that issued the loans to the public.

### E. Advances to the Unemployment Trust Fund

Advances are issued to the Department of Labor's (DOL) Unemployment Trust Fund from the General Fund for states to pay unemployment benefits. The Fiscal Service accounts for the advances issued on behalf of the General Fund. As

outlined in the United States Code (USC) 42 USC §1323, these advances bear an interest rate that is computed as the average interest rate as of the end of the calendar month preceding the issuance date of the advance for all interest-bearing obligations of the United States that form the public debt, to the nearest lower 1/8 of 1.0 percent. Interest on the advances is due on September 30th of each year. Advances are repaid by transfers from the Unemployment Trust Fund to the General Fund when the Secretary, in consultation with the Secretary of the DOL, determines that the balance in the Unemployment Trust Fund is adequate to allow repayment.

## F. Cash, Foreign Currency, and Other Monetary Assets

Substantially all of the Department's operating cash is non-entity government-wide cash held in depository institutions and Federal Reserve Bank (FRB) accounts. Agencies can deposit funds that are submitted to them directly into either a Federal Reserve Treasury General Account (TGA) or a local TGA depositary. The balances in these TGA accounts are transferred into the Federal Reserve Bank of New York's (FRBNY) TGA at the end of each day.

Operating cash of the U.S. government represents balances from tax collections, customs duties, other revenue, federal debt receipts, and other various receipts, net of cash outflows for budget outlays and other payments held in the FRBs and in foreign and domestic financial institutions. Outstanding checks net against operating cash until they clear the Federal Reserve System.

The FRBNY maintains the TGA which functions as the U.S. government's checking account for deposits and disbursements of public funds. Cash in the TGA is restricted for government-wide operations.

The Department's foreign currency investments having original maturities of three months or less are classified as cash equivalents. Special Drawing Rights (SDRs) holdings comprise most of the other monetary assets (refer to the accounting policy below entitled "Special Drawing Rights").

## G. Investments

### Investments in GSEs

The Department holds senior preferred stock and warrants for the purchase of common stock of two GSEs, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). These non-federal investment holdings are presented at their fair value. Changes in the valuation of these investments are recorded as non-entity exchange transactions on the Consolidated Statements of Net Cost. Dividends related to these investments are also recorded as non-entity exchange transactions, and accrued when declared.

The GSE Senior Preferred Stock Purchase Agreements (SPSPAs), entered into by the Department with each GSE when the GSEs were placed under conservatorship, require the Department to increase its investment in the GSEs' senior preferred stock if, at the end of any quarter, the Federal Housing Finance Agency (FHFA), acting as the conservator, determines that the liabilities of either GSE exceed its respective assets. As funding to the GSEs to pay their excess liabilities is appropriated directly to the Department, such payments are reported as entity expenses within the Economic Program on the Consolidated Statements of Net Cost and in the line item "Cumulative Results of Operations" on the Consolidated Balance Sheets. These payments also result in an increase to the non-entity investment in the GSEs' senior preferred stock, with a corresponding increase in Due To the General Fund, as the Department holds the investment on behalf of the General Fund.

### Investments in International Financial Institutions

The Department, on behalf of the United States, invests in Multilateral Development Banks (MDBs) to support poverty reduction, private sector development, transitions to market economies, and sustainable economic growth and development, thereby advancing U.S. economic, political, and commercial interests abroad. As a participating member

country, the Department, on behalf of the United States, provides a portion of the capital base of the MDBs, through subscriptions to capital, which allows the MDBs to issue loans at market-based rates to middle-income developing countries. These paid-in capital investments are non-marketable equity investments valued at cost on the Department's Consolidated Balance Sheets.

In addition, the Department, on behalf of the United States, contributes funding to MDBs to finance grants and extend credit to poor countries at below market-based interest rates. These U.S. contributions, also referred to as "concessional window" contributions, are reported as an expense on the Department's Consolidated Statements of Net Cost.

### Non-TARP Investment in American International Group, Inc.

The Department held American International Group, Inc. (AIG) common stock, a non-federal investment, on behalf of the General Fund until December 2012 when the remaining common stock held was sold. The AIG common stock was recorded at fair value. Changes in the valuation of these investments held represented non-entity, non-exchange transactions reported on the Statements of Custodial Activity. The increase or decrease in previously recognized revenue that resulted from gains or losses on sales of these investments represented non-entity, exchange transactions reported on the Statements of Custodial Activity rather than on the Consolidated Statements of Net Cost as the Department did not incur any costs related to these investments.

### Other Investments and Related Interest

ESF holds most of the Department's foreign currency investments. Other foreign currency denominated assets and investment securities are available-for-sale securities recorded at fair value. These holdings are normally invested in interest-bearing securities issued or held through foreign governments or monetary authorities. Interest on investments, amortization of premiums, and accretion of discounts are recognized on an accrual basis. Premiums and discounts are amortized or accreted over the life of the related investment security as an adjustment to yield using the effective interest method.

## H. Credit Program Receivables

The Department accounts for all of its TARP credit program receivables, including investments in common and preferred stock and warrants of public companies, loans, and loan guarantees or guaranty-like insurance activities, under the provisions of credit reform accounting pursuant to the Federal Credit Reform Act (FCRA) (Note 7). In addition to its TARP programs, the Department accounts for all other of its credit program receivables under the provisions of credit reform accounting, including the loans or equity securities associated with the Department's state and local Housing Finance Agency (HFA) initiative programs, SBLF program, CDFI program, and certain portions of the Department's participation in the IMF (Note 11).

To account for the Department's TARP and other credit program receivables, the Department applies the accounting provisions of SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees,* as amended by SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees,* and SFFAS No. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees.* SFFAS No. 2, as amended, which was promulgated as a result of FCRA, requires measurement of the asset or liability at the net present value of the estimated future cash flows. The cash flow estimates for each credit program transaction reflect the actual structure of the instruments. For each of these instruments, the Department estimates cash inflows and outflows related to the program over the estimated term of the instrument. Further, each cash-flow estimate reflects the specific terms and conditions of the program, technical assumptions regarding the underlying assets, risk of default or other losses, and other factors as appropriate. The measurement of assets within these programs is primarily derived from inputs which generally

represent market data and, when such data is not available, management's best estimate of how a market participant would assess the risk inherent in the asset.

The primary purpose of the FCRA is to measure the cost of federal credit programs, and to place the cost of such credit programs on a basis equivalent with other federal spending. FCRA requires that the ultimate costs of a credit program be calculated and the budgetary resources be obtained before incurring the direct loan obligations. To accomplish this, the Department first predicts or estimates the future performance of direct and guaranteed loans when preparing its annual budget. The data used for these budgetary estimates are re-estimated at the fiscal year-end to reflect changes in actual loan performance and actual interest rates in effect when the loans were issued. The re-estimated data reflect adjustments for market risks, asset performance, and other key variables and economic factors. The re-estimated data is then used to report the cost of the loans disbursed under the direct or guaranteed loan program as a "Program Cost" in the Department's Consolidated Statements of Net Cost.

Cash flows associated with the Department's credit programs generally include disbursements, repayments, repurchases, fees, recoveries, interest, dividends, proceeds from sales of instruments, borrowings from Treasury, negative subsidy, and the subsidy cost received from the program accounts. Security-level data and assumptions used as the basis for cash flow model forecasts and program performance are drawn from widely available market sources, as well as information published by investees. Key inputs to the cash flow forecasts include:

- Security characteristics such as unpaid principal balance, coupon rate, weighted-average loan age, issued bond balance, credit rating, maturity date, principal and interest payment schedules, priority of payments, and performance of underlying collateral
- Department actions as well as changes in legislation
- Forecast prepayment rates and default rates
- Forecast dividend payments
- Expected escrow conversion and return rates
- Default and recovery reports published by Moody's and Standard and Poor's
- Other third-party market sources

The recorded subsidy cost associated with each of the Department's credit programs represents the difference between the Department's projected costs of the program and the future cash flows anticipated to be received by the Department. The subsidy allowance specifically takes into consideration projected repayments and defaults and the projected cost of borrowings. The allowance is amortized to reflect the difference between projected and actual financing costs.

The Department's actions, as well as changes in legislation, may impact estimated future cash flows and related subsidy costs. The cost or cost savings of a modification is recognized in subsidy costs when the terms of a program are modified. Workouts are actions taken to maximize repayments of existing credit programs, and the expected effects on cash flows are included in the original estimate and re-estimates of the subsidy cost. Subsidy costs are also impacted by re-estimates which may occur as a result of updates to the original program subsidy cost estimates to reflect actual cash flows experience, as well as changes in forecasts of estimated future cash flows associated with the credit program.

### I. Taxes, Interest, and Other Receivables, Net

Federal taxes receivable, net, and the corresponding liability due to the General Fund, are not accrued until related tax returns are filed or assessments are made by the IRS and agreed to by either the taxpayer or the court. Additionally, the prepayments are netted against liabilities. Accruals are made to reflect penalties and interest on taxes receivable through the balance sheet date.

Taxes receivable consist of unpaid assessments (taxes and associated penalties and interest) due from taxpayers. The existence of a receivable is supported by a taxpayer agreement, such as filing of a tax return without sufficient payment, or a court ruling in favor of the IRS. An allowance for doubtful accounts is recorded to reflect an estimate of the portion of total taxes receivable deemed to be uncollectible.

Compliance assessments are unpaid assessments which neither the taxpayer nor a court has affirmed the taxpayer owes to the U.S. government. Examples include assessments resulting from an IRS audit or examination in which the taxpayer does not agree with the results. Compliance assessment write-offs consist of unpaid assessments for which the IRS does not expect further collections due to factors such as taxpayers' bankruptcy, insolvency, or death. Compliance assessments and related write-offs are not reported on the balance sheet. Statutory provisions require the accounts to be maintained until the statute for collection expires.

## J. Property, Plant, and Equipment, Net

### General

Property, plant, and equipment (PP&E) is composed of capital assets used in providing goods or services. It also includes assets acquired through capital leases, which are initially recorded at the amount recognized as a liability for the capital lease at its inception. PP&E is stated at full cost, including costs related to acquisition, delivery, and installation, less accumulated depreciation. Major alterations and renovations, including leasehold and land improvements, are capitalized, while maintenance and repair costs are charged to expense as incurred. Costs for construction projects are recorded as construction-in-progress until completed, and are valued at actual (direct) cost plus applied overhead and other indirect costs.

Internal-use software encompasses software design, development, and testing of projects adding significant new functionality and long-term benefits. Costs for developing internal-use software are accumulated in work-in-development until a project is placed into service, and testing and final acceptance are successfully completed. Once completed, the costs are transferred to depreciable property.

The Department leases land and buildings from the General Services Administration (GSA) to conduct most of its operations. Such leases do not meet capital lease requirements for financial reporting purposes. GSA charges a standard level user fee which approximates commercial rental rates for similar properties.

The Department's bureaus are diverse both in size and in operating environment. Accordingly, the Department's capitalization policy provides minimum capitalization thresholds which generally range from $25,000 to $50,000 for all property categories except for internal-use software thresholds which generally range from $50,000 to $250,000. The Department also uses a capitalization threshold for bulk purchases which generally ranges from $250,000 to $500,000 for non-manufacturing bureaus and $25,000 to $50,000 for manufacturing bureaus. Bureaus determine the individual items that comprise bulk purchases based on Departmental guidance. In addition, the Department's bureaus may expense individual and/or bulk purchases if they conclude that total period costs would not be materially distorted and the cost of capitalization is not economically feasible.

Depreciation is expensed on a straight-line basis over the estimated useful life of the asset with the exception of leasehold improvements and capital leases. Leasehold improvements are depreciated over the term of the lease or the useful life of the improvement, whichever is shorter. Capital leases are depreciated over the estimated life of the asset or term of the lease, whichever is shorter. Service life ranges (2 to 50 years) are wide due to the Department's diversity of PP&E. Land and land improvements, construction-in-progress, and internal-use software in development are not depreciated.

### Heritage Assets

Heritage assets are assets of historical significance. Multi-use heritage assets are those heritage assets for which the predominant use is general government operations. All acquisition, reconstruction, and betterment costs for the Treasury multi-use heritage asset buildings are capitalized as general PP&E and depreciated over their service life.

## K. Federal Debt and Interest Payable

Debt and associated interest are reported on the accrual basis of accounting. Interest costs are recorded as expenses when incurred, instead of when paid. Certain Treasury securities are issued at a discount or premium. These discounts and premiums are amortized over the term of the security using an interest method for all long-term securities and the straight-line method for short-term securities.

## L. Commitments and Contingencies

The Department, through FFB, makes loan commitments with federal agencies, or private sector borrowers whose loans are guaranteed by federal agencies, to extend credit for their own use (refer to the accounting policy above entitled "*Loans and Interest Receivable, Intra-Governmental*"). The Department establishes loan commitments when the Department and other parties fully execute promissory notes in which the Department becomes obligated to issue such loans immediately or at some future date. The Department reduces loan commitments when it issues the loans or when the commitments expire. Most obligations of the Department give a borrower the contractual right to a loan or loans immediately or at some point in the future within an agreed upon timeframe.

In accordance with SFFAS No. 5, *Accounting for Liabilities of the Federal Government*, the Department recognizes material contingent liabilities when the following criteria are met:

- A past event or exchange transaction has occurred
- A future cash outflow is probable
- A future cash outflow is measurable

The estimated liability recorded by the Department is either a specific amount or within a range of amounts. If some amount within the range is a better estimate than any other amount within the range, that amount is recognized. If no amount within the range is a better estimate than any other amount, the minimum amount in the range is recognized, and the range and a description of the nature of the contingency are disclosed. The Department follows this policy in recording a contingent liability, if any, related to the GSE SPSPA program (Note 8), and loss contingencies that may arise from claims, assessments, litigations, fines, penalties, and other sources (Note 27).

If one or more, but not all, of the above criteria for recognition are met, and there is a reasonable possibility of loss, the Department will disclose, if material, the nature of the contingent liability, along with a range of possible loss, if estimable, and a description of the nature of the contingency.

## M. Special Drawing Rights

The SDR is an international reserve asset created by the IMF to supplement its member countries' official reserves. Under its Articles of Agreement, the IMF may allocate SDRs to member countries in proportion to their IMF quotas. Pursuant to the *Special Drawing Rights Act of 1968*, as amended, the ESF holds all SDRs allocated to or otherwise acquired by the United States.

### Allocations and Holdings

The Department records the SDR holdings as part of "Cash, Foreign Currency, and Other Monetary Assets," and the SDR allocations as the "Allocation of Special Drawing Rights" liability when the IMF allocates SDRs to the Department. The

liabilities represent the amount that is payable in the event of liquidation of, or withdrawal by the United States from, the SDR department of the IMF or cancellation of the SDRs.

SDR holdings increase primarily as a result of IMF SDR allocations. SDR transactions are recorded as incurred. They include acquisitions and sales of SDRs, interest received on SDR holdings, interest charges on SDRs allocations, and valuation adjustments. The U.S. government receives remuneration in SDRs from the IMF based on claims on the IMF as represented by the U.S. Reserve Position. The remuneration is credited to the ESF which transfers to either the TGA account or a specified financing account an equivalent amount of dollars plus nominal interest. The allocations and holdings are revalued monthly based on the SDR valuation rate as calculated by the IMF, resulting in the recognition of unrealized gains or losses on revaluation that are reported on the Consolidated Statements of Net Cost.

### Certificates Issued to the Federal Reserve

The *Special Drawing Rights Act of 1968* authorizes the Secretary to issue certificates, not to exceed the value of SDR holdings, to the FRB in return for dollar amounts equal to the face value of certificates issued. The certificates may be issued to finance the acquisition of SDRs from other countries or to provide U.S. dollar resources to finance other ESF operations. Certificates issued are redeemed by the Department at such times and in such amounts as the Secretary may determine, and do not bear interest. Certificates issued to the FRB are reported at their face value which approximates their carrying value since, under the terms of the agreement, there is no set repayment date and no interest accrued while certificates remain outstanding.

## N. Refunds Payable

Refunds payable arise in the normal course of tax administration when it is determined that taxpayers have paid more than the actual taxes they owe. Amounts that the Department has concluded to be valid refunds owed to taxpayers are recorded as a liability entitled "Refunds Payable" on the Consolidated Balance Sheets, with a corresponding receivable from the General Fund included in the line entitled "Due From the General Fund."

## O. Federal Employee Benefits Payable – FECA Actuarial Liability

The *Federal Employees' Compensation Act* (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, and employees who have incurred a work-related injury or occupational disease. The FECA program is administered by the DOL which pays valid claims and subsequently seeks reimbursements from the Department for these paid claims. Generally, the Department reimburses the DOL within two to three years once funds are appropriated. The FECA liability consists of two components. The first component is based on actual claims paid by the DOL but not yet reimbursed by the Department. The second component is the estimated liability for future workers compensation as a result of past events. Both components are reported in "Other Liabilities" on the Consolidated Balance Sheets. These future workers' compensation estimates are generated by applying actuarial procedures developed to estimate the liability for FECA benefits. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases.

## P. Annual, Sick, and Other Leave

Annual and compensatory leave earned by the Department's employees, but not yet used, is reported as an accrued liability. The accrued balance is adjusted annually to reflect current pay rates. Any portion of the accrued leave for which funding is not available is recorded as an unfunded liability as reported in "Other Liabilities" on the Consolidated Balance Sheets. Sick and other leave are expensed as taken, and the Department does not record a liability for such amounts because employees do not vest in sick and other leave benefits.

## Q. Pension Costs, Other Retirement Benefits, and Other Post-Employment Benefits

### Federal Pension Costs, Other Retirement Benefits, and Other Post-Employment Benefits

The Department recognizes the full costs of its employees' pension benefits, including recognizing imputed costs for the difference between the estimated service cost and the contributions made by the Department. However, the assets and liabilities associated with these benefits are recognized by the Office of Personnel Management (OPM) rather than the Department.

Most employees of the Department hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS), to which the Department contributes between 7.0 percent and 7.5 percent of pay. On January 1, 1987, the Federal Employees' Retirement System (FERS) went into effect pursuant to Public Law (P.L.) 99-335. Employees hired after December 31, 1983 are automatically covered by FERS and Social Security. A primary feature of FERS is that it offers a savings plan to which the Department automatically contributes one percent of base pay and matches any employee contributions up to an additional four percent of base pay. For most employees hired after December 31, 1983, the Department also contributes the employer's matching share for Social Security. For the FERS basic benefit, the Department contributes 11.9 percent for regular FERS employees.

Similar to federal retirement plans, OPM, rather than the Department, reports the assets and liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program (FEHBP) and Federal Employees Group Life Insurance (FEGLI) Program. The Department reports the full cost of providing other retirement benefits (ORB). The Department also recognizes an expense and a liability for other post-employment benefits (OPEB), which includes all types of benefits, provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents. Additionally, one of the Department's bureaus, OCC, separately sponsors a defined life insurance benefit plan for current and retired employees, and is the administrator for a private defined benefit retirement plan, the Pentegra Defined Benefit Plan (PDBP), that provides certain health and life insurance benefits for certain of its retired employees who meet eligibility requirements.

### District of Columbia Pensions and Judicial Retirement Plans

Pursuant to Title XI of the *Balanced Budget Act of 1997*, as amended, the Department became responsible for certain District of Columbia (D.C.) retirement plans (Note 18). The actuarial cost method used to determine costs for the retirement plans is the Individual Entry Age Normal Funding Method, which approximates the methodology specified by the Aggregate Entry Age Normal Actuarial Cost Method. The actuarial liability is based upon long-term economic assumptions. The pension benefit costs incurred by the plans are included on the Consolidated Statements of Net Cost.

The economic assumptions used for the D.C. retirement plans differ from those used by the OPM for the following reasons: *(i)* the annual rate of salary increase assumptions are based on different plan member experience; *(ii)* the annual rate of inflation and cost-of-living adjustment assumptions are based on different statutory requirements (applicable Consumer Price Index and period of calculation); and *(iii)* for the annual rate of investment return assumption, OPM and the D.C. retirement plans use the same underlying yield curve but, unlike the D.C. Federal Pension Funds, OPM converts to a single equivalent rate.

## R. Revenue and Financing Sources

The Department's activities are financed either through exchange revenue it receives from others or through non-exchange revenue and financing sources (such as appropriations provided by the Congress and penalties, fines, and certain user fees collected). User fees primarily include collections from the public for the IRS costs to process installment agreements and accompanying photocopy and reproduction charges. Exchange revenues are recognized

when earned; i.e., goods are delivered or services are rendered. Revenue from reimbursable agreements is recognized when the services are provided. Non-exchange revenues are recorded when received or accrued when the Department has a legal claim through the respective collecting bureau. Appropriations used are recognized as financing sources when related expenses are incurred or assets are purchased.

The Department also incurs certain costs that are paid in total or in part by other federal entities, such as pension costs, the FEHBP, and any un-reimbursed payments made from the Treasury Judgment Fund on behalf of the Department. These subsidized costs are recognized on the Consolidated Statements of Net Cost, and the imputed financing for these costs is recognized on the Consolidated Statements of Changes in Net Position. As a result, there is no effect on net position. Other non-exchange financing sources, such as donations and transfers of assets without reimbursements, are also recognized for the period in which they occurred on the Consolidated Statements of Changes in Net Position.

The Department recognizes revenue it receives from disposition of forfeited property as non-exchange revenue on the Consolidated Statements of Changes in Net Position. The costs related to the Forfeiture Fund program are reported on the Consolidated Statements of Net Cost. The Treasury Forfeiture Fund is the special fund account for depositing non-tax forfeiture proceeds received pursuant to laws enforced or administered by law enforcement bureaus that participate in the Treasury Forfeiture Fund. Forfeited property balances are reported in "Other Assets" on the Consolidated Balance Sheets.

### S. Custodial Revenues and Collections

Non-entity revenue reported on the Department's Statements of Custodial Activity includes cash collected by the Department, primarily from taxes. It does not include revenue collected by other federal agencies, such as user fees and other receipts, which are remitted for general operating purposes of the U.S. government or are dedicated for certain trust funds. The Statements of Custodial Activity are presented on the "modified accrual basis." The Department recognizes revenues as cash is collected, and records a "non-cash accrual adjustment" representing the net increase or decrease during the reporting period in net revenue-related assets and liabilities, mainly taxes receivable. The Department also records as custodial revenue cash proceeds from the sale of stock and non-cash market valuation changes related to the U.S. government's holdings in AIG (Note 7).

### T. Permanent and Indefinite Appropriations

Permanent and indefinite appropriations are used to disburse tax refunds, income tax credits, and child tax credits. Refund payment funding is recognized as appropriations are used. Permanent indefinite authority for refund activity is available for an indefinite period of time in the amount necessary to cover the refund and/or credit. Tax refunds and credits are reported as a custodial activity of the Department, since they are, in substance, a custodial revenue-related activity resulting from taxpayer overpayments of their tax liabilities.

The Department also has two permanent and indefinite appropriations related to debt activity. One is used to pay interest on the public debt securities; the other is used to redeem securities that are matured, called, or eligible for early redemption. These accounts are not annual appropriations and do not have refunds. Debt activity appropriations are related to the Department's liability and are reported on the Department's Consolidated Balance Sheet. Permanent indefinite authority for debt activity is available for an indefinite period of time.

The Department also has permanent and indefinite appropriations to fund increases in the projected subsidy costs of credit programs as determined by the re-estimation process required by the FCRA. The Department's renewable energy project is also covered by permanent indefinite appropriations.

Additionally, the Department has other permanent and indefinite appropriations to make certain payments on behalf of the U.S. government. These appropriations are provided to make payments to the FRB for fiscal services provided, and to the financial institutions for services provided as financial agents of the U.S. government. They also include appropriations provided to make other disbursements on behalf of the U.S. government, including payments made to various parties as a result of certain claims and judgments rendered against the United States.

### U. Income Taxes

As an agency of the U.S. government, the Department is exempt from all income taxes imposed by any governing body, whether it is a federal, state, commonwealth, local, or foreign government.

### V. Use of Estimates

The Department has made certain estimates and assumptions relating to the reporting of assets, liabilities, revenues, expenses, and the disclosure of contingent liabilities to prepare its financial statements. Actual results may differ from these estimates. It is possible that the results of operations, cash flows or the financial position of the Department may be materially affected in future periods by adverse changes in the outlook for the key assumptions underlying management's estimates. Significant transactions subject to estimates include loan and credit program receivables, credit reform subsidy costs, investments in GSEs and other non-federal securities and related impairment, tax receivables, loan guarantees, depreciation, imputed costs, actuarial liabilities, cost and earned revenue allocations, as well as contingencies and any related recognized liabilities.

The Department accounts for all of its TARP and non-TARP credit program receivables in accordance with credit reform accounting (refer to the accounting policy above entitled "Credit Program Receivables," and Notes 7 and 11). These receivables are derived using credit reform modeling which is subject to the use of estimates and forecasts that have inherent uncertainty. The Department recognizes the sensitivity of credit reform modeling to slight changes in certain model assumptions such as general economic conditions, specific stock price volatility of the entities in which the Department has an equity interest, estimates of expected default, and prepayment rates. The "TARP Credit Program Receivables, Net" line item on the Consolidated Balance Sheets is reflective of relatively illiquid, troubled assets whose values are particularly sensitive to future economic conditions and other assumptions.

The Department uses regular review of model factors, statistical modeling, and annual re-estimates to reflect the most accurate cost of the credit programs to the U.S. government. The purpose of re-estimates is to update original program subsidy cost estimates to reflect actual cash flow experience as well as changes in forecasts of future cash flows. Forecasts of future cash flows are updated based on actual program performance to date, additional information about the portfolio, additional publicly available relevant historical market data on securities performance, revised expectations for future economic conditions, and enhancements to cash flow projection methods.

The "Liability to Government Sponsored Enterprises" line item on the Consolidated Balance Sheets related to the SPSPAs represents the recognized contingency, if any, related to the funding commitment. It is predicated on the probable future occurrence of an excess of liabilities and minimum capital reserve amounts, as defined, over the assets of either GSE at the end of any reporting quarter. The Department performs annual valuations, as of September 30, on the preferred stock and warrants in an attempt to provide a "sufficiently reliable" estimate of the outstanding commitments in order for the Department to record the remaining liability in accordance with SFFAS No. 5. The occurrence of future deficits, which ultimately determines the Department's liability to the GSEs, is most sensitive to future changes in the housing price index.

The valuation of the "Investments in Government Sponsored Enterprises" line item on the Consolidated Balance Sheets incorporates various forecasts, projections and cash flow analyses to develop an estimate of the asset's fair value. Any

changes in valuation, including impairment, are recorded and disclosed in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*. Since the valuation is an annual process, the change in valuation of the preferred stock and warrants are deemed usual and recurring. The GSEs contingent liability, if any, is assessed annually and recorded at the gross estimated amount, without considering the increase in senior preferred stock liquidation preference, or future dividend payments, or future commitment fees, due to the uncertainties involved. Note 8 includes a detailed discussion of the results of the asset valuation and any liability recorded.

Estimation of such complex and long-duration receivables, investments, and contingencies is subject to uncertainty. It is possible that new developments will adversely impact the value of receivables, investments, and contingencies, as well as ultimate amounts required to be funded by the Department.

### W. Other-Than-Temporary Impairments

A decline in the market value (either due to credit, price or currency) of any investment below cost that is deemed to be other-than-temporary is accounted for as an impairment, and the carrying value is reduced to fair value for financial reporting purposes. To determine whether an impairment is other-than-temporary, the Department considers whether it has the ability and intent to hold the investment until a market price recovery, and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary.

### X. Credit, Market and Foreign Currency Risk

Credit risk is the potential, no matter how remote, for financial loss from a failure of a borrower or counterparty to perform in accordance with underlying contractual obligations. The Department takes on possible credit risk when it makes direct loans or credits to foreign entities or becomes exposed to institutions which engage in financial transactions with foreign countries (Note 10). The following programs of the Department entail credit risk: monetary assets held; committed but undisbursed direct loans; funding commitment to the GSEs; GSE obligations obtained under the HFA initiative (the New Issue Bond Program and Temporary Credit Liquidity Program); investments, loans, and other credit programs of the TARP; non-TARP credit programs including the CDFI Fund, SBLF, and certain portions of the Department's participation in the IMF; and the Terrorism Risk Insurance Program.

Except for the Terrorism Risk Insurance Program, the Department's activities focus on the underlying problems in the credit markets, and the ongoing instability in those markets exposes the Department to potential costs and losses. The extent of the risk assumed by the Department is described in more detail in the notes to the financial statements and, where applicable, is factored into credit reform models and reflected in fair value measurements (Notes 7, 8, and 11).

For Emergency Economic Stabilization Act (EESA) programs, the statute requires that budgetary costs of the troubled assets and guarantees of troubled assets be calculated by adjusting the discount rate for market risks. Within the TARP programs, the Department invested in many assets that would traditionally be held by private investors, and their valuation would inherently include market risk. Accordingly, for all TARP direct loans, equity investments, and other credit programs, the Department calculates a Market Risk Adjusted Discount Rate (MRADR). The Department's cost estimates for the TARP programs are adjusted to reflect the additional return required by the market to compensate for variability around the expected losses reflected in the cash flows. Under SFFAS No. 2, including market risk in the cash flow estimates is consistent with the type of assets being valued. The inclusion of the MRADR is the mechanism for deriving a fair value of the assets. As directed by Congress, a MRADR is also used in the credit reform model for certain portions of the Department's participation in the IMF.

The Department faces certain risks and uncertainties as a result of holding securities denominated in foreign currency. The price of holdings of such securities may widely fluctuate as a result of volatility in foreign currency markets and changes in real and perceived credit of the Department's counterparties.

### Y. Funds from Dedicated Collections

The Department accounts for revenues and other financing sources for funds from dedicated collections (FDC) separately from other funds. Such funds are financed by specifically identified revenues provided to the U.S. government by non-federal sources, often supplemented by federal and other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes. In fiscal year 2013, the Department adopted SFFAS No. 43, *Funds from Dedicated Collections: Amending SFFAS No. 27, Identifying and Reporting Earmarked Funds*. Specifically, SFFAS No. 43 specifies the following criteria for purposes of designating funds as dedicated collections: (*i*) a statute committing the U.S. government to use specifically identified revenues and/or other financing sources that are originally provided to the U.S. government by a non-federal source only for designated activities, benefits, or purposes; (*ii*) explicit authority for the fund to retain revenues and/or other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; (*iii*) a requirement to account for and report on the receipt, use, and retention of the revenues and/or other financing sources that distinguishes the fund from the U.S. government's general revenues; and (iv) for funds comprised of both federal and non-federal sources, such funding is predominantly non-federal, or the non-federal funding is material to the Department's financial statements. See Note 24, *Funds from Dedicated Collections,* for further discussion of this change in accounting principle.

### Z. Allocation Transfers

The Department is a party to allocation transfers with other federal agencies as both a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent. Parent federal agencies report both the proprietary and budgetary activity and the child agency does not report any financial activity related to budget authority allocated from the parent federal agency to the child federal agency. However, OMB guidance (Circular No. A-136, II.4.2, question 5, for three exceptions) requires the child to report the activity in certain situations.

The Department allocates funds, as the parent, to the Department of Energy. Also, the Department receives allocation transfers, as the child, from the Agency for International Development, Department of Health and Human Services, Department of Transportation, Executive Office of the President, and General Services Administration.

### AA. Fiduciary Activities

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment, and disposition by the U.S. government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the U.S. government must uphold. Fiduciary cash and other assets are not assets of the U.S. government. These activities are not reported in the Department's consolidated financial statements, but instead are reported in Note 26.

### AB. Related Parties and Other Entities

The primary "related parties" with whom the Department conducts business are other federal agencies, mainly through the normal lending activities of the Fiscal Service and the FFB. These activities are disclosed in the consolidated financial statements. Additionally, the Secretary serves on the FHFA Oversight Board, and consults with the Director of FHFA on matters involving Fannie Mae and Freddie Mac. This provides the Department an advisory role in the FHFA's actions as the conservator for Fannie Mae and Freddie Mac. The Department has no transactions with FHFA, but rather transacts

directly with the GSEs. The Department also utilizes the services of the FRBs to execute a variety of transactions on behalf of the Fiscal Service and the ESF. Due to the magnitude and variety of services provided, the following provides an overview of the FRBs' purpose, governance, and the various services provided on behalf of the Department.

### Federal Reserve System

The Federal Reserve System (FR System) was created by Congress under the Federal Reserve Act of 1913. The FR System consists of the Federal Reserve Board of Governors (Board), the Federal Open Market Committee (FOMC), and the FRBs. Collectively, the FR System serves as the nation's central bank and is responsible for formulating and conducting monetary policy, issuing and distributing currency (Federal Reserve Notes), supervising and regulating financial institutions, providing nationwide payments systems (including large-dollar transfers of funds, automated clearinghouse (ACH) operations, and check collection), providing certain financial services to federal agencies and fiscal principals, and serving as the U.S. government's bank. Monetary policy includes actions undertaken by the FR System that influence the availability and cost of money and credit as a means of helping to promote national economic goals. The FR System also conducts operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC to carry out its central bank responsibilities. The FR System is not included in the federal budget. It is considered an independent central bank, and its decisions are not ratified by the executive branch of the U.S. government.

The Department interacts with the FRBs in a variety of ways, including the following:

- The FRBs serve as the Department's fiscal agent and depositary, executing banking and other financial transactions on the Department's behalf. The Department reimburses the FRBs for these services, the cost of which is included on the Consolidated Statements of Net Costs
- The FRBs hold Treasury and other federal securities in the FRBs' System Open Market Account (SOMA) for the purpose of conducting monetary policy (Note 16)
- The FRBs hold gold certificates issued by the Department in which the certificates are collateralized by gold (Note 6)
- The FRBs hold SDR certificates issued by the Department which are collateralized by SDRs (Notes 5 and 12)
- The FRBs are required by Board policy to transfer their excess earnings to the Department on behalf of the U.S. government (Notes 13 and 23)

The Department also consults with the FR System on matters affecting the economy and certain financial stability activities (Notes 7). The above financial activities involving the Department are accounted for and disclosed in the Department's consolidated financial statements. In accordance with SFFAC No. 2, *Entity and Display*, the FR Systems' assets, liabilities, and operations are not consolidated into the Department's financial statements.

### Federal Reserve System Structure

The Board is an independent organization governed by seven members who are appointed by the President and confirmed by the Senate. The full term of a Board member is 14 years, and the appointments are staggered so that one term expires on January 31 of each even-numbered year. The Board has a number of supervisory and regulatory responsibilities for institutions including, among others, state-chartered banks that are members of the FR System, bank holding companies, and savings and loan holding companies. In addition, the Board has general supervisory responsibilities for the 12 FRBs, and issues currency (Federal Reserve Notes) to the FRBs for distribution.

The FOMC is comprised of the seven Board members and five of the 12 FRB presidents, and is charged with formulating and conducting monetary policy primarily through open market operations (the purchase and sale of certain securities in the open market), the principal tool of national monetary policy. These operations affect the amount of reserve balances available to depository institutions, thereby influencing overall monetary and credit conditions. The 12 FRBs are

chartered under the Federal Reserve Act, which requires each member bank to own the capital stock of its FRB. Supervision and control of each FRB is exercised by a board of directors, of which three are appointed by the Board of Governors of the FR System, and six are elected by their member banks.

The FRBs participate in formulating and conducting monetary policy, distribute currency and coin, and serve as fiscal agents for the Department, other federal agencies and fiscal principals. Additionally, the FRBs provide short-term loans to depository institutions and loans to participants in programs or facilities with broad-based eligibility in unusual and crucial circumstances when approved by the Board.

### Federal Reserve System Assets and Liabilities

The FRBs hold Treasury and other securities in the SOMA for the purpose of conducting monetary policy. Treasury securities held by the FRBs totaled $1.9 trillion and $1.6 trillion at September 30, 2013 and 2012, respectively (Note 16). These assets are generally subject to the same market (principally interest-rate) and credit risks as other financial instruments. In the open market, the FR System purchases and sells Treasury securities as a mechanism for controlling the money supply.

The FRBs have deposit liabilities with Treasury and depository institutions. The FRBs issue Federal Reserve Notes, the circulating currency of the United States, which are collateralized by the Treasury securities and other assets held by the FRBs.

Financial and other information concerning the FR System, including financial statements for the Board and the FRBs, may be obtained at http://www.federalreserve.gov.

### FRB Residual Earnings Transferred to the Department

FRBs generate income from interest earned on securities, reimbursable services provided to federal agencies, and the provision of priced services to depository institutions as specified by the Monetary Control Act of 1980. Although the FRBs generate earnings from carrying out open market operations, via the earnings on securities held in the SOMA account, their execution of these operations is for the purpose of accomplishing monetary policy rather than generating earnings. Each FRB is required by Board policy to transfer to the Department its residual (or excess) earnings after providing for the cost of operations, payment of dividends, and reservation of an amount necessary to equate surplus with paid-in capital. These residual earnings may vary due to, among other things, changes in the SOMA balance levels that may occur in conducting monetary policy. In the event of losses, or a substantial increase in capital, an FRB will suspend its payments to the U.S. Treasury until such losses or increases in capital are recovered through subsequent earnings. The FRB residual earnings of $75.8 billion and $82.0 billion for fiscal years ended September 30, 2013 and 2012, respectively, are reported as custodial revenues on the Department's Statements of Custodial Activity. They constituted 2.6 percent and 3.1 percent of the Department's total custodial revenues collected in fiscal years 2013 and 2012, respectively. "Taxes, Interest and Other Receivables, Net" includes a receivable for FRB's residual earnings which represents the earnings due to the U.S. Treasury as of September 30, but not collected by the U.S. Treasury until after the end of the month (Note 13).

# 2. FUND BALANCE

As of September 30, 2013 and 2012, Fund Balance consisted of the following (in millions):

| | | 2013 | | 2012 |
|---|---|---|---|---|
| Appropriated Funds | $ | **358,611** | $ | 315,690 |
| Revolving Funds | | **7,016** | | 26,698 |
| Special Funds | | **1,403** | | 976 |
| Clearing Funds | | **503** | | 681 |
| Deposit Funds | | **115** | | 163 |
| Other Funds (principally Receipt, Suspense, and Trust Funds) | | **172** | | 138 |
| **Total Fund Balance** | $ | **367,820** | $ | 344,346 |

Appropriated funds consist of amounts appropriated annually by Congress to fund the operations of the Department.

Revolving funds are used for continuing cycles of business-like activity in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations. A public enterprise revolving fund is an account that is authorized by law to be credited with offsetting collections from the public, and those monies are used to finance operations. Also included in revolving funds are the working capital fund and financing funds. The working capital fund is a fee-for-service fund established to support operations of components within the Department. The financing funds relate to credit reform activities.

Special funds include funds designated for specific purposes, including the disbursement of non-entity monies received in connection with the Presidential Election Campaign. Clearing funds represent reconciling differences with the Department's balances as reported in the U.S. government's central accounts. These fund accounts temporarily hold unidentifiable general, special, or trust fund collections that belong to the U.S. government until they are classified to the proper receipt or expenditure account by the federal entity. Deposit funds are accounts that record amounts held temporarily by the U.S. government until ownership is determined, and include seized cash and other amounts received as an advance that are not accompanied by an order.

### STATUS OF FUND BALANCE

As of September 30, 2013 and 2012, the status of the fund balance consisted of the following (in millions):

| | | 2013 | | 2012 |
|---|---|---|---|---|
| Unobligated Balance – Available | $ | **294,009** | $ | 255,227 |
| Unobligated Balance - Not Available | | **76,341** | | 84,371 |
| Unpaid Obligations | | **233,437** | | 252,169 |
| Subtotal | | **603,787** | | 591,767 |
| Adjustment for Borrowing Authority | | **(103,333)** | | (109,930) |
| Adjustment for ESF | | **(101,777)** | | (103,763) |
| Adjustment for IMF | | **(28,197)** | | (32,093) |
| Adjustment for Intra-Treasury Investments | | **(8,334)** | | (7,251) |
| Adjustment for Authority Unavailable for Obligations | | **3,790** | | 3,706 |
| Other Adjustments | | **1,884** | | 1,910 |
| **Total Status of Fund Balance** | $ | **367,820** | $ | 344,346 |

Portions of the Unobligated Balance Not Available, as shown on the Combined Statement of Budgetary Resources, include amounts appropriated in prior fiscal years that are not available to fund new obligations. However, such amounts may be used for upward and downward adjustments for existing obligations in future years. The Unpaid Obligations represent amounts designated for payment of goods and services ordered but not received, or goods and services received but for which payment has not yet been made.

Since the following line items do not post to budgetary status accounts, the following adjustments are required to reconcile the budgetary status to the non-budgetary Fund Balance as reported on the Consolidated Balance Sheets:

- Adjustments for Borrowing Authority – Borrowing authority is in budgetary status but not in the Fund Balance
- Adjustments for ESF – ESF investments in Treasury securities (which are eliminated on the consolidated balance sheets), foreign investments, SDR holdings, and related balances that meet the criteria for reporting as part of budgetary resources are reported on the Statement of Budgetary Resources; however, they are not a component of the Fund Balance as they represent invested funds
- Adjustments for IMF – The reserve position in the IMF, loans and interest receivable, and related balances that meet the criteria for reporting as part of budgetary resources are reported on the Combined Statement of Budgetary Resources; however, they are not a component of the Fund Balance as they represent other monetary assets
- Adjustments for Intra-Treasury Investments – Budgetary resources include Treasury security investments; however, the money has been moved from the Fund Balance asset account to Investments, which is eliminated on the consolidated balance sheets
- Adjustment for Authority Unavailable for Obligations – Resources unavailable for obligations reduced the budgetary resources, however, they do not impact the Fund Balance

As of September 30, 2013 and 2012, the Department had no budgetary authority in the Fund Balance that was specifically withheld from apportionment by the OMB. The balances in non-entity funds, such as certain deposit funds (e.g., seized cash), are being held by the Department for the public or for another federal entity, such as the General Fund. Such funds have an offsetting liability equal to the Fund Balance. See Note 12 regarding restrictions related to the line of credit held on the U.S. quota in the IMF.

# 3. LOANS AND INTEREST RECEIVABLE – INTRA-GOVERNMENTAL

### ENTITY INTRA-GOVERNMENTAL

The Department, through FFB, issues loans to federal agencies for the agencies' own use or for the agencies to loan to private sector borrowers whose loans are guaranteed by the federal agencies. FFB is a wholly-owned Government corporation that operates under the general supervision of the Secretary, and has its own broad statutory authority to finance any obligations that are issued, sold, or guaranteed by federal agencies. For agencies that have the statutory authority to borrow in the market, but not from Treasury through the Fiscal Service (refer to the Non-Entity Intra-Governmental section below), FFB uses its statutory authority to make these loans directly to federal agencies.

FFB also uses its statutory authority to finance direct or indirect federally guaranteed obligations which, as a matter of long-standing Federal credit policy, is the least expensive and most efficient method of financing these credit-risk obligations when compared to private sector lendor financing. When a federal agency has to honor its guarantee because a private sector borrower defaults, the federal agency that guaranteed the loan must obtain an appropriation or use other resources to repay the FFB.

All principal and interest on FFB loans to federal agencies and private sector borrowers are, or have a commitment to be, backed by the full faith and credit of the U.S. government. The Department has not recognized any credit-related losses on its loans, nor has the Department recorded an allowance for uncollectible intra-governmental loans.

As of September 30, 2013 and 2012, entity intra-governmental loans (issued by the FFB) and interest receivable consisted of the following (in millions):

| | **Loans Receivable** | **Interest Receivable** | **2013 Total** | Loans Receivable | Interest Receivable | 2012 Total |
|---|---|---|---|---|---|---|
| Department of Agriculture | **$ 40,638** | **$ 22** | **$ 40,660** | $ 37,750 | $ 343 | $ 38,093 |
| United States Postal Service[1] | **15,000** | **49** | **15,049** | 15,000 | 48 | 15,048 |
| Department of Energy | **14,034** | **52** | **14,086** | 12,171 | 35 | 12,206 |
| General Services Administration | **1,733** | **31** | **1,764** | 1,819 | 32 | 1,851 |
| Department of Education | **1,133** | **8** | **1,141** | 929 | 6 | 935 |
| Other Agencies | **86** | **-** | **86** | 194 | 1 | 195 |
| **Total Entity Intra-governmental** | **$ 72,624** | **$ 162** | **$ 72,786** | $ 67,863 | $ 465 | $ 68,328 |

*[1] The United States Postal Service (USPS) experienced an operating deficit in both fiscal years 2013 and 2012. The Department, Congress, and other stakeholders are aware of the current and long-term financial issues of the USPS. Congress is considering legislative solutions for returning the USPS to financial stability.*

### NON-ENTITY INTRA-GOVERNMENTAL

The Department, through the Fiscal Service, accounts for and reports on the principal borrowings from and repayments to the General Fund for various funds managed by other federal agencies, as well as the related interest due to the General Fund. These federal agencies are statutorily authorized to borrow from the General Fund, through the Fiscal Service, to make loans for a broad range of purposes, such as education, housing, farming, and small business support.

As of September 30, 2013 and 2012, non-entity intra-governmental loans (issued by the Fiscal Service) and interest receivable due to the General Fund consisted of the following (in millions):

| | **Loans Receivable** | **Interest Receivable** | **2013 Total** | Loans Receivable | Interest Receivable | 2012 Total |
|---|---|---|---|---|---|---|
| Department of Education | **$ 851,295** | **$ -** | **$ 851,295** | $ 714,368 | $ - | $ 714,368 |
| Department of Agriculture | **61,777** | **1** | **61,778** | 55,787 | - | 55,787 |
| Department of Housing and Urban Development | **26,079** | **-** | **26,079** | 11,567 | - | 11,567 |
| Department of Homeland Security | **24,076** | **-** | **24,076** | 18,073 | - | 18,073 |
| Export-Import Bank of the U.S. | **18,102** | **-** | **18,102** | 11,301 | - | 11,301 |
| Small Business Administration | **8,088** | **-** | **8,088** | 7,920 | - | 7,920 |
| Department of Transportation | **6,958** | **-** | **6,958** | 5,193 | - | 5,193 |
| Department of Labor | **6,027** | **-** | **6,027** | 6,065 | - | 6,065 |
| National Credit Union Administration | **4,725** | **2** | **4,727** | 3,200 | 2 | 3,202 |
| Department of Energy | **3,967** | **26** | **3,993** | 3,616 | 20 | 3,636 |
| Railroad Retirement Board | **3,587** | **42** | **3,629** | 3,402 | 44 | 3,446 |
| Overseas Private Investment Corporation | **2,293** | **-** | **2,293** | 2,241 | - | 2,241 |
| Department of Defense | **1,175** | **-** | **1,175** | 953 | - | 953 |
| Other Agencies | **2,553** | **-** | **2,553** | 2,224 | - | 2,224 |
| **Total Non-Entity Intra-governmental** | **$ 1,020,702** | **$ 71** | **$ 1,020,773** | $ 845,910 | $ 66 | $ 845,976 |
| **Total Intra-governmental Loans and Interest Receivable (Entity and Non-Entity)** | **$ 1,093,326** | **$ 233** | **$ 1,093,559** | $ 913,773 | $ 531 | $ 914,304 |

# 4. DUE FROM THE GENERAL FUND AND DUE TO THE GENERAL FUND

The General Fund consists of assets and liabilities used to finance the daily and long-term operations of the U.S Government, as a whole. It also includes accounts used in the management of the Budget of the U.S. government.

General Fund assets, such as loans and interest receivable, cash, and investments in the GSEs, are held and managed by the Department on behalf of the U.S. government, and constitute resources available to meet the operating needs of the U.S. government. These Department-managed assets are separately reported on the Consolidated Balance Sheets, with a corresponding amount reported as Due To the General Fund that represents a liability to reflect assets owed by the Department to the General Fund.

General Fund liabilities, primarily federal debt and liability for restoration of Federal Debt Principal and Interest, are obligations of the U.S. government. These Department-managed liabilities are separately reported on the Consolidated Balance Sheets, with a corresponding amount reported as Due From the General Fund that represents a receivable, or future funds required of the General Fund to repay borrowings from the public and other federal agencies.

As of September 30, 2013 and 2012, the General Fund assets and liabilities had a negative net position of $15.7 trillion and $14.9 trillion, respectively. This negative net position represents the amount needed by the U.S. government, through a combination of future tax collections and/or continued borrowing from the public and federal agencies to meet its obligations.

As of September 30, 2013 and 2012, Due From the General Fund included the following non-entity assets (in millions):

| **Liabilities Requiring Funding from the General Fund** | **2013** | 2012 |
|---|---|---|
| Federal Debt and Interest Payable – Held by the Public (Note 16) | **$ 12,003,030** | $ 11,307,583 |
| Federal Debt and Interest Payable - Intra-governmental (Note 16) | **4,837,436** | 4,861,005 |
| Liability for Restoration of Federal Debt Principal and Interest – Due to the Public (Note 16) | **120,356** | - |
| Liability for Restoration of Federal Debt Principal and Interest - Intra-governmental (Note 16) | **128,272** | - |
| Refunds Payable (Note 23) | **2,914** | 3,255 |
| Adjustment for Eliminated Liabilities | **31,349** | 30,336 |
| **Total Due From the General Fund** | **$ 17,123,357** | $ 16,202,179 |

The Adjustment for Eliminated Liabilities principally represents investments in U.S. government securities held by the Department's reporting entities that were eliminated against Federal Debt and Interest Payable Intra-governmental.

As of September 30, 2013 and 2012, Due To the General Fund included the following non-entity liabilities (in millions):

| **Assets to be Distributed to the General Fund** | | **2013** | | 2012 |
|---|---|---|---|---|
| Fund Balance | **$** | **434** | $ | 406 |
| Loans and Interest Receivable - Intra-governmental (Note 3) | | **1,020,773** | | 845,976 |
| Advances to the Unemployment Trust Fund | | **29,696** | | 32,932 |
| Cash Due to the General Fund (Held by the Department) (Note 5) | | **82,865** | | 79,245 |
| Accounts Receivable - Intra-governmental | | **362** | | 455 |
| Foreign Currency | | **60** | | 64 |
| Custodial Gold without certificates and Silver held by the U.S. Mint | | **25** | | 25 |
| Investments in Government Sponsored Enterprises (Note 8) | | **140,221** | | 109,342 |
| Non-TARP Investments in American International Group, Inc. (Note 7) | | **-** | | 2,611 |
| Credit Reform Downward Subsidy Re-estimates | | **8,213** | | 10,444 |
| Loans and Interest Receivable | | **88** | | 94 |
| Taxes and Other Non-Entity Receivables Due to General Fund | | **38,519** | | 41,421 |
| Adjustment for Eliminated Assets | | **96,167** | | 134,737 |
| **Total Due To the General Fund** | **$** | **1,417,423** | $ | 1,257,752 |

*The assets to be distributed to the General Fund do not represent all of the non-entity assets managed by the Department. See Note 15 for all non-entity assets held by the Department.*

The Fund Balance reported above represents the non-entity funds held by the Department on behalf of the General Fund. It is used to administer programs such as the Presidential Election Campaign and payments for Legal Services Corporation and thus not available for general use by the Department.

Advances have been issued from the General Fund to the DOL's Unemployment Trust Fund to disburse to states for unemployment benefits. The Department transfers repayment of these advances to the General Fund.

The non-entity Credit Reform Downward Subsidy Re-estimates result from changes in forecasted future cash flows of the equity investments and direct loans under the Department's TARP and non-TARP credit programs (See Note 1H and 1V).

Taxes and Other Non-Entity Receivables Due to General Fund primarily represents IRS-related federal taxes receivable (Note 13).

The Adjustment for Eliminated Assets principally represents loans and interest payable owed by the Treasury reporting entities, which were eliminated against Loans and Interest Receivable Intra-governmental held by the Fiscal Service.

# 5. Cash, Foreign Currency, and Other Monetary Assets

Cash, Foreign Currency, and Other Monetary Assets held as of September 30, 2013 and 2012 were as follows (in millions):

| | 2013 | 2012 |
|---|---|---|
| **Entity:** | | |
| Cash | **$ 69** | $ 75 |
| Foreign Currency and Foreign Currency Denominated Assets | **10,125** | 10,524 |
| Other Monetary Assets: | | |
| Special Drawing Right Holdings | **54,972** | 55,240 |
| U.S. Dollars Held in Cash by the IMF | **132** | 137 |
| **Total Entity** | **65,298** | 65,976 |
| | | |
| **Non-Entity:** | | |
| Operating Cash of the U.S. government | **82,742** | 79,195 |
| Foreign Currency | **60** | 64 |
| Miscellaneous Cash Held by All Treasury Reporting Entities | **406** | 316 |
| **Total Non-Entity** | **83,208** | 79,575 |
| **Total Cash, Foreign Currency, and Other Monetary Assets** | **$ 148,506** | $ 145,551 |

Non-entity operating and other miscellaneous cash due to the General Fund which was held by the Department consisted of the following as of September 30, 2013 and 2012 (in millions):

| | 2013 | 2012 |
|---|---|---|
| Operating Cash - FRB Account | **$ 88,386** | $ 85,446 |
| Outstanding Checks | **(5,644)** | (6,251) |
| **Total Operating Cash of the U.S. government** | **82,742** | 79,195 |
| Miscellaneous Cash | **192** | 128 |
| **Subtotal** | **82,934** | 79,323 |
| Amounts Due to the Public | **(69)** | (78) |
| **Total Cash Due to the General Fund (Note 4)** | **$ 82,865** | $ 79,245 |

## ENTITY

Entity cash, foreign currency, and other monetary assets principally include foreign currency, foreign currency denominated assets (FCDAs), and SDRs. These assets are valued as of September 30, 2013 and 2012 using current exchange rates plus accrued interest.

### Foreign Currency Denominated Assets

FCDA holdings are normally invested in interest-bearing securities issued by or held through foreign governments or monetary authorities. FCDA holdings include securities whereby the FRBNY, on behalf of the ESF, enters into transactions to purchase foreign-currency-denominated government-debt securities. These government-debt securities are under agreements to resell for which the accepted collateral is the debt instruments, denominated in euros, and is issued or guaranteed in full by European governments. These agreements are subject to daily margining requirements. FCDAs with original maturities of three months or less, including securities purchased under agreement to resell, were valued at $10.1 billion and $10.5 billion as of September 30, 2013 and 2012, respectively.

### Special Drawing Rights

The SDR is an international reserve asset created by the IMF to supplement existing reserve assets. The IMF has allocated new SDRs on several occasions to members participating in the IMF's SDR department. The SDR derives its value as a reserve asset essentially from the commitments of participants to hold and accept SDRs and to honor various obligations connected with their proper functioning as a reserve asset. Pursuant to the *Special Drawing Rights Act of*

*1968*, as amended, the Department issued certificates to the Federal Reserve, valued at $5.2 billion which were reported as a liability on the Consolidated Balance Sheets as of September 30, 2013 and 2012. The certificates were issued to finance the ESF's acquisition of SDRs from other countries or to provide U.S. dollar resources for financing other ESF operations.

On a daily basis, the IMF calculates the value of the SDR using the market value in terms of the U.S. dollar from weighted amounts of each of four freely usable currencies, as defined by the IMF. These currencies are the U.S. dollar, the European euro, the Japanese yen, and the British pound sterling. The U.S. SDR holdings (assets resulting from various SDR-related activities including remuneration on the U.S. reserve position) and allocations from the IMF (liabilities of the United States coming due only in the event of a liquidation of, or United States withdrawal from, the SDR department of the IMF, or cancellation of SDRs) are revalued monthly based on the SDR valuation rate calculated by the IMF.

Pursuant to the IMF Articles of Agreement, SDR holdings and allocations acquired by the United States are permanent resources or liabilities unless:

- cancelled by the Board of Governors pursuant to an 85.0 percent majority decision of the total voting power of IMF members;
- the SDR department of the IMF is liquidated;
- the IMF is liquidated; or
- the United States chooses to withdraw from the IMF or terminate its participation in the SDR department

Except for the payment of interest and charges on SDR allocations to the United States, the payment of the U.S. commitment related to SDR allocations is conditional on events listed above, in which the United States has a substantial or controlling voice. The United States has received no SDR allocations since 2009.

As of September 30, 2013 and 2012, the total amount of SDR holdings of the United States was the equivalent of $55.0 billion and $55.2 billion, respectively. As of September 30, 2013 and 2012, the total value of SDR allocations to the United States was the equivalent of $54.2 billion and $54.5 billion, respectively.

## NON-ENTITY

Non-entity cash, foreign currency, and other monetary assets principally include the Operating Cash of the U.S. government which is managed by the Department. Also included is foreign currency maintained by various U.S. disbursing offices, miscellaneous cash such as seized monetary instruments, undistributed cash, and offers in compromises which are maintained as a result of the Department's tax collecting responsibilities.

The Operating Cash of the U.S. government represents balances from tax collections, other revenues, federal debt receipts, and other receipts, net of checks outstanding, which are held in the FRBNY. Operating Cash of the U.S. government is either insured by the Federal Deposit Insurance Corporation (for balances up to $250,000 as of September 30, 2013 and 2012), or collateralized by securities pledged by the depository institutions and held by the FRB.

# 6. Gold and Silver Reserves, and Gold Certificates Issued to the Federal Reserve Banks

The Department, through the Mint, is responsible for safeguarding most of the U.S. government's gold and all of the silver reserves in accordance with 31 USC §5117; a smaller portion of the gold is in the custody of the FRBs.

The gold reserves being held by the Department are partially offset by a liability for gold certificates issued by the Secretary to the FRBNY at the statutory rate, as provided in 31 USC §5117. Since 1934, Gold Certificates have been issued in non-definitive or book-entry form to the FRBNY. The Department's liability incurred by issuing the Gold Certificates, as reported on the Consolidated Balance Sheets, is limited to the gold being held by the Department at the statutory value. Upon issuance of Gold Certificates to the FRBNY, the proceeds from the certificates are deposited into the operating cash of the U.S. government. All of the Department's certificates issued are payable to the FRBNY. The Mint also holds 100,000 fine troy ounces (FTO) ($4 million at the statutory carrying value) of gold reserves without certificates.

The gold and silver bullion reserve (deep storage and working stock) are reported on the consolidated financial statements at the values stated in 31 USC § 5116 – 5117 (statutory rates) which are $42.2222 per FTO of gold and no less than $1.292929292 per FTO of silver. Accordingly, the silver is valued at $1.292929292 per FTO. The market values of the gold and silver reserves disclosed below are based on the London Gold Fixing. As of September 30, 2013 and 2012, the values of gold and silver reserves consisted of the following:

| | **FTOs** | **Statutory Rate** | **2013 Statutory Carrying Value (in millions)** | **Market Rate Per FTO** | **2013 Market Value (in millions)** |
|---|---|---|---|---|---|
| Gold | **248,046,116** | **$ 42.2222** | **$ 10,473** | **$ 1,326.50** | **$ 329,033** |
| Gold Held by Federal Reserve Banks | **13,452,811** | **$ 42.2222** | **568** | **$ 1,326.50** | **17,845** |
| **Total Gold** | **261,498,927** | | **11,041** | | **346,878** |
| Silver | **16,000,000** | **$ 1.2929** | **21** | **$ 21.68** | **347** |
| **Total Gold and Silver Reserves** | | | **$ 11,062** | | **$ 347,225** |

| | FTOs | Statutory Rate | 2012 Statutory Carrying Value (in millions) | Market Rate Per FTO | 2012 Market Value (in millions) |
|---|---|---|---|---|---|
| Gold | 248,046,116 | $ 42.2222 | $ 10,473 | $ 1,776.00 | $ 440,530 |
| Gold Held by Federal Reserve Banks | 13,452,811 | $ 42.2222 | 568 | $ 1,776.00 | 23,892 |
| **Total Gold** | 261,498,927 | | 11,041 | | 464,422 |
| Silver | 16,000,000 | $ 1.2929 | 21 | $ 34.65 | 554 |
| **Total Gold and Silver Reserves** | | | $ 11,062 | | $ 464,976 |

# 7. Troubled Asset Relief Program – Credit Program Receivables, Net

The Department administers a number of programs designed to help stabilize the financial system and restore the flow of credit to consumers and businesses. Through TARP, the Department made direct loans, equity investments, and entered into other credit programs. TARP's authority to make new commitments to purchase or guarantee troubled assets expired in October 2010. The table below displays the assets held as of September 30, 2013 and 2012, by the observability of inputs significant to the measurement of each value (in millions):

| **Program** | **Quoted Prices for Identical Assets[1]** | **Significant Observable Inputs[2]** | **Significant Unobservable Inputs[3]** | **2013 Total** |
|---|---|---|---|---|
| Capital Purchase Program | **$ 125** | **$ -** | **$ 1,668** | **$ 1,793** |
| Automotive Industry Financing Program | **3,647** | **11,950** | **-** | **15,597** |
| Public-Private Investment Program | **-** | **-** | **10** | **10** |
| Other Programs (TALF and CDCI) | **18** | **-** | **451** | **469** |
| **Total TARP Programs** | **$ 3,790** | **$ 11,950** | **$ 2,129** | **$ 17,869** |

*[1] Measurement is based on direct market quotes for the specific asset, e.g. quoted prices of common stock.*
*[2] Measurement is primarily derived from market observable data, other than a direct market quote, for the asset. This data could be market quotes for similar assets for the same entity.*
*[3] Measurement is primarily derived from inputs which generally represent management's best estimate of how a market participant would assess the risk inherent in the asset. These unobservable inputs are used because there is little to no direct market activity.*

| Program | Quoted Prices for Identical Assets[1] | Significant Observable Inputs[2] | Significant Unobservable Inputs[3] | 2012 Total |
|---|---|---|---|---|
| Capital Purchase Program | $ 327 | $ - | $ 5,407 | $ 5,734 |
| American International Group, Inc. Investment Program[4] | 5,067 | - | 2 | 5,069 |
| Automotive Industry Financing Program | 11,376 | - | 6,170 | 17,546 |
| Public-Private Investment Program | - | - | 10,778 | 10,778 |
| Other Programs (TALF and CDCI) | 9 | - | 1,095 | 1,104 |
| Asset Guarantee Program[5] | - | 967 | - | 967 |
| **Total TARP Programs** | $ 16,779 | $ 967 | $ 23,452 | $ 41,198 |

*See table above for explanations to (1), (2), and (3).*
*[4] Non-TARP investments in AIG totaling $2.6 billion as of September 30, 2012 are not included in this amount and reported separately on the Consolidated Balance Sheets as Non-TARP Investments in American International Group, Inc. These investments were sold in fiscal year 2013.*
*[5] Of the combined TARP Program totaling $41.2 billion as of September 30, 2012, $967 million represented other intra-governmental assets and $40.2 billion represented assets with the public as reported on the Consolidated Balance Sheets.*

## Direct Loan and Equity Investment Programs

### Capital Purchase Program

TARP implemented the Capital Purchase Program (CPP) in fiscal year 2009 which was designed to help stabilize the financial system by assisting in building the capital base of certain viable U.S. financial institutions to increase the capacity of those institutions to lend to businesses and consumers and support the economy. Under this program, the Department invested a total of $204.9 billion and purchased senior perpetual preferred stock and subordinate debentures from qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies (Qualified Financial Institution or QFI). The senior preferred stock has a stated dividend rate ranging from 5.0 percent to 9.0 percent. The dividends are cumulative for bank holding companies and non-cumulative for others; they are payable when and if declared by the institution's board of directors. QFIs that are Sub-chapter S corporations (public and non-public) issued subordinated debentures that have a maturity of generally 30 years, and interest rates ranging from 7.7 percent to 13.8 percent.

In addition to the senior preferred stock, the Department received warrants, with a ten-year term, from public QFIs to purchase a number of shares of common stock. Additionally, the Department exercised warrants received from non-

public QFIs resulting in additional holdings of senior preferred stock (or subordinated debentures as appropriate) of non-public QFIs.

In fiscal years 2013 and 2012, repayments and sales of CPP investments totaled $4.8 billion and $8.2 billion, respectively. Of these CPP investment repayments and sales in fiscal years 2013 and 2012, net proceeds of $1.5 billion and $1.3 billion, respectively, resulted from auction sales from the Department's decision in fiscal year 2012 to sell certain CPP investments to the public in auction sales. Total CPP repayments and sales resulted in net proceeds less than cost of $493 million and $285 million in fiscal year 2013 and 2012, respectively. The initial auction sales were not considered in the formulation estimate for the CPP program and, as such, a modification was recorded, increasing the cost of the program by $973 million in fiscal year 2012.

The estimated value of the CPP preferred equity investments is based on the net present values of the expected dividend payments and proceeds from repurchases and sales. The model assumes a probabilistic evolution of each institution's asset-to-liability ratio (based on the estimated fair value of the institution's assets against its liabilities). Historical volatility is used to scale the likely evolution of each institution's asset-to-liability ratio. Inputs to the model include institution specific accounting data obtained from regulatory filings, an institution's stock price volatility, historical bank failure information, as well as market prices of comparable securities trading in the market. The market risk adjustment is obtained through a calibration process to the market value of certain trading securities of financial institutions within the TARP programs or other comparable financial institutions. The Department estimates the values and projects the cash flows of warrants using an option-pricing approach based on the current stock price and its volatility. Investments in common stock which are exchange traded are valued at the quoted market price as of fiscal year end.

### American International Group, Inc. Investment Program

The Department provided assistance to systemically significant financial institutions on a case by case basis to provide stability to those institutions and protect the economy from being adversely affected by the failure of these firms. In fiscal year 2009, the Department invested $40.0 billion in AIG in the form of AIG's cumulative 10.0 percent Series D preferred stock. Additionally, the Department made available to AIG an equity capital facility under which AIG drew $27.8 billion, and the Department received additional AIG preferred stock. By January 2011, the Department (in combination with AIG and the FRBNY) had restructured the AIG investments into a $20.3 billion interest in AIG SPVs, and 1.1 billion shares of AIG common stock. Additionally, the credit facility between FRBNY and AIG was terminated, and the Department on behalf of the General Fund separately received 563 million shares of AIG common stock at no cost, reported separately on the Consolidated Balance Sheets as Non-TARP Investments in AIG. Upon completion of the restructuring, the Department (including TARP) held a combined total of 1.7 billion shares of AIG common stock, or 92.1 percent of AIG's common stock equity.

During fiscal years 2011 and 2012, the Department received a total of $21.1 billion in distributions from the AIG SPVs, fully repaying the $20.3 billion original investment balance and $204 million of capitalized dividend income, of which $9.6 billion and $11.5 billion were received in fiscal years 2012 and 2011, respectively. The Department recorded proceeds in excess of cost of $127 million in fiscal year 2012 (none in 2011), along with investment income of $191 million and $246 million in fiscal years 2012 and 2011, respectively.

Between fiscal years 2011 and 2013, the Department sold all of its 1.7 billion AIG common shares held by the General Fund and TARP together, on a pro-rata basis, in the open market. In fiscal year 2011, the Department sold in the open market 200 million shares of AIG common stock held by the General Fund and TARP (68 million and 132 million shares, respectively) for total gross cash proceeds of $5.8 billion, of which the General Fund and TARP received $2.0 billion and $3.8 billion, respectively. Sales continued in fiscal year 2012 in which the Department sold an additional 1.2 billion

shares of AIG common stock held by the General Fund and TARP (415 million and 806 million shares, respectively) for total gross cash proceeds of $38.2 billion, of which the General Fund and TARP received $13.0 billion and $25.2 billion, respectively. During fiscal year 2013, the Department sold the remaining 234 million shares of AIG common stock held by the General Fund and TARP (80 million and 154 million shares, respectively) for total gross cash proceeds of $7.6 billion, of which the General Fund and TARP received $2.6 billion and $5.0 billion, respectively. For the TARP shares sold in fiscal years 2013, 2012 and 2011, the proceeds were less than the Department's cost by $1.7 billion, $9.9 billion and $1.9 billion, respectively.

As of September 30, 2013, the Department no longer held any ownership interest in AIG. The remaining 234 million shares of AIG common stock held by the Department (including TARP) as of September 30, 2012 constituted 15.9 percent of AIG's total outstanding common shares. These common shares held had a fair value which approximated their carrying value totaling approximately $7.7 billion at September 30, 2012, of which $2.6 billion and $5.1 billion related to the General Fund and TARP, respectively. The fair value of the AIG common stock was based on the New York Stock Exchange (NYSE) quoted market price as of September 30, 2012.

During fiscal year 2013, the carrying value of the AIG investments held on behalf of the General Fund declined by $2.6 billion from the end of the prior fiscal year due to the sale of the remaining AIG common stock for $2.588 billion which resulted in a $23 million loss from the final sale. The September 30, 2012 carrying value of these investments had declined by $8.3 billion from September 30, 2011 due to sales of $13.0 billion during fiscal year 2012, partially offset by a fair value gain of $4.7 billion on the remaining existing portfolio as of September 30, 2012. Accordingly, the carrying value of the AIG common stock investment was adjusted by these amounts, and a corresponding amount was reported as custodial expense on the Statements of Custodial Activity.

### Automotive Industry Financing Program

The Automotive Industry Financing Program (AIFP) was designed to help prevent a significant disruption of the American automotive industry, which could have had a negative effect on the economy of the United States.

#### *General Motors Company and General Motors Corporation*

In fiscal year 2009, the Department provided $51.0 billion to General Motors Corporation (Old GM) through various loan agreements while Old GM was in bankruptcy. During fiscal year 2009, General Motors Company (New GM) was created and, through various sales and restructurings of its investment, the Department held 500 million shares of New GM common stock, or 31.9 percent of New GM's total outstanding common shares, as of September 30, 2012. During fiscal year 2013, the Department sold 399 million shares of the New GM common stock for $12.0 billion, which resulted in net proceeds less than cost of $5.4 billion. There were no sales of common stock during fiscal year 2012. As of September 30, 2013, the Department held 101 million shares of New GM common stock, or 7.3 percent of New GM's total outstanding common shares. The fair value of the New GM common shares held as of September 30, 2013 and 2012 was $3.6 billion and $11.4 billion, respectively, based on the NYSE quoted market price, plus the value of any traded but not settled shares. Traded but not settled shares were valued based on the actual trade proceeds.

#### *Ally Financial Inc. (formerly known as GMAC Inc.)*

The Department invested a total of $16.3 billion in GMAC Inc. between December 2008 and December 2009 to help support its ability to originate new loans to GM and Chrysler dealers and consumers, and to help address GMAC's capital needs. In 2010, GMAC changed its corporate name to Ally Financial, Inc. (Ally). As a result of original investments, exchanges, conversions and warrant exercises, the Department held 981,971 shares of Ally common stock, representing 73.8 percent of Ally's outstanding common stock, as of September 30, 2013 and 2012. The Department also held 119 million shares of Ally Series F-2 Mandatorily Convertible Preferred Securities (Series F-2), with a stated dividend rate of

9.0 percent, which were convertible into at least 513,000 shares of Ally common stock. In both fiscal years 2013 and 2012, the Department received $534 million in dividends from Ally. The fair value of the Ally investments held was $12.0 billion and $6.2 billion at September 30, 2013 and 2012, respectively.

Per an August 2013 agreement, Ally repurchased all of the Series F-2 from the Department for $5.2 billion in November 2013. The Department received an additional $725 million for the elimination of certain rights under the original agreement. This August 2013 agreement also included terms for Ally to issue a November 2013 private offering of new common stock at a price of $6,000 per share. To value the holdings in Ally at September 30, 2013, the Department considered observable market data from the November 2013 transactions pursuant to the August 2013 agreement. Proceeds and dividends received in November 2013 were discounted to September 30, 2013, at a risk-free discount rate to reflect the timing of the expected cash flows. The Department's remaining investment in Ally, consisting of 981,971 shares of common stock, representing 63.4 percent of Ally's outstanding common stock, was valued at the price per share in Ally's private offering.

Investments in Ally's common equity and mandatorily convertible preferred stock were valued on an "if-converted" basis at September 30, 2012, and the Department used an average of valuation multiples such as price-to-earnings, price-to-tangible book value, and asset manager valuations to estimate the value of the shares. The multiples were based on those of comparable publicly-traded entities. The adjustment for market risk was incorporated in the data points the Department uses to determine the measurement for Ally as all points relied on market data.

### Public-Private Investment Program

The Public-Private Investment Program (PPIP) was part of the Department's efforts to help restart the financial securities market and provide liquidity for legacy securities. Under this program, the Department (as a limited partner) made equity investments in and loans to nine investment vehicles (referred to as Public-Private Investment Funds or "PPIFs") established by private investment managers between September and December 2009. The equity investments were used to match private capital and equaled 49.9 percent of the total equity invested.

During fiscal year 2013, all of the remaining PPIFs fully liquidated their portfolios and repaid investors, including the Department. At September 30, 2013, the Department had no PPIF equity investments or loans outstanding. At September 30, 2012, the Department had investments in six PPIFs which included $4.1 billion of equity investments outstanding and $5.7 billion of loans outstanding, for an aggregate total of $9.8 billion. At September 30, 2012, the fair value of these loans outstanding was $10.8 billion. These portfolios were comprised of 74.0 percent non-agency residential mortgage-backed securities (RMBS) and 26.0 percent commercial mortgage-backed securities (CMBS). The Department made no disbursements to the PPIFs during fiscal year 2013, compared to fiscal year 2012 in which the Department disbursed $245 million as equity investments and $803 million as loans to the PPIFs. In both fiscal years 2013 and 2012, the Department received $5.7 billion in loan principal and interest repayments from the PPIFs. Also during fiscal year 2013, the Department received $5.5 billion in equity distributions, comprised of $254 million of investment income, $1.2 billion of net proceeds in excess of cost, and $4.1 billion reduction of the gross investment outstanding. In fiscal year 2012, the Department received $3.2 billion in equity distributions, comprised of $1.3 billion of investment income, $223 million of net proceeds in excess of cost, and $1.7 billion reduction of the gross investment outstanding.

The $10 million positive subsidy allowance at September 30, 2013 represents additional proceeds expected upon final liquidation of remaining partnerships at the net present value. As of September 30, 2013, the Department had legal commitments to disburse up to $984 million in additional equity to PPIFs which will remain until all distributions have been received from PPIFs and all PPIF liabilities have been settled.

For the valuation at September 30, 2012, the Department estimated cash flows to the PPIFs by simulating the performance of the collateral supporting the assets held by the PPIF. Inputs used to simulate the cash flows, which considered market risks, included unemployment forecasts, home price appreciation/depreciation forecasts, the current term structure of interest rates, historical pool performance, and estimates of the net income and value of commercial real estate supporting the CMBS. The simulated cash flows were then run through a financial model that defined distributions of the RMBS/CMBS to determine the estimated cash flows to the PPIF.

### Other Direct Loan and Equity Investment Programs

The Department initiated other programs intended to help unlock the flow of credit to consumers and small businesses. The following programs were established to help accomplish this: the Term Asset-Backed Securities Loan Facility (TALF) and the Community Development Capital Initiative (CDCI). Each program is discussed in more detail below and included in the "Other Programs" column of the table within this note.

#### *Term Asset-Backed Securities Loan Facility*

The TALF was created by the FRB to provide low-cost funding to investors in certain classes of Asset Backed Securities (ABS). The Department agreed to participate in the program by providing liquidity and credit protection to the FRB. Under the TALF, the FRBNY, as implementer of the TALF program, originated loans on a non-recourse basis to purchasers of certain AAA rated ABS secured by consumer and commercial loans and CMBS. The FRBNY ceased issuing new loans in 2010. Approximately $101 million and $1.5 billion of loans due to the FRBNY remained outstanding as of September 30, 2013 and 2012, respectively.

As part of the program, the FRBNY created the TALF, Limited Liability Corporation (LLC), an SPV that agreed to purchase from the FRBNY any collateral it has seized due to borrower default. Upon its creation, the Department disbursed a $100 million loan to fund the facility. The TALF, LLC would fund purchases from the accumulation of monthly fees paid by FRBNY as compensation for the agreement. Only if the TALF, LLC had insufficient funds to purchase the collateral did the Department commit to invest up to $20.0 billion in non-recourse subordinated notes issued by the TALF, LLC. This commitment amount has been reduced periodically since 2010, and was terminated in fiscal year 2013. In fiscal year 2013, a modification to the terms of the legal agreement resulted in $55 million is subsidy income for the program. The modification allowed the Department to receive $100 million in repayments, $13 million in interest and $570 million of contingent interest, recorded as proceeds in excess of cost, in fiscal year 2013 rather than in fiscal year 2015 as originally expected. As of September 30, 2013 and 2012, no TALF loans were in default and consequently no collateral was purchased by the TALF, LLC.

In valuing the TALF loan, the Department model derives the cash flows to the SPV, and ultimately to the Department, by simulating the performance of underlying collateral. Loss probabilities on the underlying collateral are calculated based on analysis of historical loan loss and charge-off experience by credit sector and subsector. Impaired TALF-eligible securities are projected to be purchased by the SPV, which could require additional Department funding. Simulation outcomes consisting of a range of loss scenarios are probability-weighted to generate the expected net present value of future cash flows.

#### *Community Development Capital Initiative*

In fiscal year 2010, the CDCI was created to provide additional low cost capital in Community Development Financial Institutions (CDFIs) to encourage more lending to small businesses. Under the terms of the program, the Department purchased senior preferred stock (or subordinated debt) from eligible CDFIs with an initial dividend rate of 2.0 percent that will increase to 9.0 percent after eight years. The Department invested a total of $570 million in 84 institutions

under the CDCI. In fiscal years 2013 and 2012, the Department received $86 million and $3 million in repayments, respectively. The Department values the CDCI preferred stock investments in a manner broadly analogous to the methodology used to value the preferred stock securities within the CPP program.

## OTHER CREDIT PROGRAMS

### Asset Guarantee Program

The Asset Guarantee Program (AGP) provided guarantees for assets held by systemically significant financial institutions that faced a risk of losing market confidence due in large part to a portfolio of distressed or illiquid assets. Section 102 of the EESA required the Secretary to establish the AGP to guarantee troubled assets originated or issued prior to March 14, 2008, including MBS.

In January 2009, the Department entered into a guarantee agreement with Citigroup under which the Department's protection was limited to $5.0 billion. The Department, Federal Deposit Insurance Corporation (FDIC), and the FRBNY provided protection against the possibility of large losses on a Citigroup asset pool of approximately $301.0 billion of loans and securities backed by residential and commercial real estate and other such assets. In fiscal year 2010, this guarantee agreement was terminated and, accordingly, FDIC agreed to transfer to the Department $800 million of Citigroup trust preferred securities (TruPS) holdings plus dividends by December 31, 2012, reduced by any losses FDIC incurred on its Citigroup guaranteed debt. The Department recorded a TruPS-related receivable from the FDIC valued at $967 million at September 30, 2012. The Department sold this investment in fiscal year 2013 for $894 million. During fiscal year 2013, the Department also received $200 million of dividends on the TruPS. A downward modification of $94 million and a closing downward re-estimate of $24 million were recorded in fiscal year 2013. The Department valued the AGP preferred stock investments in a manner broadly analogous to the methodology used to value the preferred stock securities within the CPP program. As of September 30, 2013, the Department held no remaining holding in the AGP program.

### FHA-Refinance Program

In fiscal year 2010, the Department entered into a loss-sharing agreement with the FHA to support a program in which FHA guarantees refinancing of borrowers whose homes are worth less than the remaining amounts owed under their mortgage loans. The Department established a $50 million account, held by a commercial bank as its agent, from which any required reimbursements for losses will be paid to third-party claimants, including banks or other investors. FHA disbursed $182 million and $234 million of loans during fiscal year 2013 and 2012, respectively. At September 30, 2013 and 2012, 3,015 and 1,774 loans that FHA had guaranteed with a total value of $489 million and $307 million, respectively, had been refinanced under the program. At September 30, 2013 and 2012, the Department's maximum exposure related to the FHA guarantee totaled $59 million and $41 million, respectively. The Department's guarantee resulted in the Department incurring a $9 million and $7 million liability as of September 30, 2013 and 2012, respectively, that was reported in Other Liabilities on the Consolidated Balance Sheets.

Based on credit reform accounting, the liability was derived as the present value of the future cash outflows for the Department's share of losses incurred on any defaults of the disbursed loans. The budget subsidy rates for the program, entirely for defaults, excluding modifications and re-estimates, were set at 2.5 percent and 4.0 percent for loans guaranteed in fiscal years 2013 and 2012, respectively. As of September 30, 2013 and 2012, the Department recorded subsidy cost of $5 million and $9 million, respectively, for projected losses due to defaults. The program recorded a $3 million downward re-estimate for the year ended September 30, 2013 and 2012, due to a reduction in market risks and lower than projected defaults.

### SUMMARY TABLES

The following tables provide the net composition, subsidy cost, modifications and re-estimates, a reconciliation of subsidy cost allowances, and subsidy by component for each TARP direct loan, equity investment or other credit programs for the fiscal years ended September 30, 2013 and 2012. There were no budget subsidy rates for fiscal year 2013 and 2012, except for the FHA- Refinance Program as previously disclosed in this note. All of the disbursements in fiscal year 2012, were from loans or investments obligated in prior years.

## Troubled Asset Relief Program Direct Loans and Equity Investments

| As of September 30, 2013 (in millions) | CPP | AIG | AIFP | PPIP | Other Programs | 2013 |
|---|---|---|---|---|---|---|
| **Direct Loans and Equity Investment Programs:** | | | | | | |
| Direct Loans and Equity Investment Outstanding, Gross | $ 3,143 | $ - | $ 19,878 | $ - | $ 475 | **$ 23,496** |
| Subsidy Cost Allowance | (1,350) | - | (4,281) | 10 | (6) | **(5,627)** |
| **Direct Loans and Equity Investments Outstanding, Net** | $ 1,793 | $ - | $ 15,597 | $ 10 | $ 469 | **$ 17,869** |
| **Obligations for Loans and Investments Not Yet Disbursed** | $ - | $ - | $ - | $ 984 | $ - | **$ 984** |
| **Reconciliation of Subsidy Cost Allowance:** | | | | | | |
| Balance, Beginning of Period | $ 2,930 | $ 1,658 | $ 19,706 | $ (1,015) | $ (437) | **$ 22,842** |
| Subsidy Income for Modifications | - | - | - | - | (55) | **(55)** |
| Interest and Dividend Revenue | 262 | - | 534 | 271 | 25 | **1,092** |
| Net Proceeds from Sales and Repurchases of Assets in Excess of (Less than) Cost | (493) | (1,679) | (5,361) | 1,173 | 570 | **(5,790)** |
| Write-Offs | (104) | - | - | - | (7) | (111) |
| Net Interest Income (Expense) on Borrowings from the Fiscal Service and Financing Account Balance | (105) | (11) | (412) | (59) | (25) | **(612)** |
| Balance, End of Period, Before Re-estimates | 2,490 | (32) | 14,467 | 370 | 71 | **17,366** |
| Subsidy Re-estimates | (1,140) | 32 | (10,186) | (380) | (65) | **(11,739)** |
| **Balance, End of Period** | $ 1,350 | $ - | $ 4,281 | $ (10) | $ 6 | **$ 5,627** |
| **Reconciliation of Subsidy Cost:** | | | | | | |
| Subsidy Cost for Modifications | $ - | $ - | $ - | $ - | $ (55) | **$ (55)** |
| Subsidy Re-estimates | (1,140) | 32 | (10,186) | (380) | (65) | **(11,739)** |
| **Total Direct Loans and Equity Investment Programs Subsidy Cost (Income)** | $ (1,140) | $ 32 | $ (10,186) | $ (380) | $ (120) | **$ (11,794)** |

| As of September 30, 2012 (in millions) | CPP | AIG | AIFP | PPIP | Other Programs | 2012 |
|---|---|---|---|---|---|---|
| **Direct Loans and Equity Investment Programs:** | | | | | | |
| Direct Loans and Equity Investment Outstanding, Gross | $ 8,664 | $ 6,727 | $ 37,252 | $ 9,763 | $ 667 | $ 63,073 |
| Subsidy Cost Allowance | (2,930) | (1,658) | (19,706) | 1,015 | 437 | (22,842) |
| **Direct Loans and Equity Investments Outstanding, Net** | $ 5,734 | $ 5,069 | $ 17,546 | $ 10,778 | $ 1,104 | $ 40,231 |
| **New Loans or Investments Disbursed** | $ - | $ - | $ - | $ 1,048 | $ - | $ 1,048 |
| **Obligations for Loans and Investments Not Yet Disbursed** | $ - | $ - | $ - | $ 3,058 | $ 1,300 | $ 4,358 |
| **Reconciliation of Subsidy Cost Allowance:** | | | | | | |
| Balance, Beginning of Period | $ 4,857 | $ 20,717 | $ 19,440 | $ (2,434) | $ (279) | $ 42,301 |
| Subsidy Cost (Income) for Disbursements and Modifications | 973 | - | - | (31) | - | 942 |
| Interest and Dividend Revenue | 572 | 191 | 534 | 1,426 | 10 | 2,733 |
| Net Proceeds from Sales and Repurchases of Assets in Excess of (Less than) Cost | (285) | (9,735) | 9 | 223 | - | (9,788) |
| Net Interest Income (Expense) on Borrowings from the Fiscal Service and Financing Account Balance | (290) | (349) | (507) | (439) | (41) | (1,626) |
| Balance, End of Period, Before Re-estimates | 5,827 | 10,824 | 19,476 | (1,255) | (310) | 34,562 |
| Subsidy Re-estimates | (2,897) | (9,166) | 230 | 240 | (127) | (11,720) |
| **Balance, End of Period** | $ 2,930 | $ 1,658 | $ 19,706 | $ (1,015) | $ (437) | $ 22,842 |
| **Reconciliation of Subsidy Cost:** | | | | | | |
| Subsidy Cost for Disbursements | $ - | $ - | $ - | $ (31) | $ - | $ (31) |
| Subsidy Cost for Modifications | 973 | - | - | - | - | 973 |
| Subsidy Re-estimates | (2,897) | (9,166) | 230 | 240 | (127) | (11,720) |
| **Total Direct Loans and Equity Investment Programs Subsidy Cost (Income)** | $ (1,924) | $ (9,166) | $ 230 | $ 209 | $ (127) | $ (10,778) |

**Troubled Asset Relief Program Asset Guarantee Program**
**As of September 30, 2013 and 2012**
**(in millions)**

| | 2013 | 2012 |
|---|---|---|
| **Asset Guarantee Program** | **$ -** | $ 967 |
| **Reconciliation of Asset Guarantee Program:** | | |
| Balance, Beginning of Period | **$ (967)** | $ (739) |
| Subsidy Income for Modification | **(94)** | - |
| Dividend Revenue | **200** | - |
| Net Proceeds from Sale of Assets in Excess of cost | **894** | - |
| Net Interest Expense on Borrowings from the Fiscal Service | **(9)** | (21) |
| Balance, End of Period, Before Re-estimate | **24** | (760) |
| Subsidy Re-estimate | **(24)** | (207) |
| Balance, End of Period | **$ -** | $ (967) |
| **Reconciliation of Subsidy Income:** | | |
| Subsidy Income for Modification | **$ (94)** | $ - |
| Subsidy Re-estimates | **(24)** | (207) |
| **Total Subsidy Income** | **$ (118)** | $ (207) |

## HOUSING PROGRAMS UNDER TARP

Housing programs under TARP are designed to provide stability for both the housing market and homeowners. These programs assist homeowners who are experiencing financial hardships to remain in their homes until their financial position improves or they relocate to a more sustainable living situation. As of September 30, 2013 and 2012, the Department had committed up to $38.5 billion and $45.6 billion, respectively, for these programs. For fiscal year 2013 and 2012, payments made on behalf of the housing programs under TARP totaled $3.9 billion and $3.1 billion, respectively.

# 8. Investments in Government Sponsored Enterprises

Congress established Fannie Mae and Freddie Mac as GSEs to support the supply of mortgage loans. A key function of the GSEs is to package purchased mortgages into securities, which are subsequently sold to investors.

Leading up to the financial crisis, increasingly difficult conditions in the housing market challenged the soundness and profitability of the GSEs, thereby undermining the entire housing market. This led Congress to pass the Housing and Economic Recovery Act (HERA) (P.L. 110-289) in July 2008. This act created FHFA, with enhanced regulatory authority over the GSEs, and provided the Secretary with certain authorities intended to ensure the financial stability of the GSEs, if necessary. In September 2008, FHFA placed the GSEs under conservatorship, and the Department entered into a Senior Preferred Stock Purchase Agreement (SPSPA) with each GSE. These actions were taken to preserve the GSEs' assets, ensure a sound and solvent financial condition, and mitigate systemic risks that contributed to current market instability. The SPSPAs were amended in August 2012 (the amended SPSPAs) which changed, among other things, the basis for determining quarterly dividends that are paid by the GSEs to the U.S. government. The dividend change in the amended SPSPAs became operationally effective commencing with the quarter ending March 31, 2013.

The actions taken by the Department are intended to provide financial stability. The purpose of the Department's actions is to maintain the solvency of the GSEs so they can continue to fulfill their vital roles in the home mortgage market while the Administration and Congress determine what structural changes should be made. The FHFA director may terminate the conservatorship if safe and solvent conditions can be established. Draws under the SPSPAs result in an increased investment in the GSEs as further discussed below.

Under the SPSPAs, the Department initially received from each GSE: *(i)* 1,000,000 shares of non-voting variable liquidation preference senior preferred stock with a liquidation preference value of $1,000 per share, and *(ii)* a non-transferrable warrant for the purchase, at a nominal cost, of 79.9 percent of common stock on a fully-diluted basis. The warrants expire on September 7, 2028. Through December 31, 2012, the senior preferred stock accrued dividends at 10.0 percent per year, payable quarterly. Under the amended SPSPAs, the quarterly dividend payment changed from a 10.0 percent per annum fixed rate dividend to an amount equivalent to the GSE's positive net worth above a capital reserve amount. The capital reserve amount was initially set at $3.0 billion for calendar year 2013, and declines by $600 million at the beginning of each calendar year thereafter until it reaches zero by calendar year 2018. The GSEs will not pay a quarterly dividend if their positive net worth is below the required capital reserve threshold. Cash dividends of $95.7 billion and $18.4 billion were declared and received during fiscal years ended September 30, 2013 and 2012, respectively. The significant increase in dividends received in fiscal year 2013 compared to 2012 was attributable to a federal income tax benefit that was recognized in the 2013 earnings of one of the GSEs resulting in improved net worth and, thus, increased dividends remitted to the Department.

The SPSPAs, which have no expiration date, provide for the Department to disburse funds to the GSEs if, at the end of any quarter, the FHFA determines that the liabilities of either GSE exceed its assets. Draws from the Department under the SPSPAs are designed to ensure that the GSEs maintain positive net worth. The maximum amount available to each GSE under this agreement was previously based on a formulaic cap that increased by the amount of actual draws made for a three-year period which ended December 31, 2012, at which time, the maximum amount was automatically adjusted downward by each GSE's positive net worth as of December 31, 2012 and became fixed effective December 31, 2012 (refer to the "Contingent Liability to GSEs" section below). Draws against the funding commitment of the SPSPAs do not result in the issuance of additional shares of senior preferred stock; instead, the liquidation preference of the initial 1,000,000 shares is increased by the amount of the draw. There were no payments to the GSEs for the fiscal year ended September 30, 2013. Payments to the GSEs for fiscal year ended September 30, 2012 were $18.5 billion.

### ACCOUNTING TREATMENT

***Entity Transactions*** – The estimated contingent liability to the GSEs on the Department's Consolidated Balance Sheets is accrued pursuant to the SPSPAs and funded through the Department's direct appropriations. Therefore, the liability accrual is reflected at its gross amount as an "entity" cost on the Department's Consolidated Statements of Net Cost, within the line item, "Cumulative Results of Operations" on the Department's Consolidated Balance Sheets, without considering the increase in senior preferred stock liquidation preference/fair value adjustments, and future dividend receipts from the GSEs.

***Non-Entity Transactions*** – As actual payments are made to the GSEs, they result in increases to the U.S. government's liquidation preference in the GSEs' senior preferred stock, and thus represent General Fund exchange revenue reported on the Department's Consolidated Statements of Net Cost as "GSEs Non-Entity Cost (Revenue)." Changes in the fair valuation of the GSE preferred stock and common stock warrants, and related dividends received, are General Fund-related costs and revenues that are likewise reported as "GSEs Non-Entity Cost (Revenue)."

### INVESTMENTS IN GSES

As of September 30, 2013 and 2012, the Department's investments in the GSEs consisted of the following (in millions):

| **GSEs Investments** | **Gross Investments As of 9/30/13** | **Cumulative Valuation Gain/(Loss)** | **9/30/13 Fair Value** |
|---|---|---|---|
| Fannie Mae Senior Preferred Stock | **$ 116,989** | **$ (40,429)** | **$ 76,560** |
| Freddie Mac Senior Preferred Stock | **72,160** | **(16,295)** | **55,865** |
| Fannie Mae Warrants Common Stock | **3,104** | **1,978** | **5,082** |
| Freddie Mac Warrants Common Stock | **2,264** | **450** | **2,714** |
| **Total GSEs Investments** | **$ 194,517** | **$ (54,296)** | **$ 140,221** |

| **GSEs Investments** | Gross Investments As of 9/30/12 | Cumulative Valuation Loss | 9/30/12 Fair Value |
|---|---|---|---|
| Fannie Mae Senior Preferred Stock | $ 116,989 | $ (51,331) | $ 65,658 |
| Freddie Mac Senior Preferred Stock | 72,160 | (30,224) | 41,936 |
| Fannie Mae Warrants Common Stock | 3,104 | (1,956) | 1,148 |
| Freddie Mac Warrants Common Stock | 2,264 | (1,664) | 600 |
| **Total GSEs Investments** | $ 194,517 | $ (85,175) | $ 109,342 |

### SENIOR PREFERRED STOCK AND WARRANTS FOR COMMON STOCK

In determining the fair value of the senior preferred stock and warrants for common stock, the Department relied on the GSEs' public filings and press releases concerning their financial statements, as well as non-public, long-term financial forecasts, monthly summaries, quarterly credit supplements, independent research regarding high-yield bond and preferred stock trading, independent research regarding the GSEs' common stock trading, discussions with each of the GSEs and FHFA, and other information pertinent to the fair valuations. Because of the nature of the instruments, which are not publicly traded and for which there is no comparable trading information available, the fair valuations rely on significant unobservable inputs that reflect assumptions about the expectations that market participants would use in pricing.

The fair value of the senior preferred stock considers the amount of forecasted dividend payments. The fair valuations assume that a hypothetical buyer would acquire the discounted dividend stream as of the transaction date. The fair value

of the senior preferred stock increased at September 30, 2013 when compared to 2012 primarily due to the GSEs' improved financial performance as discussed below.

The fair value of the warrants is impacted by the nominal exercise price and the large number of potential exercise shares, the market trading of the common stock that underlies the warrants as of September 30, the principal market, and the market participants. Other factors impacting the fair value include, among other things, the holding period risk related directly to the amount of time that it will take to sell the exercised shares without depressing the market. The fair value of the warrants increased at the end of fiscal year 2013 when compared to 2012 primarily due to increases in the market price of the underlying common stock of each GSE.

### CONTINGENT LIABILITY TO GSES

As part of the annual process undertaken by the Department, a series of long-term financial forecasts are prepared to assess the probability and magnitude of draws under the SPSPAs as of September 30. The Department used financial forecasts prepared through year 2038 and 2025 in estimating the contingent liability as of September 30, 2013 and 2012, respectively. If future payments under the SPSPAs are deemed to be probable within the forecast horizon, the Department will estimate and accrue a contingent liability to the GSEs to reflect the forecasted equity deficits of the GSEs. This accrued contingent liability will be undiscounted and will not take into account any of the offsetting dividends which would be received, as the dividends would be owed directly to the General Fund. Such recorded accruals are adjusted as new information develops or circumstances change.

Based on the annual assessment of the Department's estimated future contingent liability, as of September 30, 2013, the Department estimated and accrued no contingent liability, compared to a $9.0 billion estimated contingent liability accrued as of September 30, 2012. Accordingly, the Department reduced its estimated liability by $9.0 billion and $288.7 billion at the end of fiscal years 2013 and 2012, respectively, via a reduction in expense. The reduction in the estimated liability in both years is primarily due to a decrease in the amount of estimated future draws forecasted to be required by the GSEs within the forecast time horizon. The $288.7 billion reduction in 2012 resulted in a remaining contingent liability of $9.0 billion at the end of that fiscal year to reflect the Department's forecast of draws that may have been required by the GSEs for the quarter ended December 31, 2012 to meet the 10.0 percent per annum dividend payment requirement in accordance with the pre-amended SPSPAs. As a result of the amended SPSPAs in which the new dividend payment requirement became operationally effective commencing with the quarter ended March 31, 2013, coupled with the long-term financial forecasts of the GSEs, the Department reduced by $9.0 billion the contingent liability as of September 30, 2013. The Department reported this expense reduction in entity costs within the Economic Program section of the Department's Consolidated Statements of Net Cost.

At September 30, 2013, the maximum remaining contractual commitment to the GSEs for the remaining life of the SPSPAs was $258.1 billion which, as discussed above, was established on December 31, 2012. At September 30, 2012, the maximum remaining potential commitment to the GSEs for the remaining life of the SPSPAs was estimated at $282.3 billion, which was based upon case scenario estimates ranging from $274.0 billion to $291.5 billion.

In determining the contingent liability estimates, the Department relied on the GSEs' public filings and press releases concerning their financial statements, monthly summaries, and quarterly credit supplements, as well as non-public, long-term financial forecasts, the FHFA House Price Index, discussions with each of the GSEs and FHFA, and other information pertinent to the liability estimates. The forecasts include three potential wind-down scenarios, with varying assumptions regarding the timing as to when new guarantee mortgage-backed securities would cease being underwritten by the GSEs. The forecasts also assume a continued gradual wind-down of the retained portfolios (and corresponding net interest income) through 2018, as directed under the amended SPSPAs for each GSE to reduce the maximum balance of

its retained mortgage portfolio by 15.0 percent per annum beginning December 31, 2013 (a change from the 10.0 percent per annum prior to the amended SPSPAs). The maximum balance of the GSEs' retained mortgage portfolio was initially set at $650 billion as of December 31, 2012, and is required under the amended SPSPAs to be reduced to $250.0 billion by December 31, 2018.

### FINANCIAL PERFORMANCE OF THE GSEs

The summarized unaudited aggregated financial condition of the GSEs as of September 30, 2013 and 2012, along with their summarized unaudited aggregated financial operating results for the nine months ended September 30, 2013 and 2012 were as follows (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Combined Assets | | | | |
| Investment Securities | **$** | **266,305** | $ | 338,974 |
| Mortgage Loans | | **4,702,674** | | 4,641,231 |
| Other | | **294,028** | | 262,548 |
| Total Combined Assets | | **5,263,007** | | 5,242,753 |
| Combined Liabilities | | | | |
| Long-Term Debt | | **4,959,558** | | 4,963,297 |
| Other | | **258,396** | | 272,137 |
| Total Combined Liabilities | | **5,217,954** | | 5,235,434 |
| Combined Net Equity | **$** | **45,053** | $ | 7,319 |
| **For the Nine Months Ended September 30** | | | | |
| Combined Net Interest Income | **$** | **30,238** | $ | 29,097 |
| Combined Benefit (Provision) for Loan Losses | | **11,213** | | (3,628) |
| Combined Net Interest Income After Provision for Loan Losses | **$** | **41,451** | $ | 25,469 |
| Combined Regulatory Capital - Minimum Capital Deficit as of September 30 | **$** | **(195,697)** | $ | (231,949) |

*Excludes financial guarantees not consolidated on GSE balance sheets.*

The above information was taken directly from the quarterly reports filed with the SEC, which are publicly available on the SEC's website (www.SEC.gov) and also the GSE investor relations websites.

The improved financial performance of the GSEs in 2013 compared to 2012 was primarily attributable to a federal income tax benefit that the GSEs recognized in their 2013 earnings. The GSEs' improved financial performance in 2013 also reflects increased guarantee fees on single family mortgages and reduced credit losses due to improving regional housing markets and a higher quality credit portfolio of mortgage loans originated after 2008, coupled with the ongoing run-off of troubled loans that were originated during 2005 through 2008.

Under the amended SPSPAs, the Department's forecasts indicate that neither GSE will fully utilize the amount of funding available. The Department's forecasts of future draws by the GSEs may differ from actual experience. Future actual draw amounts will depend on numerous factors that are difficult to predict including, but not limited to, changes in government policy with respect to the GSEs, the business cycle, inflation, home prices, unemployment rates, interest rates, changes in housing preferences, home financing alternatives, availability of debt financing, market rates of guarantee fees, outcomes of loan refinancings and modifications, new housing programs, and other applicable factors.

## GSEs Non-Entity Cost (Revenue)

For the fiscal years ended September 30, 2013 and 2012, GSEs Non-Entity Cost (Revenue) consisted of the following (in millions):

| **Summary of GSEs Non-Entity Cost (Revenue)** | **2013** | 2012 |
|---|---|---|
| General Fund Revenue from Increase in Liquidation Preference of GSEs Preferred Stock | **$ -** | $ (18,519) |
| Fair Value (Gain)/Loss on GSEs Warrants/Preferred Stock | **(30,879)** | 42,220 |
| GSEs Preferred Stock Dividends | **(95,727)** | (18,379) |
| **Total GSEs Non-Entity Cost (Revenue)** | **$ (126,606)** | $ 5,322 |

## Regulatory Environment

Pursuant to a provision within the Dodd Frank Act, the Secretary conducted a study and developed recommendations regarding the options for ending the conservatorship. In 2011, the President delivered to Congress a report from the Secretary that provided recommendations regarding the options for ending the conservatorship and plans to wind down the GSEs. To date, Congress has not approved a plan to address the future of the GSEs, thus the GSEs continue to operate under the direction of their conservator, the FHFA, whose stated strategic goals for the GSEs are to: *(i)* build a new infrastructure for the secondary mortgage market; *(ii)* contract the GSEs' presence in the marketplace; and *(iii)* maintain foreclosure prevention activities and credit availability.

In December 2011, Congress passed the Temporary Payroll Tax Cut Continuation Act of 2011 which was funded by an increase of ten basis points in the GSEs' guarantee fees (referred to as "the increased fees") beginning April 1, 2012, and is effective through October 1, 2021. The increased fees are to be remitted to the Department and not retained by the GSEs. Accordingly, the increased fees do not affect the profitability of the GSEs. The Department received its first remittance of the increased fees from the GSEs on September 28, 2012. For fiscal years 2013 and 2012, the GSEs remitted to the Department the increased fees totaling $946 million and $35 million, respectively.

# 9. INVESTMENTS IN INTERNATIONAL FINANCIAL INSTITUTIONS

As of September 30, 2013 and 2012, Investments in International Financial Institutions (or Multilateral Development Banks) consisted of the following (in millions):

| | **2013** | 2012 |
|---|---|---|
| International Bank for Reconstruction and Development | **$ 2,216** | $ 2,103 |
| Inter-American Development Bank [1] | **1,695** | 1,587 |
| Asian Development Bank | **772** | 671 |
| European Bank for Reconstruction and Development | **636** | 636 |
| International Finance Corporation | **569** | 569 |
| North American Development Bank | **225** | 225 |
| African Development Bank | **238** | 207 |
| Multilateral Investment Guarantee Agency | **45** | 45 |
| **Total** | **$ 6,396** | $ 6,043 |

*Refer to Note 27 for a description of the additional commitments related to these institutions.*
[1] *Includes Inter-American Investment Corporation*

# 10. OTHER INVESTMENTS AND RELATED INTEREST

Other investments and related interest include foreign currency holdings that are typically invested in interest-bearing securities issued or held through foreign governments or monetary authorities (See Note 5). ESF holds most of the Department's foreign currency investments.

As of September 30, 2013 and 2012, Other Investments and Related Interest consisted of the following (in millions):

| Type of Investment | **Cost/ Acquisition Value** | **Unamortized (Premium)/ Discount** | **Interest Receivable** | **9/30/13 Net Investment** | **Unrealized Gain/(Loss)** | **9/30/13 Fair Value** |
|---|---|---|---|---|---|---|
| Foreign Investments: | | | | | | |
| Euro Bonds & Notes | **$ 4,556** | **$ 143** | **$ 75** | **$ 4,774** | **$ 85** | **$ 4,859** |
| Japanese Government Bonds | **6,326** | **15** | **4** | **6,345** | **8** | **6,353** |
| Other FCDAs | **2,884** | **-** | **-** | **2,884** | **-** | **2,884** |
| Other Investments | **28** | **(2)** | **-** | **26** | **(8)** | **18** |
| **Total Non-Federal** | **$ 13,794** | **$ 156** | **$ 79** | **$ 14,029** | **$ 85** | **$ 14,114** |

| Type of Investment | Cost/ Acquisition Value | Unamortized (Premium)/ Discount | Interest Receivable | 9/30/12 Net Investment | Unrealized Gain/(Loss) | 9/30/12 Fair Value |
|---|---|---|---|---|---|---|
| Foreign Investments: | | | | | | |
| Euro Bonds & Notes | $ 4,317 | $ 109 | $ 83 | $ 4,509 | $ 156 | $ 4,665 |
| Japanese Government Bonds | 7,959 | 27 | 7 | 7,993 | 18 | 8,011 |
| Other FCDAs | 2,739 | - | - | 2,739 | - | 2,739 |
| Other Investments | 30 | (2) | - | 28 | (7) | 21 |
| **Total Non-Federal** | $ 15,045 | $ 134 | $ 90 | $ 15,269 | $ 167 | $ 15,436 |

# 11. Other Credit Program Receivables, Net

The Department administers a number of programs, in addition to the TARP programs, designed to stabilize the nation's financial system and restore the flow of credit to consumers, businesses, and homeowners. As of September 30, 2013 and 2012, Other Credit Program Receivables, Net consisted of the following (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| State and Local Housing Finance Agency Program (GSE sponsored) | **$** | **8,420** | $ | 12,556 |
| Small Business Lending Fund Program | | **3,605** | | 3,930 |
| International Monetary Fund Programs: | | | | |
| U.S. Quota in the IMF Program (FCRA portion) | | **1,896** | | 1,858 |
| New Arrangements to Borrow Program (FCRA portion) | | **3,668** | | 1,511 |
| Other Direct Loans Program | | **39** | | 33 |
| **Total** | **$** | **17,628** | $ | 19,888 |

### State and Local Housing Finance Agency (HFA) Initiative

Under HERA, the Department, together with the FHFA, Fannie Mae, and Freddie Mac, created an initiative in October 2009 to provide support to HFAs. This initiative was designed to support low mortgage rates and expand resources for low and middle income borrowers to purchase or rent homes, making them more affordable over the long term. The HFA Initiative is comprised of two separate programs: *(i)* the New Issue Bond Program (NIBP) and *(ii)* the Temporary Credit and Liquidity Program (TCLP). As of September 30, 2013 and 2012, the HFA net credit program receivable of $8.4 billion and $12.6 billion, respectively, included a positive subsidy allowance of $915 million and $1.1 billion, respectively, which reflects the Department's projection that the HFA program will result in a net cost to the Department after accounting for repayments, interest, and fees.

Under the terms of the NIBP, the Department purchased securities of Fannie Mae and Freddie Mac backed by new mortgage revenue bonds issued by HFAs. As of September 30, 2013 and 2012, the NIBP gross credit program receivable was $9.3 billion and $13.7 billion, respectively. The Department performed a financial statement re-estimate of the NIBP program's cost as of September 30, 2013 and 2012. These re-estimates resulted in a downward re-estimate, or a decrease in the cost of the program, of $74 million as of September 30, 2013, and an upward re-estimate, or increase in cost of the program, of $588 million as of September 30, 2012. The downward re-estimate in fiscal year 2013 was primarily driven by higher than estimated principal collections. The upward re-estimate in fiscal year 2012 was primarily driven by lower forecasted prepayment rates and lower than expected market interest rates which reduced coupon rates for the HFA bonds converted from escrow in fiscal year 2012. The drop in prepayment rates increases the cost of the program since the HFA bonds carry a lower weighted average coupon than the funding cost of the program.

Under the terms of the TCLP, the Department purchased participation certificates issued by Fannie Mae and Freddie Mac, representing participating interests in credit and liquidity facilities that the GSEs are providing to certain HFAs as part of the program. Fannie Mae and Freddie Mac provided replacement credit and liquidity facilities to HFAs to help reduce the costs of maintaining existing financing and relieve financial strains on the HFAs. The Department agreed to support the GSE replacement credit and liquidity facilities by purchasing from the GSEs interests in certain HFA bonds in the event such bonds were tendered to the GSEs. As of September 30, 2013 and 2012, the liquidity facilities covered $2.0 billion and $3.9 billion, respectively, of single-family and multi-family variable-rate demand obligations (VRDOs). As of September 30, 2013 and 2012, none of these bonds had been tendered to the GSEs and, accordingly, the Department had not disbursed any funds. As such, the Department did not perform September 30, 2013 or 2012 subsidy re-estimates for TCLP.

### SMALL BUSINESS LENDING FUND

The *Small Business Jobs Act of 2010* (P.L. 111-240) created the SBLF program. Pursuant to the Act, the Department provided capital to qualified community banks, for purposes of encouraging bank lending to small businesses, by purchasing qualifying non-cumulative preferred stock or equivalents in each bank. As an incentive to participating banks to increase lending to small businesses, the dividend rate a bank pays to the Department for SBLF funding will be reduced as the bank's small business lending increases. For most banks, the initial dividend rate of 5.0 percent may be reduced to as low as 1.0 percent. For institutions which did not increase lending by the end of the first two years of the program, the rate will increase to 7.0 percent, effective for the quarter ending March 31, 2014. The program provides an incentive for banks to repay loans within 4 ½ years. At that time, the rate will increase to 9.0 percent for banks remaining in the program. The Department treats these purchases of capital as direct loans in accordance with the requirements of FCRA. The Department's authority to provide new capital to SBLF participants expired on September 27, 2011 and, accordingly, there were no new capital disbursements since that date.

As of September 30, 2013 and 2012, SBLF net credit program receivable was $3.6 billion and $3.9 billion, respectively. These amounts include a positive subsidy allowance of $28 million and $50 million at September 30, 2013 and 2012, respectively, which reflects the Department's projection that the SBLF program will result in a net cost to the Department.

The Department performed financial statement re-estimates of the program's cost as of September 30, 2013 and 2012 which resulted in an upward re-estimate, or an increase in the cost of the program, of $34 million and $105 million. Both the 2013 and 2012 upward re-estimates were driven by changes in performance assumptions, actual performance to-date, and actual program funding costs. The 2013 performance assumptions anticipate an overall cost to the program due to lower dividend rates, both actual and projected, paid by participating institutions relative to previously projected dividend rates. These lower dividend rates are the result of participating banks increasing small business lending to qualify for lower dividend rates.

### INTERNATIONAL MONETARY FUND

The *Supplemental Appropriations Act of 2009* authorized an increase in the U.S. quota in the IMF, as well as an increase in U.S. participation in the New Arrangements to Borrow (NAB), one of the IMF's supplemental borrowing arrangements (Note 12). The legislation applied FCRA to both program increases and, thus, the program increases are treated as direct loans to the IMF. For U.S. budget and accounting purposes, there are effectively two portions of the IMF quota and NAB programs. As of September 30, 2013 and 2012, the U.S. quota in the IMF totaled $64.6 billion and $65.0 billion, respectively, and comprised a FCRA and non-FCRA portion of $7.6 billion and $57.0 billion, respectively, at September 30, 2013, and $7.7 billion and $57.3 billion, respectively, at September 30, 2012. As of September 30, 2013 and 2012, the U.S. NAB arrangement with the IMF totaled $106.0 billion and $106.5 billion, respectively, and comprised a FCRA and non-FCRA portion of $95.8 billion and $10.2 billion, respectively, at September 30, 2013, and $96.3 billion and $10.2 billion, respectively, at September 30, 2012. These designations only affect the manner in which the Department accounts for the use and repayment of these funds. The U.S. commitments to the IMF are denominated in SDRs and, thus, the dollar amounts of these commitments fluctuate with the SDR valuation rate. The following is a discussion of the FCRA portions of both the U.S. quota and NAB programs.

#### United States Quota in the IMF

On March 25, 2011, the Department disbursed $2.0 billion (SDR 1.2 billion) to increase the reserve asset portion of the U.S. quota. The undisbursed FCRA portion is reported as a letter of credit (Note 12). At September 30, 2013 and 2012, the FCRA portion of the U.S. quota in the IMF had a net credit program receivable of $1.9 billion, including positive subsidy allowances of $99 million and $137 million, respectively, which reflect the Department's projection that the

program will result in a net cost to the Department after accounting for repayments and net interest. The Department performed financial statement re-estimates of the program's cost as of September 30, 2013 and 2012. The re-estimates resulted in an increase in program costs (or an upward re-estimate) of $5 million and $67 million for fiscal years 2013 and 2012, respectively, primarily due to a fluctuation in the valuation of the SDR rate since the calculation of the prior fiscal year's re-estimate.

### New Arrangements To Borrow

FCRA disbursements outstanding under the NAB for fiscal years ended 2013 and 2012 totaled $3.7 billion and $1.5 billion, respectively. The program had a negative subsidy allowance of $15 million and $21 million as of September 30, 2013 and 2012, respectively.

The Department performed a financial statement re-estimate of the program's cost as of September 30, 2013 and 2012. The re-estimates as of September 30, 2013 and 2012 resulted in a decrease in the projected cost of the program (or a downward re-estimate) of $1 million and $25 million, respectively, due to, among other factors, the fluctuation in the valuation of the SDR rate since the prior year's re-estimate.

## SUMMARY TABLES

The following tables provide the net composition of the Department's portfolio, subsidy cost, modifications and re-estimates, a reconciliation of subsidy cost allowances, budget subsidy rates, and the components of the subsidy for each credit program for the fiscal years ended September 30, 2013 and 2012. The subsidy rates disclosed in the following tables pertain only to that year's cohorts. These rates cannot be applied to the direct loans disbursed during the current reporting year to yield the subsidy expense. The subsidy expense reported in 2013 and 2012 also includes modifications (in 2012 only) and re-estimates.

| | 2013 | | | | | |
|---|---|---|---|---|---|---|
| *(in millions)* | **HFA** | **SBLF** | **IMF-Quota** | **IMF-NAB** | **Other** | **TOTAL** |
| **Credit Program Receivables, Net:** | | | | | | |
| Credit Program Receivables, Gross | $ 9,335 | $ 3,633 | $ 1,995 | $ 3,653 | $ 56 | $ 18,672 |
| Subsidy Cost Allowance | (915) | (28) | (99) | 15 | (17) | (1,044) |
| **Net Credit Program Receivables** | $ 8,420 | $ 3,605 | $ 1,896 | $ 3,668 | $ 39 | $ 17,628 |
| **New Credit Program Loans Disbursed** | $ - | $ - | $ - | $ 2,163 | $ 14 | $ 2,177 |
| **Obligations for Loans Not Yet Disbursed** | $ - | $ - | $ - | $ - | $ 333 | $ 333 |
| **Budget Subsidy Rate, Excluding Modifications and Re-estimates:** | | | | | | |
| Interest Differential | - | - | - | 0.26% | 28.25% | |
| Defaults | - | - | - | - | 12.01% | |
| Other | - | - | - | 0.08% | - | |
| **Total Budget Subsidy Rate** | **-** | **-** | **-** | **0.34%** | **40.26%** | |
| **Subsidy Cost by Component:** | | | | | | |
| Interest Differential | $ - | $ - | $ - | $ 5 | $ 4 | $ 9 |
| Defaults | - | - | - | - | 2 | 2 |
| Other | - | - | - | 2 | - | 2 |
| **Total Subsidy Cost, Excluding Modifications and Re-estimates** | $ - | $ - | $ - | $ 7 | $ 6 | $ 13 |
| **Reconciliation of Subsidy Cost Allowance:** | | | | | | |
| Balance, Beginning | $ 1,128 | $ 50 | $ 137 | $ (21) | $ 13 | $ 1,307 |
| Subsidy Cost for Disbursements | - | - | - | 7 | 6 | 13 |
| Fees Received | 27 | - | - | - | - | 27 |
| Loans Written Off | - | - | - | - | (1) | (1) |
| Subsidy Allowance Amortized | (166) | (56) | (43) | - | (1) | (266) |
| Balance, Ending, Before Re-estimates | 989 | (6) | 94 | (14) | 17 | 1,080 |
| Subsidy Re-estimates | (74) | 34 | 5 | (1) | - | (36) |
| **Balance, Ending** | $ 915 | $ 28 | $ 99 | $ (15) | $ 17 | $ 1,044 |
| **Re-estimates** | | | | | | |
| Interest on Re-estimate | $ (10) | $ 2 | $ - | $ - | $ - | $ (8) |
| Technical/Default Re-estimate | (64) | 32 | 5 | (1) | - | (28) |
| **Total Re-estimates – Increase (Decrease) in Subsidy Cost** | $ (74) | $ 34 | $ 5 | $ (1) | $ - | $ (36) |
| **Reconciliation of Subsidy Costs:** | | | | | | |
| Subsidy Cost for Disbursements | $ - | $ - | $ - | $ 7 | $ 6 | $ 13 |
| Subsidy Re-estimates | (74) | 34 | 5 | (1) | - | (36) |
| **Total Credit Program Receivables Subsidy Costs** | $ (74) | $ 34 | $ 5 | $ 6 | $ 6 | $ (23) |
| **Administrative Expense** | $ 9 | $ 16 | $ - | $ - | $ - | $ 25 |

| | 2012 | | | | | | |
|---|---|---|---|---|---|---|---|
| *(in millions)* | GSE MBS[1] | HFA | SBLF | IMF-Quota | IMF-NAB | Other | TOTAL |
| **Credit Program Receivables, Net:** | | | | | | | |
| Credit Program Receivables, Gross | $ - | $ 13,684 | $ 3,980 | $ 1,995 | $ 1,490 | $ 46 | $ 21,195 |
| Subsidy Cost Allowance | - | (1,128) | (50) | (137) | 21 | (13) | (1,307) |
| **Net Credit Program Receivables** | $ - | $ 12,556 | $ 3,930 | $ 1,858 | $ 1,511 | $ 33 | $ 19,888 |
| **New Credit Program Loans Disbursed** | $ - | $ - | $ - | $ - | $ 1,490 | $ - | $ 1,490 |
| **Budget Subsidy Rate, Excluding Modifications and Re-estimates:** | | | | | | | |
| Interest Differential | - | - | - | - | 0.26% | - | |
| Other | - | - | - | - | 0.08% | - | |
| **Total Budget Subsidy Rate** | - | - | - | - | 0.34% | - | |
| **Subsidy Cost by Component:** | | | | | | | |
| Interest Differential | $ - | $ - | $ - | $ - | $ 4 | $ - | $ 4 |
| Other | - | - | - | - | 1 | - | 1 |
| **Total Subsidy Cost, Excluding Modifications and Re-estimates** | $ - | $ - | $ - | $ - | $ 5 | $ - | $ 5 |
| **Reconciliation of Subsidy Cost Allowance:** | | | | | | | |
| Balance, Beginning | $ (1,831) | $ 815 | $ (80) | $ 64 | $ - | $ 17 | $ (1,015) |
| Subsidy Cost for Disbursements | - | - | - | - | 5 | - | 5 |
| Subsidy Cost for Modifications | - | (73) | - | - | - | - | (73) |
| Fees Received | - | 38 | - | - | - | - | 38 |
| Subsidy Allowance Amortized | 915 | (240) | 25 | 6 | (1) | (1) | 704 |
| Other | 1,621 | - | - | - | - | - | 1,621 |
| Balance, Ending, Before Re-estimates | 705 | 540 | (55) | 70 | 4 | 16 | 1,280 |
| Subsidy Re-estimates | (705) | 588 | 105 | 67 | (25) | (3) | 27 |
| **Balance, Ending** | $ - | $ 1,128 | $ 50 | $ 137 | $ (21) | $ 13 | $ 1,307 |
| **Re-estimates** | | | | | | | |
| Interest Rate Re-estimate | $ 128 | $ - | $ - | $ - | $ - | $ - | $ 128 |
| Interest on Re-estimate | (82) | 61 | 4 | - | - | (1) | (18) |
| Technical/Default Re-estimate | (751) | 527 | 101 | 67 | (25) | (2) | (83) |
| **Total Re-estimates – Increase (Decrease) in Subsidy Cost** | $ (705) | $ 588 | $ 105 | $ 67 | $ (25) | $ (3) | $ 27 |
| **Reconciliation of Subsidy Costs:** | | | | | | | |
| Subsidy Cost for Disbursements | $ - | $ - | $ - | $ - | $ 5 | $ - | $ 5 |
| Subsidy Cost for Modifications | - | (73) | - | - | - | - | (73) |
| Subsidy Re-estimates | (705) | 588 | 105 | 67 | (25) | (3) | 27 |
| **Total Credit Program Receivables Subsidy Costs** | $ (705) | $ 515 | $ 105 | $ 67 | $ (20) | $ (3) | $ (41) |
| **Administrative Expense** | $ 11 | $ - | $ 16 | $ - | $ - | $ - | $ 27 |

*(1) The Department completed sales of its MBS portfolio in fiscal year 2012. As of September 30, 2012, the Department performed a financial statement re-estimate of the program's cost that identified excess sales proceeds of $705 million. A closing re-estimate was completed in May 2013 at which time the $705 million of excess sales proceeds were transferred to the General Fund.*

# 12. Reserve Position in the International Monetary Fund and Related Loans and Interest Receivable

The United States participates in the IMF through a quota subscription and certain borrowing arrangements that supplement IMF resources. The *Supplemental Appropriations Act of 2009* (P.L. 111-32) provided for an increase of approximately SDR 5.0 billion (approximately $8.0 billion) in the U.S. quota in the IMF, as well as an increase in the United States' participation in the NAB up to the dollar equivalent of SDR 75 billion. These increases in the U.S. quota and NAB arrangement became effective in fiscal year 2011. Unlike all prior U.S. funding for the IMF, P.L. 111-32 subjects the increases in both the U.S. quota and the NAB to the requirements of FCRA. All U.S. quota and NAB funding prior to P.L. 111-32, referred to as "non-FCRA funds," do not result in net budgetary outlays. All such funding provided pursuant to P.L. 111-32, referred to as "FCRA funds," is accounted for in accordance with credit reform accounting guidelines (Note 11). A credit program receivable is established for FCRA fund amounts disbursed. Additionally, FCRA fund amounts disbursed do not result in net budgetary outlays, except for subsidy costs of the programs which constitute the excess of program disbursements over the net present value of expected future repayments.

## Reserve Position in the International Monetary Fund

Quota subscriptions are paid partly through the transfer of reserve assets, such as foreign currencies or SDRs, which are international reserve assets created by the IMF, and partly by making domestic currency available as needed through a non-interest-bearing letter of credit. This letter of credit, issued by the Department and maintained by the FRBNY, represents the Department's available commitment to the IMF which may be drawn upon by the IMF.

Transfers to the IMF under the U.S. quota do not result in net budgetary outlays as they constitute an exchange of monetary assets in which the United States receives an equal offsetting claim on the IMF in the form of an increase in the U.S. reserve position in the IMF. Similarly, when the IMF repays dollars to the United States, no net budgetary receipt results because the U.S. reserve position declines concurrently in an equal amount. The U.S. reserve position is an interest-bearing asset like other international reserve assets held by the United States, and is available at any time to meet U.S. funding needs.

The U.S. quota is denominated in SDRs. As of September 30, 2013 and 2012, the U.S. quota in the IMF was SDR 42.1 billion. The equivalent U.S. dollar value of the U.S. quota consisted of the following (in millions):

| | **Non-FCRA** | **FCRA** | **Total 2013** | Non-FCRA | FCRA | Total 2012 |
|---|---|---|---|---|---|---|
| Letter of Credit[1] | **$ 39,075** | **$ 5,706** | **$ 44,781** | $ 35,718 | $ 5,747 | $ 41,465 |
| Reserve Position[2] | **17,915** | **1,923** | **19,838** | 21,573 | 1,923 | 23,496 |
| **Total U.S. Quota in the IMF** | **$ 56,990** | **$ 7,629** | **$ 64,619** | $ 57,291 | $ 7,670 | $ 64,961 |

*(1) Letter of Credit amounts are included as part of the "Fund Balance" as reported on the Consolidated Balance Sheets and "Appropriated Funds" as disclosed in Note 2. Amounts also include approximately 0.25 percent of the U.S. quota that is held in cash in an IMF account at the FRBNY.*

*(2) The Reserve Position amounts shown in the non-FCRA columns are included in "Reserve Position in the IMF" as reported on the Consolidated Balance Sheets, while amounts shown in the FCRA columns are included in "Other Credit Program Receivables, Net" as reported on the Consolidated Balance Sheets. The FCRA amount shown represents the initial 2011 disbursement under P.L. 111-32 of SDR 1.2 billion at the current exchange rate (Note 11).*

Fluctuations in the value of the U.S. dollar with respect to the SDR result in valuation changes in dollar terms for the U.S. quota. The Department periodically adjusts this balance to maintain the SDR value of the U.S. quota. As of September 30, 2013 and 2012, the U.S. quota reflects a net downward adjustment in value of $342 million and $818 million, respectively, due to the appreciation of the U.S. dollar against the SDR.

### LOANS AND INTEREST RECEIVABLE

In addition to quota subscriptions, the IMF maintains borrowing arrangements to supplement its resources in order to forestall or cope with an impairment of the international monetary system when IMF liquidity is low. The United States currently participates in two such arrangements – the NAB and the General Arrangements to Borrow (GAB). In accordance with P.L. 111-32 which provided for an increase in the United States' participation in the NAB of up to the dollar equivalent of SDR 75 billion, the United States increased its NAB participation from SDR 6.6 billion to SDR 69.1 billion, which was equivalent to $106.0 billion and $106.5 billion as of September 30, 2013 and 2012, respectively. As of September 30, 2013 and 2012, under the U.S. NAB arrangement with the IMF, there was $10.0 billion and $10.2 billion of U.S. non-FCRA loans outstanding, and $3.7 billion and $1.5 billion of U.S. FCRA loans (Note 11) outstanding under the NAB arrangement, respectively. These amounts are liquid and interest-bearing claims on the IMF, and the non-FCRA portions are reported as Loans and Interest Receivable on the Consolidated Balance Sheets, while the FCRA portions are reported as Other Credit Program Receivables, Net on the Consolidated Balance Sheets. As of September 30, 2013, the IMF had not utilized the GAB.

## 13. TAXES, INTEREST, AND OTHER RECEIVABLES, NET

As of September 30, 2013 and 2012, Taxes, Interest and Other Receivables, Net consisted of the following (in millions):

| | **2013** | 2012 |
|---|---|---|
| **Non-Entity** | | |
| Federal Taxes Receivable, Gross | **$ 159,087** | $ 152,060 |
| Less: Allowance on Taxes Receivable | **(124,074)** | (113,046) |
| Interest Receivable on FRB Deposits of Earnings | **3,079** | 2,282 |
| Other Receivables | **465** | 148 |
| Less: Allowance on Other Receivables | **(30)** | (17) |
| **Total Non-Entity (Note 15)** | **38,527** | 41,427 |
| | | |
| **Entity** | | |
| Miscellaneous Entity Receivables and Related Interest | **75** | 36 |
| **Total Taxes, Interest and Other Receivables, Net** | **$ 38,602** | $ 41,463 |

Federal taxes receivable constitutes the largest portion of these receivables, with IRS-related taxes receivable representing the majority of the balance. IRS federal taxes receivable consists of tax assessments, penalties, and interest which were not paid or abated, and which were agreed to by either the taxpayer and IRS, or the courts. Federal taxes receivable is reduced by an allowance for doubtful accounts which is established to represent an estimate for uncollectible amounts. The portion of tax receivables estimated to be collectible and the allowance for doubtful accounts are based on projections of collectability from a statistical sample of taxes receivable (refer to the section entitled Required Supplemental Information (unaudited) - IRS Federal Taxes Receivable, Net).

In addition to amounts attributed to taxes, these receivables also include accrued interest income due on funds deposited in FRBs. The Department does not establish an allowance for the receivable on deposits of FRB earnings.

# 14. Property, Plant, and Equipment, Net

As of September 30, 2013 and 2012, Property, Plant and Equipment, Net consisted of the following (in millions):

| | Depreciation Method | Service Life | Cost | Accumulated Depreciation | 2013 Book Net Value |
|---|---|---|---|---|---|
| Buildings, structures, and facilities | S/L | 3-50 years | $ 737 | $ (382) | $ 355 |
| Furniture, fixtures, and equipment | S/L | 2-20 years | 2,867 | (2,005) | 862 |
| Construction in progress | N/A | N/A | 133 | - | 133 |
| Land and land improvements | N/A | N/A | 18 | (1) | 17 |
| Internal-use software in use | S/L | 2-15 years | 1,837 | (1,143) | 694 |
| Internal-use software in development | N/A | N/A | 343 | - | 343 |
| Assets under capital lease | S/L | 2-25 years | 9 | (3) | 6 |
| Leasehold improvements | S/L | 2-25 years | 403 | (167) | 236 |
| **Total** | | | $ 6,347 | $ (3,701) | $ 2,646 |

| | Depreciation Method | Service Life | Cost | Accumulated Depreciation | 2012 Book Net Value |
|---|---|---|---|---|---|
| Buildings, structures, and facilities | S/L | 3-50 years | $ 739 | $ (381) | $ 358 |
| Furniture, fixtures, and equipment | S/L | 2-20 years | 3,012 | (2,164) | 848 |
| Construction in progress | N/A | N/A | 172 | - | 172 |
| Land and land improvements | N/A | N/A | 17 | (1) | 16 |
| Internal-use software in use | S/L | 2-15 years | 1,662 | (1,002) | 660 |
| Internal-use software in development | N/A | N/A | 162 | - | 162 |
| Assets under capital lease | S/L | 2-25 years | 9 | (2) | 7 |
| Leasehold improvements | S/L | 2-25 years | 411 | (199) | 212 |
| Total | | | $ 6,184 | $ (3,749) | $ 2,435 |

*The service life ranges vary significantly due to the diverse nature of PP&E held by the Department.*

### Heritage Assets

The Department has a total of fifteen heritage assets, of which five are considered multi-use, for fiscal years 2013 and 2012. The Treasury Complex (Main Treasury Building and Annex), declared a national historical landmark in 1972, is treated as a multi-use heritage asset and is expected to be preserved indefinitely. The buildings that house the Mint in Denver, San Francisco, Fort Knox, and West Point are also considered multi-use heritage assets and included on the National Register of Historic Places. Additionally, the Mint maintains heritage assets consisting of four coin collections and six historical artifacts. The condition of the heritage assets is disclosed within the Required Supplemental Information (Unaudited) section of this report.

# 15. NON-ENTITY VS. ENTITY ASSETS

Non-entity assets are those that are held and managed by the Department on behalf of the U.S. government (General Fund) but are not available for use by the Department. As of September 30, 2013 and 2012, the Department's total assets, segregated between non-entity and entity, are shown below (in millions):

| | 2013 | | |
|---|---|---|---|
| | **Non-Entity** | **Entity** | **Total** |
| **Intra-governmental Assets:** | | | |
| Fund Balance [a] | **$ 1,254** | **$ 366,566** | **$ 367,820** |
| Loans and Interest Receivable (Note 3) | **1,020,773** | **72,786** | **1,093,559** |
| Advances to the Unemployment Trust Fund (Note 4) | **29,696** | **-** | **29,696** |
| Due From the General Fund (Note 4) | **17,123,357** | **-** | **17,123,357** |
| Other Intra-governmental Assets | **364** | **71** | **435** |
| **Total Intra-governmental Assets** | **18,175,444** | **439,423** | **18,614,867** |
| Cash, Foreign Currency, and Other Monetary Assets (Note 5)[b] | **83,208** | **65,298** | **148,506** |
| Gold and Silver Reserves (Note 6)[c] | **11,062** | **-** | **11,062** |
| Investments in GSEs (Note 8) | **140,221** | **-** | **140,221** |
| Taxes, Interest and Other Receivables, Net (Note 13) | **38,527** | **75** | **38,602** |
| Other Assets [d] | **90** | **87,276** | **87,366** |
| **Total Assets** | **$ 18,448,552** | **$ 592,072** | **$ 19,040,624** |

*[a] $434 million of the non-entity balance represents assets held on behalf of the General Fund (Note 4).*
*[b] $82.9 billion of the non-entity balance represents assets held on behalf of the General Fund (Note 4).*
*[c] $25 million of the non-entity balance represents assets held on behalf of the General Fund (Note 4).*
*[d] Other Assets (Entity) include TARP and non-TARP credit program receivables, net, totaling $17.9 billion and $17.6 billion, respectively, a reserve position in the IMF of $17.9 billion, and other various assets on the Consolidated Balance Sheets not separately presented in this table.*

| | 2012 | | |
|---|---|---|---|
| | Non-Entity | Entity | Total |
| Intra-governmental Assets: | | | |
| Fund Balance [e] | $ 1,879 | $ 342,467 | $ 344,346 |
| Loans and Interest Receivable (Note 3) | 845,976 | 68,328 | 914,304 |
| Advances to the Unemployment Trust Fund (Note 4) | 32,932 | - | 32,932 |
| Due From the General Fund (Note 4) | 16,202,179 | - | 16,202,179 |
| Other Intra-governmental Assets | 456 | 1,039 | 1,495 |
| **Total Intra-governmental Assets** | 17,083,422 | 411,834 | 17,495,256 |
| Cash, Foreign Currency, and Other Monetary Assets (Note 5)[f] | 79,575 | 65,976 | 145,551 |
| Gold and Silver Reserves (Note 6)[g] | 11,062 | - | 11,062 |
| Investments in GSEs (Note 8) | 109,342 | - | 109,342 |
| Taxes, Interest and Other Receivables, Net (Note 13) | 41,427 | 36 | 41,463 |
| Non-TARP Investments in American International Group, Inc. (Note 7) | 2,611 | - | 2,611 |
| Other Assets [h] | 95 | 116,482 | 116,577 |
| **Total Assets** | $ 17,327,534 | $ 594,328 | $ 17,921,862 |

*[e] $406 million of the non-entity balance represents assets held on behalf of the General Fund (Note 4).*
*[f] $79.2 billion of the non-entity balance represents assets held on behalf of the General Fund (Note 4).*
*[g] $25 million of the non-entity balance represents assets held on behalf of the General Fund (Note 4).*
*[h] Other Assets (Entity) include TARP and non-TARP credit program receivables, net, totaling $40.2 billion and $19.9 billion, respectively, a reserve position in the IMF of $21.6 billion, and other various assets on the Consolidated Balance Sheets not separately presented in this table.*

# 16. Federal Debt and Interest Payable and Related Liabilities

The Department is responsible for administering the federal debt on behalf of the U.S. government. The federal debt includes borrowings from the public as well as borrowings from federal agencies. The federal debt does not include debt issued by other governmental agencies, such as the Tennessee Valley Authority or the HUD.

The Federal Debt and Interest Payable as of September 30, 2013 and 2012 was as follows (in millions):

| **Intra-governmental** | | **2013** | | 2012 |
|---|---|---|---|---|
| Beginning Balance | **$** | **4,759,532** | $ | 4,625,038 |
| New Borrowings/(Repayments) | | **(34,396)** | | 134,494 |
| Subtotal at Par Value | | **4,725,136** | | 4,759,532 |
| Premium/(Discount) | | **69,210** | | 55,964 |
| Debt Principal Not Covered by Budgetary Resources (Note 19) | | **4,794,346** | | 4,815,496 |
| Interest Payable Covered by Budgetary Resources | | **43,090** | | 45,509 |
| **Total** | **$** | **4,837,436** | $ | 4,861,005 |

| **Held by the Public** | | **2013** | | 2012 |
|---|---|---|---|---|
| Beginning Balance | **$** | **11,269,586** | $ | 10,127,031 |
| New Borrowings | | **706,693** | | 1,142,555 |
| Subtotal at Par Value | | **11,976,279** | | 11,269,586 |
| Premium/(Discount) | | **(24,444)** | | (19,225) |
| Debt Principal Not Covered by Budgetary Resources (Note 19) | | **11,951,835** | | 11,250,361 |
| Interest Payable Covered by Budgetary Resources | | **51,195** | | 57,222 |
| **Total** | **$** | **12,003,030** | $ | 11,307,583 |

Debt held by the public primarily represents the amount the U.S. government has borrowed to finance cumulative cash deficits. In contrast, intra-governmental debt holdings, primarily trust funds, represent balances of Treasury securities held by individual federal agencies with either the authority or the requirement to invest excess receipts in U.S. Treasury securities in which the principal and interest are guaranteed by the full faith and credit of the U.S. government.

### FEDERAL DEBT HELD BY OTHER FEDERAL AGENCIES

Certain federal agencies are allowed to invest excess funds in debt securities issued by the Department on behalf of the U.S. government. The terms and the conditions of debt securities issued are designed to meet the cash needs of the U.S. government. The vast majority of debt securities are non-marketable securities issued at par value, but others are issued at market prices and interest rates that reflect market terms. The average intra-governmental interest rate for debt held by the federal entities, excluding Treasury Inflation-Protected Securities (TIPS), for fiscal years 2013 and 2012 was 3.6 percent and 3.7 percent, respectively. The average intra-governmental interest rate on TIPS for fiscal years 2013 and 2012 was 1.3 percent and 1.5 percent, respectively. The average interest rate represents the original issue weighted effective yield on securities outstanding at the end of the fiscal year.

The federal debt also includes intra-governmental marketable debt securities that certain agencies are permitted to buy and sell on the open market. The debt held by federal agencies at par value (not including premium/discount or interest payable) as of September 30, 2013 and 2012 was as follows (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Social Security Administration | **$** | **2,756,390** | $ | 2,719,042 |
| Office of Personnel Management | | **821,466** | | 927,302 |
| Department of Defense Agencies | | **620,815** | | 562,657 |
| Department of Health and Human Services | | **278,766** | | 302,932 |
| All Other Federal Agencies - Consolidated | | **247,699** | | 247,599 |
| **Total Federal Debt Held by Other Federal Agencies** | **$** | **4,725,136** | $ | 4,759,532 |

### FEDERAL DEBT HELD BY THE PUBLIC

Federal debt held by the public at par value (not including premium/discount or interest payable) as of September 30, 2013 and 2012 consisted of the following (in millions):

| *(at par value)* | **Term** | **Average Interest Rates** | | **2013** |
|---|---|---|---|---|
| **Marketable:** | | | | |
| Treasury Bills | **1 Year or Less** | **0.1%** | **$** | **1,527,909** |
| Treasury Notes | **Over 1 Year - 10 Years** | **1.8%** | | **7,750,336** |
| Treasury Bonds | **Over 10 Years** | **5.1%** | | **1,363,114** |
| Treasury Inflation-Protected Security (TIPS) | **5 Years or More** | **1.1%** | | **936,041** |
| **Total Marketable** | | | | **11,577,400** |
| Non-Marketable | **On Demand to Over 10 Years** | **2.4%** | | **398,879** |
| **Total Federal Debt Held by the Public** | | | **$** | **11,976,279** |

| *(at par value)* | Term | Average Interest Rates | | 2012 |
|---|---|---|---|---|
| **Marketable:** | | | | |
| Treasury Bills | 1 Year or Less | 0.1% | $ | 1,613,026 |
| Treasury Notes | Over 1 - 10 Years | 2.0% | | 7,114,961 |
| Treasury Bonds | Over 10 Years | 5.4% | | 1,194,715 |
| Treasury Inflation-Protected Security (TIPS) | 5 Years or More | 1.4% | | 807,469 |
| **Total Marketable** | | | | 10,730,171 |
| Non-Marketable | On Demand to Over 10 Years | 2.1% | | 539,415 |
| **Total Federal Debt Held by the Public** | | | $ | 11,269,586 |

The Department issues marketable bills at a discount or at par, and pays the par amount of the security upon maturity. The average interest rate on Treasury bills represents the original issue effective yield on securities outstanding at year end. Treasury bills are issued with a term of one year or less.

The Department issues marketable notes and bonds as long-term securities that pay semi-annual interest based on the securities' stated interest rates. These securities are issued at either par value or at an amount that reflects a discount or a premium. The average interest rate on marketable notes and bonds represents the stated interest rate adjusted by any discount or premium on securities outstanding at year-end. Treasury notes are issued with a term of over one year to ten years, and Treasury bonds are issued with a term of more than ten years. The Department also issues TIPS that have interest and redemption payments tied to the Consumer Price Index (CPI) for all Urban Consumers, a widely used measurement of inflation. TIPS are issued with a term of five years or more, and the principal for TIPS is adjusted daily over the life of the security based on the CPI for all Urban Consumers. At maturity, TIPS are redeemed at the inflation-adjusted principal amount, or the original par value, whichever is greater. TIPS pay a semi-annual fixed rate of interest applied to the inflation-adjusted principal. The average interest rate on TIPS represents the stated interest rate on principal plus inflation, adjusted by any discount or premium on securities outstanding as of the end of the fiscal year. The inflation-adjusted TIPS principal balance of federal debt held by the public included inflation of $88.5 billion and $77.9 billion as of September 30, 2013 and 2012, respectively.

During fiscal year 2013, the Department issued bills, notes, bonds, and TIPS to meet the borrowing needs of the U.S. government. Treasury bills outstanding decreased by $85.1 billion; whereas, Treasury notes, bonds, and TIPS outstanding increased by $635.4 billion, $168.4 billion, and $128.6 billion, respectively, in fiscal year 2013.

September 30, 2012 occurred on a Sunday and, therefore, debt repayments on matured securities occurred on Monday, October 1, 2012. Accordingly, $53.0 billion of marketable Treasury notes and $36 million of non-marketable securities, matured but not repaid, are included in the fiscal year 2012 balance of the total debt held by the public.

Federal Debt Held by the Public includes federal debt held outside of the U.S. government by individuals, corporations, FRBs, state and local governments, foreign governments, and central banks. As of September 30, 2013, the FRBs had total holdings of $1.9 trillion which: *(i)* excluded $145 billion in Treasury securities used in overnight reverse repurchase transactions, and *(ii)* included a net of $3.1 billion in Treasury securities held by the FRB as collateral for securities lending activities. As of September 30, 2012, the FRBs had total holdings of $1.6 trillion, which included a net of $1.5 billion in Treasury securities held by the FRBs as collateral for securities lending activities. Treasury securities are held by the FRB in the FRB System Open Market Account for the purpose of conducting monetary policy.

### Debt Issuance Suspension Period Measures

Congress provided the Department with statutory authority to take certain extraordinary measures during a debt issuance suspension period (DISP) in the event that Treasury debt nears the statutory debt limit. These measures authorize the Department to depart from its normal debt management practices and exercise legal authorities to avoid exceeding the statutory debt limit.

The Secretary declared a DISP effective from December 31, 2012 through February 4, 2013. On February 4, 2013, Congress enacted a law to temporary suspend the debt limit until May 18, 2013. As Congress did not suspend or increase the debt limit prior to May 18, 2013, the Secretary declared another DISP effective from May 19, 2013 through October 16, 2013, on which date Congress enacted another law to suspend the debt limit through February 7, 2014.

In fiscal year 2013, the Department undertook the following extraordinary measures during the two DISPs: *(i)* suspended investments in Treasury debt securities to the Government Securities Investment Fund of the Federal Employees' Retirement System Thrift Savings Plan (TSP), the Civil Service Retirement and Disability Trust Fund (Civil Service

Fund), and the Postal Service Retiree Health Benefits Fund (Postal Benefits Fund); *(ii)* redeemed early a certain amount of Treasury debt securities held by the Civil Service Fund; (*iii*) suspended new issuances of State and Local Government Series securities; and (*iv*) issued cash management bills to manage short-term financing needs.

When a DISP ends, the Department is required by statute to restore the TSP, Civil Service Fund and Postal Benefits Fund with the accumulated principal balance of Treasury debt securities that bears such interest rates and maturity dates necessary to replicate the investments the funds would have held had the DISP not occurred (the uninvested principal). The Department is also required by statute to pay these funds the related lost interest (forgone interest) on the uninvested principal. Following the DISP period that ended on February 4, 2013, the Department restored the funds with the uninvested principal and interest totaling $31 billion and $20 million, respectively. Forgone interest paid to the funds in connection with DISPs that occurred in fiscal years 2013 and 2012 totaling $20 million and $59 million, respectively, was reported on the Department's Consolidated Statements of Net Cost as a non-entity expense entitled "Restoration of Foregone Federal Debt Interest," with an offsetting amount reported as "Accrued Interest and Discount on Debt" on the Consolidated Statements of Changes in Net Position.

Since the second DISP (which commenced on May 19, 2013) did not end until October 16, 2013, none of the uninvested principal and foregone interest payable to the funds as a result of the extraordinary measures had been restored to the three funds as of September 30, 2013. Uninvested principal owed to the three funds as of September 30, 2013 totaled $247.8 billion, and forgone interest payable to the funds for the period May 19, 2013 through September 30, 2013 totaled $801 million. Accordingly, the Department recorded a liability for the uninvested principal and foregone interest payable to the funds as of September 30, 2013. This liability, coupled with an additional liability for the uninvested principal and foregone interest that was incurred during the DISP period October 1, 2013 through October 16, 2013, as discussed below, was payable to the three funds subsequent to the October 16, 2013 ending of the DISP.

The uninvested principal and foregone interest payable as of September 30, 2013 was reported on the Department's Consolidated Balance Sheets as a liability entitled "Liability for Restoration of Federal Debt Principal and Interest," of which $128.3 billion represented an intra-governmental liability of combined principal and interest payable to the Civil Service Fund and Postal Benefits Fund which are administered by the OPM, and the remaining $120.3 billion represented the principal and interest payable to the TSP, a public liability. Corresponding amounts were reported in the "Due From the General Fund" on the Consolidated Balance Sheets for the $248.6 billion of uninvested principal and foregone interest owed to the funds (Note 4). Additionally, the accrued forgone interest expense of $801 million was reported as a non-entity expense entitled "Accrued Restoration of Foregone Federal Debt Interest" on the Consolidated Statements of Net Cost, with an offsetting amount reported as "Accrued Interest on Restoration of Federal Debt Principal" on the Consolidated Statements of Changes in Net Position.

DISP measures such as those discussed above continued from October 1 through October 16, 2013. when the DISP ended and Congress enacted a law to suspend temporarily the debt limit. In addition to those activities previously discussed, other types of extraordinary measures were taken during the DISP periods, including temporarily suspending investments in Treasury debt securities by the ESF, and utilization of FFB to redeem outstanding Treasury debt securities held by the Civil Service Fund (refer to Note 17). On October 17, 2013, the Department discontinued its use of extraordinary actions and resumed normal debt management operations. On this date, the Department restored uninvested principal of $173.9 billion to the TSP, and $117.7 billion and $4.6 billion to the Civil Service Fund and Postal Benefits Fund, respectively. The Department restored forgone interest to the TSP on October 18, 2013 in the amount of $653 million. Forgone interest payable to the Civil Service Fund and Postal Benefits Fund will be restored on the next semi-annual interest payment date of December 31, 2013. As of October 17, 2013, these amounts totaled $562 million and $24 million, respectively. In addition, the Department authorized ESF to resume investments in Treasury debt

securities; however, the Department did not restore the ESF for lost interest incurred during the DISP in accordance with statute.

## 17. Other Debt and Interest Payable

The Department, through FFB, has outstanding borrowings and related accrued interest owed to the Civil Service Fund. At September 30, 2013 and 2012, FFB had outstanding borrowings of $5.8 billion and $7.2 billion, inclusive of $66 million and $83 million of accrued interest payable, respectively. During fiscal years 2013 and 2012, the Department paid $1.4 billion and $1.3 billion in principal, respectively. The outstanding borrowings at September 30, 2013 and 2012 had a stated interest rate of 4.63 percent and an effective interest rate of 4.63 percent. Maturity dates ranged from June 30, 2014 to June 30, 2019 for outstanding borrowings at September 30, 2013, and from June 30, 2013 to June 30, 2019 for outstanding borrowings at September 30, 2012.

On October 1, 2013, the Department, through FFB, exchanged $9.3 billion of non-Treasury debt securities held that do not count against the debt limit for an equivalent amount of Treasury debt securities previously held by the Civil Service Fund and that do count against the debt limit. FFB used the Treasury debt securities it had received from the Civil Service Fund to repay $8.8 billion of outstanding principal borrowings, including interest, owed to the Fiscal Service. The Fiscal Service then extinguished the Treasury debt securities it had received from FFB, thereby helping the Department to remain below the statutory debt limit. The Department, FFB, and the Civil Service Fund took this extraordinary measure to help prevent Treasury debt from exceeding the statutory debt limit. These transactions resulted in an additional $9.3 billion outstanding debt obligation owed by FFB to the Civil Service Fund as of October 1, 2013 to be reported as an intra-governmental liability on the Department's Consolidated Balance Sheets entitled "Other Debt and Interest Payable."

# 18. D.C. Pensions and Judicial Retirement Actuarial Liability

Title XI of the *Balanced Budget Act of 1997*, as amended was intended to relieve the D.C. government of the burden of unfunded pension liabilities transferred to the District by the U.S. government in 1979. To fulfill its responsibility, the Department manages two funds – the D.C. Teachers', Police Officers', and Firefighters' Federal Pension Fund (the D.C. Federal Pension Fund) and the District of Columbia Judicial Retirement and Survivors' Annuity Fund (the Judicial Retirement Fund). The Department is required to make annual amortized payments from the General Fund to the D.C. Federal Pension Fund and the Judicial Retirement Fund. The D.C. Federal Pension Fund benefit payments are related to creditable service performed on or before June 30, 1997, while the Judicial Retirement Fund benefit payments are related to all creditable service.

A reconciliation of the combined actuarial pension liability for the D.C. Federal Pension Fund and the Judicial Retirement Fund as of September 30, 2013 and 2012 is as follows (in millions):

| | **2013** | 2012 |
|---|---|---|
| **Beginning Liability Balance** | **$ 10,059** | $ 9,671 |
| **Pension Expense:** | | |
| Normal cost | **5** | 4 |
| Interest on Pension Liability During the Year | **199** | 215 |
| | | |
| **Actuarial (Gains) Losses During the Year:** | | |
| From Experience | **128** | 23 |
| From Discount Rate Assumption Change | **(523)** | 532 |
| From Other Assumption Changes | **(156)** | 158 |
| Total Pension Expense | **(347)** | 932 |
| Less Amounts Paid | **(548)** | (544) |
| **Ending Liability Balance** | **$ 9,164** | $ 10,059 |

Additional Information ($ in millions):

| | | **D.C. Federal Pension Fund** | | **Judicial Retirement Fund** | | **2013 Total** |
|---|---|---|---|---|---|---|
| Pension and Other Actuarial Liability | **$** | **8,972** | **$** | **192** | **$** | **9,164** |
| Funded Liability | | **(3,652)** | | **(138)** | | **(3,790)** |
| **Unfunded Liability** | **$** | **5,320** | **$** | **54** | **$** | **5,374** |
| | | | | | | |
| Amount Received from the General Fund | **$** | **496** | **$** | **9** | **$** | **505** |
| | | | | | | |
| Annual Rate of Investment Return Assumption | | **1.86% - 4.41%** | | **1.86% - 4.41%** | | |
| | | | | | | |
| Future Annual Rate of Inflation and Cost-of-Living Adjustment: | | | | | | |
| Police Officers | | **2.43%** | | **N/A** | | |
| Firefighters | | **2.43%** | | **N/A** | | |
| Teachers | | **2.53%** | | **N/A** | | |
| Judicial | | **N/A** | | **2.56%** | | |
| | | | | | | |
| Future Annual Rate of Salary Increases: | | | | | | |
| Police Officers | | **3.40%** | | **N/A** | | |
| Firefighters | | **3.08%** | | **N/A** | | |
| Teachers | | **3.90%** | | **N/A** | | |
| Judicial | | **N/A** | | **2.34%** | | |

| | | D.C. Federal Pension Fund | | Judicial Retirement Fund | | 2012 Total |
|---|---|---|---|---|---|---|
| Pensions and Other Actuarial Liability | $ | 9,863 | $ | 196 | $ | 10,059 |
| Receipts and Appropriations Temporarily Precluded from Obligations | | (3,571) | | (134) | | (3,705) |
| **Unfunded Liability** | $ | 6,292 | $ | 62 | $ | 6,354 |
| | | | | | | |
| Amount Received from the General Fund | $ | 482 | $ | 10 | $ | 492 |
| | | | | | | |
| Annual Rate of Investment Return Assumption | | 2.02% - 4.70% | | 2.02% - 4.70% | | |
| | | | | | | |
| Future Annual Rate of Inflation and Cost-of-Living Adjustment | | | | | | |
| Police Officers | | 2.55% | | N/A | | |
| Firefighters | | 2.55% | | N/A | | |
| Teachers | | 2.55% | | N/A | | |
| Judicial | | N/A | | 2.53% | | |
| | | | | | | |
| Future Annual Rate of Salary Increases: | | | | | | |
| Police Officers | | 4.25% | | N/A | | |
| Firefighters | | 4.25% | | N/A | | |
| Teachers | | 4.25% | | N/A | | |
| Judicial | | N/A | | 1.50% | | |

# 19. LIABILITIES

## LIABILITIES NOT COVERED BY BUDGETARY AND OTHER RESOURCES

As of September 30, 2013 and 2012, liabilities not covered by budgetary and other resources consisted of the following (in millions):

| | 2013 | 2012 |
|---|---|---|
| **Intra-governmental Liabilities Not Covered by Budgetary and Other Resources** | | |
| Federal Debt Principal, Premium/Discount (Note 16) | **$ 4,794,346** | $ 4,815,496 |
| Liability for Restoration of Federal Debt Principal and Interest (Note 16) | **128,272** | - |
| Other Intra-governmental Liabilities | **123** | 124 |
| **Total Intra-governmental Liabilities Not Covered by Budgetary and Other Resources** | **4,922,741** | 4,815,620 |
| Federal Debt Principal, Premium/Discount (Note 16) | **11,951,835** | 11,250,361 |
| Liability for Restoration of Federal Debt Principal and Interest (Note 16) | **120,356** | - |
| Gold and Silver Reserves (Note 6) | **11,062** | 11,062 |
| D.C. Pensions and Judicial Retirement - Unfunded Liability (Note 18) | **5,374** | 6,354 |
| Liability to GSEs (Note 8) | **-** | 9,003 |
| Other Liabilities | **2,624** | 2,866 |
| **Total Liabilities Not Covered by Budgetary and Other Resources** | **17,013,992** | 16,095,266 |
| **Total Liabilities Covered by Budgetary and Other Resources** | **1,585,489** | 1,437,200 |
| **Total Liabilities** | **$ 18,599,481** | $ 17,532,466 |

## OTHER LIABILITIES

Total "Other Liabilities" displayed on the Consolidated Balance Sheets consists of both liabilities that are covered and not covered by budgetary resources. Other liabilities at September 30, 2013 and 2012 consisted of the following (in millions):

| | 2013 Current | 2013 Non-Current | 2013 Total | 2012 Current | 2012 Non-Current | 2012 Total |
|---|---|---|---|---|---|---|
| **Intra-governmental** | | | | | | |
| Accounts Payable | **$ 204** | **$ -** | **$ 204** | $ 203 | $ - | $ 203 |
| Unfunded Federal Workers Compensation Program Liability (FECA) | **48** | **56** | **104** | 47 | 58 | 105 |
| Other Accrued Liabilities | **169** | **-** | **169** | 233 | - | 233 |
| **Total Intra-governmental** | **$ 421** | **$ 56** | **$ 477** | $ 483 | $ 58 | $ 541 |
| **With the Public** | | | | | | |
| Liability for Deposit Funds (Held by the U.S. government for Others) and Suspense Accounts | **$ 245** | **$ -** | **$ 245** | $ 275 | $ - | $ 275 |
| Actuarial Federal Workers Compensation Program Liability (FECA) | **-** | **618** | **618** | - | 576 | 576 |
| Accrued Funded Payroll and Benefits | **269** | **-** | **269** | 558 | - | 558 |
| Accounts Payable and Other Accrued Liabilities | **3,047** | **55** | **3,102** | 3,905 | 60 | 3,965 |
| **Total with the Public** | **$ 3,561** | **$ 673** | **$ 4,234** | $ 4,738 | $ 636 | $ 5,374 |

# 20. NET POSITION

Unexpended Appropriations represents the amount of spending authorized as of year-end that is unliquidated or unobligated and has not lapsed, been rescinded, or withdrawn. No-year appropriations remain available for obligation until expended. Annual appropriations remain available for upward or downward adjustment of obligations until expired.

Cumulative Results of Operations represents the net results of operations since inception, and includes cumulative amounts related to investments in capitalized assets and donations and transfers of assets in and out without reimbursement. Also included as a reduction in Cumulative Results of Operations are accruals for which the related expenses require funding from future appropriations and assessments. These future funding requirements include, among others: (a) accumulated annual leave earned but not taken, (b) accrued FECA, (c) credit reform cost re-estimates, (d) unfunded D.C. pensions, and (d) expenses for contingent liabilities including Liability to GSEs.

### APPROPRIATIONS RECEIVED

The amount reported as "appropriations received" is appropriated by Congress from the General Fund receipts, such as income taxes, that are not dedicated by law for a specific purpose. This amount will not necessarily agree with the "appropriations (discretionary and mandatory)" amount reported on the Combined Statements of Budgetary Resources because of differences between proprietary and budgetary accounting concepts and reporting requirements. For example, certain dedicated receipts are recorded as "appropriations (discretionary and mandatory)" on the Combined Statements of Budgetary Resources, but are recognized as exchange or non-exchange revenue (i.e., typically in special and non-revolving trust funds) and reported on the Statement of Changes in Net Position in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*.

### TRANSFERS TO THE GENERAL FUND AND OTHER

The amount reported as "Transfers to the General Fund and Other" on the Consolidated Statement of Changes in Net Position under "Other Financing Sources" includes the following as of September 30, 2013 and 2012 (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| **Categories of Transfers to the General Fund and Other** | | | | |
| Interest Revenue | $ | **38,436** | $ | 38,874 |
| Increase/(Decrease) in Liquidation Preference of GSEs Preferred Stock, GSEs Preferred Stock Dividends and Valuation Changes (Note 8) | | **126,606** | | (5,322) |
| Downward Re-estimates of Credit Reform Subsidies (Notes 7 and 11) | | **11,718** | | 11,648 |
| Other | | **1,216** | | 1,141 |
| **TOTAL** | **$** | **177,976** | $ | 46,341 |

Included in "Transfers to the General Fund and Other" are the GSE Senior Preferred Stock investments and related dividends, as well as the annual valuation adjustment to those investments. These transfers also include distribution of interest revenue to the General Fund. The interest revenue is accrued on inter-agency loans held by the Department on behalf of the U.S. government. A corresponding amount is reported on the Consolidated Statements of Net Cost under "Non-Entity Costs: Less Interest Revenue from Loans." The amount reported on the Consolidated Statements of Net Cost is reduced by eliminations with Treasury bureaus. The credit reform downward re-estimate subsidies that are transferred to the General Fund result from a change in forecasts of future cash flows.

The "Other" line mainly represents collections from other federal agencies as reimbursement of costs incurred by the Department for its administration of trust funds established within the Social Security Act. The Department is directed by statute to execute these administrative services. Seigniorage and numismatic profits also are included in the "Other" line. Seigniorage is the face value of newly minted circulating coins less the cost of production. Numismatic profit is any

profit on the sale of proof coins, uncirculated coins, commemorative coins, and related products and accessories. The United States Mint is required to distribute seigniorage and numismatic profits in excess of operating expenses to the General Fund. In any given year, the amount recognized as seigniorage may differ from the amount distributed to the General Fund by an insignificant amount due to timing differences.

# 21. Consolidated Statements of Net Cost and Net Costs of Treasury Sub-Organizations

The Department's Consolidated Statements of Net Cost display information on a consolidated basis. The Department consists of DO and seven operating bureaus that the Department provides supporting schedules for Net Cost in the notes to the financial statements (Note 1). These supporting schedules provide consolidating information, which fully displays the costs, revenues, and net cost of DO and each operating bureau.

The classification of sub-organizations has been determined in accordance with SFFAS No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Governmen*t which states that the predominant factor is the reporting entity's organization structure and existing responsibility components, such as bureaus, administrations, offices, and divisions within a department.

Each sub-organization is responsible for accumulating costs. The assignment of the costs to Department-wide programs is the result of using the following cost assignment methods: (1) direct costs, (2) cause and effect, and (3) cost allocation.

### Intra-Departmental Costs/Revenues

Intra-departmental costs/revenues resulting from the provision of goods and/or services on a reimbursable basis among Departmental sub-organizations are reported as costs by providing sub-organizations and as revenues by receiving sub-organizations. The Department recognized intra-departmental imputed costs on the Consolidated Statements of Net Cost of $621 million and $518 million during fiscal years 2013 and 2012, respectively. Accordingly, such costs or revenues are eliminated in the consolidation process.

### Intra-governmental Costs

Intra-governmental costs relate to the source of goods and services purchased by the Department and not to the classification of the related intra-governmental revenue.

In certain cases, other federal agencies incur costs that are directly identifiable to the Department's operations. In accordance with SFFAS No. 30, *Inter-Entity Cost Implementation Amending* SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, the Department recognizes identified costs paid on behalf of the Department by other agencies. The imputed inter-departmental financing sources currently recognized by the Department include the actual cost of future benefits for the federal pension plans that are paid by other federal entities, the FEHB, and any un-reimbursed contract dispute payments made from the Treasury Judgment Fund on behalf of the Department. The funding for these costs is reflected as costs on the Consolidated Statements of Net Cost, and as imputed financing sources on the Statements of Changes in Net Position. Costs paid by other agencies on behalf of the Department were $776 million and $812 million for the fiscal years ended September 30, 2013 and 2012, respectively.

## CONSOLIDATED STATEMENTS OF NET COST PRESENTATION

OMB Circular No. A-136, *Financial Reporting Requirements*, as revised, requires that the presentation of the Consolidated Statements of Net Cost align directly with the goals and outcomes identified in the Strategic Plan. Accordingly, the Department has presented the gross costs and earned revenues by the applicable strategic goals in its fiscal years 2012 – 2015 Strategic Plan. The majority of Treasury bureaus' and reporting entities' net cost information falls within a single strategic goal in the Consolidated Statements of Net Cost. TTB, IRS, and DO allocate costs and related revenues to multiple programs using a net cost percentage calculation.

The Department's Consolidated Statements of Net Cost also present interest expense on the Federal Debt and other federal costs incurred on behalf of the U.S. government. These costs are not reflected as program costs related to the Department's strategic plan missions. Such costs are eliminated in the consolidation process to the extent that they involve transactions with Treasury sub-organizations.

Non-entity other federal costs shown on the Consolidated Statements of Net Cost for the years ended September 30, 2013 and 2012 consisted of the following (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Credit Reform Interest on Uninvested Fund (Intra-governmental) | $ | **8,210** | $ | 8,745 |
| Judgment Claims and Contract Disputes | | **5,125** | | 3,480 |
| Resolution Funding Corporation | | **2,503** | | 2,628 |
| Corporation for Public Broadcasting | | **422** | | 444 |
| All Other Payments | | **746** | | 993 |
| **Total** | **$** | **17,006** | $ | 16,290 |

# 21. Consolidated Statement of Net Cost and Net Costs of Treasury Sub-Organizations (in millions)

**For Fiscal Year Ended September 30, 2013**

| Program Costs | Bureau of Engraving & Printing | Bureau of the Fiscal Service[a] | Depart-mental Office[b] | Fin. Crimes Enforcement Network | Internal Revenue Service | U.S. Mint |
|---|---|---|---|---|---|---|
| **FINANCIAL PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | $ - | $ 426 | $ 2,443 | $ - | $ 4,256 | $ - |
| Less: Earned Revenue | - | (401) | (2,814) | - | (75) | - |
| Intra-governmental Net Costs | - | 25 | (371) | - | 4,181 | - |
| Gross Costs with the Public | - | 1,550 | 672 | - | 7,908 | - |
| Less: Earned Revenue | - | (1) | (32) | - | (402) | - |
| Net Costs with the Public | - | 1,549 | 640 | - | 7,506 | - |
| Net Cost: Financial Program | - | 1,574 | 269 | - | 11,687 | - |
| **ECONOMIC PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | 95 | - | 1,505 | - | - | 76 |
| Less: Earned Revenue | (2) | - | (327) | - | - | (3) |
| Intra-governmental Net Costs | 93 | - | 1,178 | - | - | 73 |
| Gross Costs with the Public | 591 | - | (6,744) | - | - | 4,009 |
| Less: Earned Revenue | (693) | - | (1,528) | - | - | (4,165) |
| Net Costs with the Public | (102) | - | (8,272) | - | - | (156) |
| Net Cost (Revenue): Economic Program | (9) | - | (7,094) | - | - | (83) |
| **SECURITY PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | - | - | 184 | 43 | 153 | - |
| Less: Earned Revenue | - | - | (46) | (1) | (24) | - |
| Intra-governmental Net Costs | - | - | 138 | 42 | 129 | - |
| Gross Costs with the Public | - | - | 162 | 71 | 484 | - |
| Less: Earned Revenue | - | - | - | - | - | - |
| Net Costs with the Public | - | - | 162 | 71 | 484 | - |
| Net Cost: Security Program | - | - | 300 | 113 | 613 | - |
| **Total Net Program Cost (Revenue) Before Changes in Actuarial Assumptions** | (9) | 1,574 | (6,525) | 113 | 12,300 | (83) |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | - | - | (679) | - | - | - |
| **Total Net Cost of (Revenue From) Treasury Operations** | $ (9) | $ 1,574 | $ (7,204) | $ 113 | $ 12,300 | $ (83) |

(a) *Includes the combined financial information of the BPD and FMS operating bureaus which merged effective October 2012 (Note 1A). The salaries and other administrative expenses of the legacy BPD and FMS bureaus will continue to be funded separately until Congress enacts legislation to fund these costs through a single appropriation.*

(b) *Of the total $7.1 billion of net revenue reported by Departmental Offices for the Economic Program, GSE and OFS contributed $9.2 billion and $7.7 billion, respectively, of net revenue, partially offset by Do Policy Offices, ESF, and Treasury International Assistance Programs of $5.6 billion, $1.7 billion, and $2.2 billion, respectively. Other immaterial net costs were spread throughout other DO programs or offices.*

# 21. Consolidated Statement of Net Cost and Net Costs of Treasury Sub-Organizations (in millions) (con't):

**For Fiscal Year Ended September 30, 2013**

| Program Costs | Office of the Comptroller of the Currency | Alcohol and Tobacco Tax and Trade Bureau | Combined Total | Eliminations | 2013 Consolidated |
|---|---|---|---|---|---|
| **FINANCIAL PROGRAM** | | | | | |
| Intra-governmental Gross Costs | $ - | $ 14 | $ 7,139 | $ 3,015 | $ 4,124 |
| Less: Earned Revenue | - | (3) | (3,293) | (603) | (2,690) |
| Intra-governmental Net Costs | - | 11 | 3,846 | 2,412 | 1,434 |
| Gross Costs with the Public | - | 39 | 10,169 | - | 10,169 |
| Less: Earned Revenue | - | (2) | (437) | - | (437) |
| Net Costs with the Public | - | 37 | 9,732 | - | 9,732 |
| Net Cost: Financial Program | - | 48 | 13,578 | 2,412 | 11,166 |
| **ECONOMIC PROGRAM** | | | | | |
| Intra-governmental Gross Costs | 142 | 15 | 1,833 | 1,462 | 371 |
| Less: Earned Revenue | (32) | (1) | (365) | (338) | (27) |
| Intra-governmental Net Costs | 110 | 14 | 1,468 | 1,124 | 344 |
| Gross Costs with the Public | 899 | 40 | (1,205) | - | (1,205) |
| Less: Earned Revenue | (975) | (1) | (7,362) | - | (7,362) |
| Net Costs with the Public | (76) | 39 | (8,567) | - | (8,567) |
| Net Cost (Revenue): Economic Program | 34 | 53 | (7,099) | 1,124 | (8,223) |
| **SECURITY PROGRAM** | | | | | |
| Intra-governmental Gross Costs | - | - | 380 | 67 | 313 |
| Less: Earned Revenue | - | - | (71) | (64) | (7) |
| Intra-governmental Net Costs | - | - | 309 | 3 | 306 |
| Gross Costs with the Public | - | - | 717 | - | 717 |
| Less: Earned Revenue | - | - | - | - | - |
| Net Costs with the Public | - | - | 717 | - | 717 |
| Net Cost: Security Program | - | - | 1,026 | 3 | 1,023 |
| **Total Net Program Cost (Revenue) Before Changes in Actuarial Assumptions** | 34 | 101 | 7,505 | 3,539 | 3,966 |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | (5) | - | (684) | - | (684) |
| **Total Net Cost of (Revenue From) Treasury Operations** | $ 29 | $ 101 | $ 6,821 | $ 3,539 | $ 3,282 |

# 21. Consolidated Statement of Net Cost and Net Costs of Treasury Sub-Organizations (in millions) (con't):

**For Fiscal Year Ended September 30, 2012**

| Program Costs | Bureau of Engraving & Printing | Bureau of the Fiscal Service | Depart-mental Office[c] | Fin. Crimes Enforcement Network | Internal Revenue Service | U.S. Mint |
|---|---|---|---|---|---|---|
| **FINANCIAL PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | $ - | $ 418 | $ 2,412 | $ - | $ 4,225 | $ - |
| Less: Earned Revenue | - | (429) | (2,762) | - | (47) | - |
| Intra-governmental Net Costs | - | (11) | (350) | - | 4,178 | - |
| Gross Costs with the Public | - | 1,599 | 587 | - | 8,329 | - |
| Less: Earned Revenue | - | (2) | (1) | - | (433) | - |
| Net Costs with the Public | - | 1,597 | 586 | - | 7,896 | - |
| Net Cost: Financial Program | - | 1,586 | 236 | - | 12,074 | - |
| **ECONOMIC PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | 88 | - | 4,216 | - | - | 76 |
| Less: Earned Revenue | (2) | - | (1,220) | - | - | (3) |
| Intra-governmental Net Costs | 86 | - | 2,996 | - | - | 73 |
| Gross Costs with the Public | 594 | - | (285,280) | - | - | 3,194 |
| Less: Earned Revenue | (726) | - | (3,707) | - | - | (3,303) |
| Net Costs with the Public | (132) | - | (288,987) | - | - | (109) |
| Net Cost (Revenue): Economic Program | (46) | - | (285,991) | - | - | (36) |
| **SECURITY PROGRAM** | | | | | | |
| Intra-governmental Gross Costs | - | - | 150 | 59 | 169 | - |
| Less: Earned Revenue | - | - | (29) | 6 | (2) | - |
| Intra-governmental Net Costs | - | - | 121 | 65 | 167 | - |
| Gross Costs with the Public | - | - | 154 | 60 | 526 | - |
| Less: Earned Revenue | - | - | - | - | - | - |
| Net Costs with the Public | - | - | 154 | 60 | 526 | - |
| Net Cost: Security Program | - | - | 275 | 125 | 693 | - |
| **Total Net Program Cost (Revenue) Before Changes in Actuarial Assumptions** | (46) | 1,586 | (285,480) | 125 | 12,767 | (36) |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | - | - | 690 | - | - | - |
| **Total Net Cost of (Revenue From) Treasury Operations** | $ (46) | $ 1,586 | $ (284,790) | $ 125 | $ 12,767 | $ (36) |

*(c) Of the total $286.0 billion of net revenue reported by Departmental Offices for the Economic Program, GSE and OFS contributed $288.4 billion and $7.8 billion of net revenue, respectively, partially offset by other DO policy offices net cost.*

# 21. Consolidated Statement of Net Cost and Net Costs of Treasury Sub-Organizations (in millions) (con't):

**For Fiscal Year Ended September 30, 2012**

| Program Costs | Office of the Comptroller of the Currency | Alcohol and Tobacco Tax and Trade Bureau | Combined Total | Eliminations | 2012 Consolidated |
|---|---|---|---|---|---|
| **FINANCIAL PROGRAM** | | | | | |
| Intra-governmental Gross Costs | $ - | $ 14 | $ 7,069 | $ 2,742 | $ 4,327 |
| Less: Earned Revenue | - | (1) | (3,239) | (578) | (2,661) |
| Intra-governmental Net Costs | - | 13 | 3,830 | 2,164 | 1,666 |
| Gross Costs with the Public | - | 41 | 10,556 | - | 10,556 |
| Less: Earned Revenue | - | (3) | (439) | - | (439) |
| Net Costs with the Public | - | 38 | 10,117 | - | 10,117 |
| Net Cost: Financial Program | - | 51 | 13,947 | 2,164 | 11,783 |
| **ECONOMIC PROGRAM** | | | | | |
| Intra-governmental Gross Costs | 136 | 14 | 4,530 | 4,035 | 495 |
| Less: Earned Revenue | (31) | - | (1,256) | (1,226) | (30) |
| Intra-governmental Net Costs | 105 | 14 | 3,274 | 2,809 | 465 |
| Gross Costs with the Public | 913 | 39 | (280,540) | - | (280,540) |
| Less: Earned Revenue | (969) | - | (8,705) | - | (8,705) |
| Net Costs with the Public | (56) | 39 | (289,245) | - | (289,245) |
| Net Cost (Revenue): Economic Program | 49 | 53 | (285,971) | 2,809 | (288,780) |
| **SECURITY PROGRAM** | | | | | |
| Intra-governmental Gross Costs | - | - | 378 | 59 | 319 |
| Less: Earned Revenue | - | - | (25) | (21) | (4) |
| Intra-governmental Net Costs | - | - | 353 | 38 | 315 |
| Gross Costs with the Public | - | - | 740 | - | 740 |
| Less: Earned Revenue | - | - | - | - | - |
| Net Costs with the Public | - | - | 740 | - | 740 |
| Net Cost: Security Program | - | - | 1,093 | 38 | 1,055 |
| **Total Net Program Cost (Revenue) Before Changes in Actuarial Assumptions** | 49 | 104 | (270,931) | 5,011 | (275,942) |
| (Gain)/Loss on Pension, ORB, or OPEB Assumption Changes | 5 | - | 695 | - | 695 |
| **Total Net Cost of (Revenue From) Treasury Operations** | $ 54 | $ 104 | $ (270,236) | $ 5,011 | $ (275,247) |

# 22. Additional Information Related to the Combined Statements of Budgetary Resources

## Undelivered Orders

Undelivered orders represent goods and services ordered and obligated, which have not been received. This includes any orders for which advance payment has been made, but for which delivery or performance has not yet occurred. Undelivered orders at September 30, 2013 and 2012 are shown below (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Paid | **$** | **42** | $ | 107 |
| Unpaid | | **172,804** | | 190,252 |
| **Undelivered orders at the end of the year** | **$** | **172,846** | $ | 190,359 |

## Contributed Capital

Contributed capital represents the current year authority and prior year balances of amounts actually transferred through non-expenditure transfers to miscellaneous receipt accounts of the General Fund of the Treasury to repay a portion of a capital investment. Contributed capital for the fiscal years ended September 30, 2013 and 2012 was $42 million and $78 million, respectively.

## Apportionment Categories of Obligations Incurred

Apportionment categories are determined in accordance with the guidance provided in OMB Circular No. A-11, *Preparation, Submission and Execution of the Budget*. Apportionment Category A represents resources apportioned for calendar quarters. Apportionment Category B represents resources apportioned for other time periods for activities, projects or objectives, or for any combination thereof. Obligations incurred for direct and reimbursable obligations by apportionment category for the fiscal years ended September 30, 2013 and 2012 are shown below (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Direct - Category A | **$** | **173** | $ | 17,958 |
| Direct - Category B | | **51,173** | | 83,093 |
| Direct - Exempt from Apportionment | | **429,364** | | 369,596 |
| **Total Direct** | | **480,710** | | 470,647 |
| | | | | |
| Reimbursable - Category B | | **5,448** | | 4,490 |
| Reimbursable - Exempt from Apportionment | | **1,273** | | 1,326 |
| **Total Reimbursable** | | **6,721** | | 5,816 |
| **Total Direct and Reimbursable** | **$** | **487,431** | $ | 476,463 |

## Terms of Borrowing Authority Used

Several Departmental programs have authority to borrow under the FCRA, as amended. The FCRA provides indefinite borrowing authority to financing accounts to fund the unsubsidized portion of direct loans and to satisfy obligations in the event the financing account's resources are insufficient. Repayment requirements are defined by OMB Circular No. A-11. Interest expense due is calculated based on the beginning balance of borrowings outstanding and the borrowings/repayments activity that occurred during the fiscal year. Undisbursed Departmental borrowings earn interest at the same rate as the financing account pays on its debt owed to the Fiscal Service. In the event that principal and interest collections exceed the interest expense due, the excess will be repaid to the Department. If principal and interest do not exceed interest expense due, the Department will borrow the difference. The Department makes periodic principal repayments based on the analysis of cash balances and future disbursement needs. All interest on borrowings were due on September 30, 2013. Interest rates on FCRA borrowings range from 0.07 percent to 7.59 percent.

### AVAILABLE BORROWING

The available borrowing authority and related changes in available borrowing authority as of and for the fiscal years ended September 30, 2013 and 2012 are shown below (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Beginning Balance | **$** | **109,930** | $ | 123,844 |
| Current Authority | | **576** | | 11,019 |
| Borrowing Authority Withdrawn | | **(5,130)** | | (10,038) |
| Borrowing Authority Converted to Cash | | **(2,043)** | | (14,895) |
| **Ending Balance** | **$** | **103,333** | $ | 109,930 |

### RECONCILIATION OF THE PRESIDENT'S BUDGET

The Budget of the United States (also known as the President's Budget), with actual numbers for fiscal year 2013, was not published at the time that these financial statements were issued. The President's Budget is expected to be published in February 2014, and can be located at the OMB website http://www.whitehouse.gov/omb and will be available from the U.S. government Printing Office. The following chart displays the differences between the Combined Statement of Budgetary Resources (SBR) in the fiscal year 2012 Agency Financial Report and the actual fiscal year 2012 balances included in the fiscal year 2014 President's Budget.

**Reconciliation of Fiscal Year 2012 Combined Statement of Budgetary Resources to the Fiscal Year 2014 President's Budget**

| (in millions) | Budgetary Resources | Outlays (net of offsetting collections) | Distributed Offsetting Receipts | Net Outlays | Obligations Incurred |
|---|---|---|---|---|---|
| **Statement of Budgetary Resources (SBR) Amounts** | $ 816,061 | $ 315,199 | $ (73,881) | $ 241,318 | $ 476,463 |
| **Included in the Treasury Department Chapter of the President's Budget (PB) but not in the SBR** | | | | | |
| IRS non-entity tax credit payments [1] | 91,563 | 91,562 | - | 91,562 | 91,563 |
| Tax and Trade Bureau (TTB) non-entity collections for Puerto Rico | 376 | 376 | - | 376 | 376 |
| Continued dumping subsidy - U.S. Customs and Border Patrol | 125 | 418 | - | 418 | 418 |
| Other | 3 | 4 | (13) | (9) | 5 |
| **Subtotal** | 92,067 | 92,360 | (13) | 92,347 | 92,362 |
| **Included in the SBR but not in the Treasury Department chapter of the PB** | | | | | |
| Treasury resources shown in non-Treasury chapters of the PB [2] | (51,521) | (6,670) | - | (6,670) | (6,696) |
| Offsetting collections net of collections shown in PB | (8,725) | - | (276) | (276) | - |
| Treasury offsetting receipts shown in other chapters of PB | - | - | 544 | 544 | - |
| Unobligated balance carried forward, recoveries of prior year funds and expired accounts | (247,926) | - | - | - | - |
| ESF resources not shown in PB [3] | (44,092) | - | - | - | - |
| Treasury Financing Accounts (CDFI, GSE, OFS and SBLF) | (37,112) | 137,881 | - | 137,881 | (18,321) |
| Enacted reduction, 50% Transfer Accounts, and Capital Transfers to General Fund not included in PB | (44) | - | - | - | - |
| Unobligated balance transfers | 14 | - | - | - | - |
| Other | - | - | - | - | (5) |
| **Subtotal** | (389,406) | 131,211 | 268 | 131,479 | (25,022) |
| Trust Funds [4] | (2,465) | (250) | (436) | (686) | (1,371) |
| **President's Budget Amounts[5]** | **$ 516,257** | **$ 538,520** | **$ (74,062)** | **$ 464,458** | **$ 542,432** |

[1] *These are primarily Earned Income Tax Credit, Child Tax Credit, and Aid to First Time Homebuyers payments that are reported with refunds as custodial activities in the Department's financial statements and thus are not reported as budgetary resources.*

[2] *The largest of these resources relate to the Department's International Assistance Programs.*

[3] *The ESF is a self-sustaining component. Its primary sources of revenue are derived from interest on the ESF's SDR holdings, investments in U.S. Treasury securities, and investments in foreign currency-denominated assets.*

[4] *The Trust Funds (OCC, CDFI Capital Magnet Fund & Cheyenne River Restoration) negative outlay appear in the offsetting receipts section of the Analytical Perspectives.*

[5] *Per the President's Budget for fiscal year 2014 – Budgetary Resources and Outlays are from the Analytical Perspective. Offsetting Receipts and Obligations Incurred are from the Appendix.*

## LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

The use of unobligated balances is restricted based on annual legislation requirements or enabling authorities. Funds are presumed to be available for only one fiscal year unless otherwise noted in the annual appropriation language. Unobligated balances in unexpired fund symbols are available in the next fiscal year for new obligations unless some restrictions had been placed on those funds by law. In those situations, the restricted funding will be temporarily unavailable until such time as the reasons for the restriction have been satisfied or legislation has been enacted to remove the restriction.

Amounts in expired fund symbols are not available for new obligations, but may be used to adjust obligations and make disbursements that were recorded before the budgetary authority expired or to meet a bona fide need that arose in the fiscal year for which the appropriation was made.

# 23. COLLECTION AND DISPOSITION OF CUSTODIAL REVENUE

The Department collects the majority of federal revenue from income and excise taxes. Collection activity, by revenue type and tax year, for the fiscal years ended September 30, 2013 and 2012 are shown below (in millions):

| | Tax Year | | | | |
|---|---|---|---|---|---|
| | **2013** | **2012** | **2011** | **Pre-2011** | **2013 Collections** |
| Individual Income and FICA Taxes | **$ 1,580,379** | **$ 821,555** | **$ 22,270** | **$ 24,342** | **$ 2,448,546** |
| Corporate Income Taxes | **217,602** | **83,575** | **2,005** | **8,812** | **311,994** |
| Estate and Gift Taxes | **27** | **10,243** | **625** | **8,935** | **19,830** |
| Excise Taxes | **60,880** | **22,912** | **50** | **128** | **83,970** |
| Railroad Retirement Taxes | **4,192** | **1,317** | **1** | **1** | **5,511** |
| Unemployment Taxes | **3,974** | **3,786** | **51** | **85** | **7,896** |
| Fines, Penalties, Interest, & Other Revenue - Tax Related | **1,155** | **113** | **-** | **-** | **1,268** |
| **Tax Related Revenue Received** | **1,868,209** | **943,501** | **25,002** | **42,303** | **2,879,015** |
| Deposit of Earnings , Federal Reserve System | **53,958** | **21,809** | **-** | **-** | **75,767** |
| Fines, Penalties, Interest & Other Revenue - Non-Tax Related | **1,322** | **296** | **-** | **-** | **1,618** |
| **Non-Tax Related Revenue Received** | **55,280** | **22,105** | **-** | **-** | **77,385** |
| **Total Revenue Received** | **$ 1,923,489** | **$ 965,606** | **$ 25,002** | **$ 42,303** | **$ 2,956,400** |
| Less Amounts Collected for Non-Federal Entities | | | | | **358** |
| **Total** | | | | | **$ 2,956,042** |

| | Tax Year | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | Pre-2010 | 2012 Collections |
| Individual Income and FICA Taxes | $ 1,415,326 | $ 699,498 | $ 20,718 | $ 24,448 | $ 2,159,990 |
| Corporate Income Taxes | 197,244 | 73,126 | 739 | 10,353 | 281,462 |
| Estate and Gift Taxes | 77 | 6,753 | 167 | 7,453 | 14,450 |
| Excise Taxes | 59,105 | 20,244 | 42 | 163 | 79,554 |
| Railroad Retirement Taxes | 3,609 | 1,163 | - | 1 | 4,773 |
| Unemployment Taxes | 3,886 | 3,162 | 28 | 83 | 7,159 |
| Fines, Penalties, Interest, & Other Revenue - Tax Related | 351 | - | - | - | 351 |
| **Tax Related Revenue Received** | 1,679,598 | 803,946 | 21,694 | 42,501 | 2,547,739 |
| Deposit of Earnings, Federal Reserve System | 66,102 | 15,855 | - | - | 81,957 |
| Fines, Penalties, Interest, & Other Revenue - Non-Tax Related | 216 | 56 | - | - | 272 |
| **Non-Tax Related Revenue Received** | 66,318 | 15,911 | - | - | 82,229 |
| **Total Revenue Received** | $ 1,745,916 | $ 819,857 | $ 21,694 | $ 42,501 | $ 2,629,968 |
| Less Amounts Collected for Non-Federal Entities | | | | | 386 |
| **Total** | | | | | $ 2,629,582 |

## AMOUNTS PROVIDED TO FUND THE U.S. GOVERNMENT

For the years ended September 30, 2013 and 2012, collections of custodial revenue transferred to other federal entities were as follows (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Department of the Interior | **$** | **763** | $ | 511 |
| General Fund | | **2,593,079** | | 2,268,311 |
| **Total**[1] | **$** | **2,593,842** | $ | 2,268,822 |

(1) *Transferred amounts include Amounts Provided to Fund the Federal Government and Cash Proceeds from (AIG) Stock Sales Provided to Fund the Federal Government, as reported on the Statements of Custodial Activity.*

## FEDERAL TAX REFUNDS PAID

Refund activity, by revenue type and tax year, was as follows for the years ended September 30, 2013 and 2012 (in millions):

| | **Tax Year** | | | | |
|---|---|---|---|---|---|
| | **2013** | **2012** | **2011** | **Pre-2011** | **2013 Refunds** |
| Individual Income and FICA Taxes | **$ 702** | **$ 287,132** | **$ 21,861** | **$ 10,740** | **$ 320,435** |
| Corporate Income Taxes | **5,358** | **12,893** | **6,717** | **16,601** | **41,569** |
| Estate and Gift Taxes | **-** | **188** | **298** | **561** | **1,047** |
| Excise Taxes | **512** | **797** | **91** | **118** | **1,518** |
| Railroad Retirement Taxes | **-** | **2** | **-** | **70** | **72** |
| Unemployment Taxes | **1** | **112** | **20** | **14** | **147** |
| Fines, Penalties, Interest & Other Revenue | **-** | **-** | **-** | **-** | **-** |
| **Total** | **$ 6,573** | **$ 301,124** | **$ 28,987** | **$ 28,104** | **$ 364,788** |

| | Tax Year | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | Pre-2010 | 2012 Refunds |
| Individual Income and FICA Taxes | $ 514 | $ 293,434 | $ 23,719 | $ 10,008 | $ 327,675 |
| Corporate Income Taxes | 5,093 | 10,567 | 7,356 | 20,954 | 43,970 |
| Estate and Gift Taxes | - | 180 | 80 | 245 | 505 |
| Excise Taxes | 433 | 839 | 79 | 136 | 1,487 |
| Railroad Retirement Taxes | - | 4 | - | 4 | 8 |
| Unemployment Taxes | 1 | 78 | 11 | 16 | 106 |
| Fines, Penalties, Interest & Other Revenue | 1 | - | - | - | 1 |
| **Total** | $ 6,042 | $ 305,102 | $ 31,245 | $ 31,363 | $ 373,752 |

## FEDERAL TAX REFUNDS PAYABLE

As of September 30, 2013 and September 30, 2012, refunds payable to taxpayers consisted of the following (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Internal Revenue Service | **$** | **2,910** | $ | 3,252 |
| Alcohol and Tobacco Tax and Trade Bureau | | **4** | | 3 |
| **Total** | **$** | **2,914** | $ | 3,255 |

# 24. FUNDS FROM DEDICATED COLLECTIONS

The majority of the Department's FDC activities are attributed to the ESF. In addition, such funds managed by BEP, Mint, and OCC (the Department's non-appropriated bureaus) and certain funds managed by the IRS are public enterprise (or revolving) funds and receive no appropriations from the Congress. Other miscellaneous FDCs are managed by the Fiscal Service, DO, IRS, OFR, and TFF.

The following is a list of FDCs and a brief description of the purpose, accounting, and uses of these funds.

| Bureau | Fund Code | Fund Title/Description |
|---|---|---|
| **Exchange Stabilization Fund (ESF)** | | |
| ESF | 20X4444 | Exchange Stabilization Fund |
| **Public Enterprise/Revolving Funds** | | |
| BEP | 20X4502 | Bureau of Engraving and Printing Fund |
| MNT | 20X4159 | Public Enterprise Fund |
| OCC | 20X8413 | Assessment Funds |
| IRS | 20X4413 | Federal Tax Lien Revolving Fund |
| **Other FDC Funds** | | |
| Fiscal Service | 20X5080 | Gifts to Reduce Public Debt |
| Fiscal Service | 20X5081 | Presidential Election Campaign |
| Fiscal Service | 20X8625 | Gulf Coast Restoration Trust Fund |
| Fiscal Service | 20X8902 | Esther Cattell Schmitt Gift Fund |
| Fiscal Service | 955585 | Travel Promotion Fund, Corp for Travel Promotion |
| Fiscal Service | 95X5585 | Travel Promotion Fund, Corp for Travel Promotion |
| Fiscal Service | 207/85445 | Debt Collection Special Fund |
| Fiscal Service | 208/95445 | Debt Collection Special Fund |
| Fiscal Service | 209/05445 | Debt Collection Special Fund |
| Fiscal Service | 200/15445 | Debt Collection Special Fund |
| Fiscal Service | 201/25445 | Debt Collection Special Fund |
| Fiscal Service | 202/35445 | Debt Collection Special Fund |
| Fiscal Service | 203/45445 | Debt Collection Special Fund |
| DO | 20X5816 | Confiscated and Vested Iraqi Property and Assets |
| DO | 20X8790 | Gifts and Bequests Trust Fund |
| IRS | 20X5510 | Private Collection Agency Program |
| IRS | 20X5433 | Informant Reimbursement |
| OFR | 20X5590 | Financial Research Fund |
| TFF | 20X5697 | Treasury Forfeiture Fund |

Pursuant to the legal authority found in Section 10 of the Gold Reserve Act of 1934, as amended, the ESF may purchase or sell foreign currencies, hold U.S. foreign exchange and SDR assets, and may provide financing to foreign governments and foreign entities. The ESF accounts for and reports its holdings to the Fiscal Service on the Standard Form 224, "Statement of Transactions," and provides other reports to Congress. Interest on SDRs in the IMF, investments in U.S. Treasury securities, and investments in foreign currency assets are ESF's primary sources of revenue. The ESF's earnings and realized gains on foreign currency assets represent inflows of resources to the government, and the interest revenues earned from U.S. Securities are the result of intra-Departmental flows.

The BEP, Mint, OCC, and IRS operate "public enterprise/revolving funds" to account for their respective revenues and expenses. 31 USC § 5142 established the revolving fund for BEP to account for revenue and expenses related to the currency printing activities. P.L. 104-52 (31 USC § 5136) established the Public Enterprise Fund for the Mint to account for all revenue and expenses related to the production and sale of numismatic products and circulating coinage. Revenues and other financing sources at the Mint are mainly from the sale of numismatic and bullion products and the

sale of circulating coins to the FRB system. These revenues represent inflows of resources to the government. 12 USC § 481 established the Assessment Funds for OCC. Revenue and financing sources are from the bank examinations and assessments for the oversight of the national banks, savings associations, and savings and loan holding companies. These non-appropriated funds contribute to the inflows of resources to the government to specifically fund these entity's operations. 26 USC § 7810 established the Federal Tax Lien Revolving Fund to account for revenue and expenses from the sale of property foreclosed upon by a holder of a lien. Such revenue represents inflows of resources to the federal government. There are minimal transactions with other government agencies.

There are other FDCs at several Treasury bureaus, such as donations to the Presidential Election Campaign Fund, gifts to reduce the public debt, and other enforcement related activities. Public laws and the U.S. Code established and authorized the use of these funds. Sources of revenues and other financing sources include contributions, cash and property forfeited in enforcement activities, and public donations, all which represent inflows to the government.

### INTRA-GOVERNMENTAL INVESTMENTS IN TREASURY SECURITIES

The U.S. government does not set aside assets to pay future benefits or other expenditures associated with FDCs. The Department's bureaus and other federal agencies invest some of the funds that they collect from the public, if they have the statutory authority to do so, in securities issued by the Fiscal Service. The cash collected by the Fiscal Service is deposited in the General Fund, which uses the cash for general government purposes.

The investments provide Department bureaus and other federal agencies with authority to draw upon the General Fund to make future benefit payments or other expenditures. When the Department bureaus or other federal agencies require redemption of these securities to make expenditures, the government finances those redemptions out of accumulated cash balances, by raising taxes or other receipts, by borrowing from the public or repaying less debt, or by curtailing other expenditures. This is the same way that the government finances all other expenditures.

The securities are an asset to the Department bureaus and other federal agencies and a liability of the Fiscal Service. The General Fund is liable to the Fiscal Service. Because the Department bureaus and other federal agencies are parts of the U.S. government, these assets and liabilities offset each other from the standpoint of the government as a whole. For this reason, they do not represent an asset or a liability in the U.S. government-wide financial statements.

The balances related to the investments made by the Department bureaus are not displayed on the Department's financial statements because the bureaus are subcomponents of the Department. However, the General Fund remains liable to the Fiscal Service for the invested balances and the Fiscal Service remains liable to the investing Department bureaus (See Note 4).

### CHANGE IN ACCOUNTING PRINCIPLE

In fiscal year 2013, the Department adopted SFFAS No. 43, *Funds from Dedicated Collections: Amending SFFAS No. 27, Identifying and Reporting Earmarked Funds* which, among other things, clarifies the definition of a fund from dedicated collection (Note 1Y). In connection with this adoption, the Department determined that the D.C. Pension funds that were previously classified and reported as FDCs under SFFAS No. 27 no longer met the requirements for such classification in accordance with SFFAS No. 43. The D.C. Pension funds had a negative net position totaling $5.1 billion and $6.0 billion as of September 30, 2013 and 2012, respectively, primarily due to the net unfunded liability of the D.C. Pension fund of $5.4 billion and $6.4 billion at September 30, 2013 and 2012, respectively. Accordingly, these funds are no longer reported in the Consolidated Balance Sheet line item "Cumulative Results of Operations: Funds from Dedicated Collections," but rather they are reported within the line item "Cumulative Results of Operations: Other Funds" as of September 30, 2013. The Department adjusted the corresponding Consolidated Balance Sheet line items by $6.0 billion as of September 30, 2012 to conform to the current year financial statement presentation of these funds. This change in

accounting had no impact to the total "Cumulative Results of Operations" or "Total Net Position" at September 30, 2013 and 2012. In addition to the Consolidated Balance Sheet, the Department adjusted the fiscal year 2012 presentation of and amounts included in the following table to exclude the activity and related balances associated with those funds that are no longer designated as FDCs. Furthermore, as permitted by SFFAS No. 43, the Department no longer separately presents non-exchange revenue and other financing sources related to FDCs on the its Consolidated Statements of Changes in Net Position.

**Summary Information for Funds from Dedicated Collections as of and for the Fiscal Year Ended September 30, 2013**

| (in millions) | Exchange Stabilization Fund | Public Enterprise/ Revolving Funds | Other FDC Fund | Combined FDC Funds |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Fund Balance | $ - | $ 801 | $ 742 | $ 1,543 |
| Investments and Related Interest – Intra-governmental | 22,670 | 1,310 | 3,210 | 27,190 |
| Cash, Foreign Currency and Other Monetary Assets | 65,097 | - | 12 | 65,109 |
| Investments and Related Interest | 14,096 | - | - | 14,096 |
| Other Assets | - | 1,549 | 120 | 1,669 |
| **Total Assets** | $ 101,863 | $ 3,660 | $ 4,084 | $ 109,607 |
| **LIABILITIES** | | | | |
| Intra-governmental Liabilities | $ - | $ 33 | $ 499 | $ 532 |
| Certificates Issued to Federal Reserve Banks | 5,200 | - | - | 5,200 |
| Allocation of Special Drawing Rights | 54,177 | - | - | 54,177 |
| Other Liabilities | 6 | 562 | 453 | 1,021 |
| **Total Liabilities** | 59,383 | 595 | 952 | 60,930 |
| **Net Position** | | | | |
| Unexpended Appropriations | 200 | - | - | 200 |
| Cumulative Results of Operations | 42,280 | 3,065 | 3,132 | 48,477 |
| **Total Liabilities and Net Position** | $ 101,863 | $ 3,660 | $ 4,084 | $ 109,607 |
| **Statement of Net Cost** | | | | |
| Gross Cost | $ 2,163 | $ 5,812 | $ 468 | $ 8,443 |
| Less: Earned Revenue | (453) | (5,871) | - | (6,324) |
| Gains/Losses on Pension, ORB, or OPEB Assumption Changes | - | (5) | - | (5) |
| **Total Net Cost of (Revenue From) Operations** | $ 1,710 | $ (64) | $ 468 | $ 2,114 |
| **Statement of Changes in Net Position** | | | | |
| **Cumulative Results of Operations:** | | | | |
| Beginning Balance | $ 43,990 | $ 3,165 | $ 1,892 | $ 49,047 |
| Budgetary Financing Sources | - | (42) | 1,647 | 1,605 |
| Other Financing Sources | - | (122) | 61 | (61) |
| **Total Financing Sources** | - | (164) | 1,708 | 1,544 |
| Net Cost of (Revenue From) Operations | (1,710) | 64 | (468) | (2,114) |
| Change in Net Position | (1,710) | (100) | 1,240 | (570) |
| **Ending Balance** | $ 42,280 | $ 3,065 | $ 3,132 | $ 48,477 |

## Summary Information for Funds from Dedicated Collections as of and for the Fiscal Year Ended September 30, 2012

| (in millions) | Exchange Stabilization Fund | Public Enterprise/ Revolving Funds | Other FDC Funds | Combined FDC Funds |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Fund Balance | $ - | $ 1,093 | $ 749 | $ 1,842 |
| Investments and Related Interest – Intra-governmental | 22,680 | 1,380 | 1,634 | 25,694 |
| Cash, Foreign Currency and Other Monetary Assets | 65,764 | - | 18 | 65,782 |
| Investments and Related Interest | 15,416 | - | - | 15,416 |
| Other Assets | - | 1,350 | 139 | 1,489 |
| **Total Assets** | $ 103,860 | $ 3,823 | $ 2,540 | $ 110,223 |
| **LIABILITIES** | | | | |
| Intra-governmental Liabilities | $ - | $ 37 | $ 395 | $ 432 |
| Certificates Issued to Federal Reserve Banks | 5,200 | - | - | 5,200 |
| Allocation of Special Drawing Rights | 54,463 | - | - | 54,463 |
| Other Liabilities | 7 | 621 | 253 | 881 |
| **Total Liabilities** | 59,670 | 658 | 648 | 60,976 |
| **Net Position** | | | | |
| Unexpended Appropriations | 200 | - | - | 200 |
| Cumulative Results of Operations | 43,990 | 3,165 | 1,892 | 49,047 |
| **Total Liabilities and Net Position** | $ 103,860 | $ 3,823 | $ 2,540 | $ 110,223 |
| **Statement of Net Cost** | | | | |
| Gross Cost | $ 1,557 | $ 5,001 | $ 406 | $ 6,964 |
| Less: Earned Revenue | (956) | (5,033) | - | (5,989) |
| Gains/Losses on Pension, ORB, or OPEB Assumption Changes | - | 5 | - | 5 |
| **Total Net Cost of (Revenue From) Operations** | $ 601 | $ (27) | $ 406 | $ 980 |
| **Statement of Changes in Net Position** | | | | |
| **Cumulative Results of Operations:** | | | | |
| Beginning Balance | $ 44,591 | $ 3,024 | $ 1,665 | $ 49,280 |
| Budgetary Financing Sources | - | (77) | 572 | 495 |
| Other Financing Sources | - | 191 | 61 | 252 |
| **Total Financing Sources** | - | 114 | 633 | 747 |
| Net Cost of (Revenue From) Operations | (601) | 27 | (406) | (980) |
| Change in Net Position | (601) | 141 | 227 | (233) |
| **Ending Balance** | $ 43,990 | $ 3,165 | $ 1,892 | $ 49,047 |

# 25. Reconciliation of Net Cost of Treasury Operations and Non-Entity Costs to Budget

The Reconciliation of Net Cost of Operations to Budget explains the difference between the budgetary net obligations and the proprietary net cost of Treasury operations and non-entity costs. For the fiscal years ended September 30, 2013 and 2012, the Reconciliation of Net Cost of Operations to Budget consisted of the following (in millions):

| | 2013 | 2012 |
|---|---|---|
| **RESOURCES USED TO FINANCE ACTIVITIES** | | |
| **Budgetary Resources Obligated:** | | |
| Obligations Incurred (Note 22) | **$ 487,431** | $ 476,463 |
| Less: Spending Authority from Offsetting Collections and Recoveries of Prior Year Unpaid Obligations | **(67,901)** | (180,078) |
| Obligations Net of Offsetting Collections and Recoveries | **419,530** | 296,385 |
| Less: Distributed Offsetting Receipts | **(151,404)** | (73,881) |
| **Net Obligations** | **268,126** | 222,504 |
| **Other Resources:** | | |
| Donations and Forfeiture of Property | **135** | 174 |
| Financing Sources for Accrued Interest and Discount on Debt | **10,905** | 95,877 |
| Financing Sources for Accrued Interest on Restoration of Federal Debt Principal (Note 16) | **801** | - |
| Transfers In/Out Without Reimbursement | **(42)** | (47) |
| Imputed Financing Sources from Cost Absorbed by Others | **776** | 812 |
| Transfers to the General Fund and Other (Note 20) | **(177,976)** | (46,341) |
| Net Other Resources Used to Finance Activities | **(165,401)** | 50,475 |
| **Total Resources Used to Finance Activities** | **102,725** | 272,979 |
| **RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF TREASURY OPERATIONS AND NON-ENTITY COSTS** | | |
| Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided | **(12,595)** | (11,371) |
| Resources that Fund Expenses Recognized in Prior Periods | **(8,930)** | 330,975 |
| Budgetary Offsetting Collections & Receipts that do not affect Net Cost of Treasury Operations and Non-Entity Costs | **(175,527)** | (145,649) |
| Adjustment to Accrued Interest and Discount on the Debt | **1,381** | 22,720 |
| Resources that Finance the Acquisition of Assets or Liquidation of Liabilities | **(1,225)** | (69,359) |
| Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Treasury Operations and Non-Entity Costs | **(332)** | (11,233) |
| Total Resources Used to Finance Items Not Part of the Net Cost of Treasury Operations and Non-Entity Costs | **(197,228)** | 116,083 |
| **Total Resources Used to Finance the Net Cost of Treasury Operations and Non-Entity Costs** | **299,953** | 156,896 |
| Total Components of Net Cost of Treasury Operations and Non-Entity Costs That Will Require or Generate Resources in Future Periods | **(18,865)** | (15,760) |
| Total Components of Net Cost of Treasury Operations and Non-Entity Costs That Will Not Require or Generate Resources[a] | **2,536** | 4,045 |
| **Total Components of Net Cost of Treasury Operations and Non-Entity Costs That Will Not Require or Generate Resources in the Current Period** | **(16,329)** | (11,715) |
| **Net Cost of Treasury Operations and Non-Entity Costs** | **$ 283,624** | $ 145,181 |

[a] *The Components not requiring or generating resources primarily include depreciation and amortization and revaluation of assets or liabilities.*

# 26. SCHEDULE OF FIDUCIARY ACTIVITY

The following funds have been identified by the Department as meeting the criteria for fiduciary activity. Details of the funds are provided below.

| Bureau | Fund Code | Authority | Fund Title/Description |
|---|---|---|---|
| BEP | 20X6513.013 | 31 USC 5119 | Mutilated Currency Claims Funds |
| Fiscal Service | 20X6045 | 31 USC 3328 | Proceeds, Payments of Unpaid Checks |
| Fiscal Service | 20X6048 | 31 USC 3329, 3330 | Proceeds of Withheld Foreign Checks |
| Fiscal Service | 2015X6078 | 50 APP. USC 2012 | War Claims Fund, Foreign Claims Settlement Commission |
| Fiscal Service | 20X6092 | 31 USC 1321 | Debt Management Operations |
| Fiscal Service | 20X6104 | 22 USC 1627 | Albanian Claims Fund, Treasury |
| Fiscal Service | 20X6133 | 31 USC 1322 | Payment of Unclaimed Moneys |
| Fiscal Service | 20X6210 | 22 USC 1623 | Iraq Claims Settlement Fund |
| Fiscal Service | 20X6309 | 22 USC 1627(a) | Libyan Claims Settlement Fund |
| Fiscal Service | 20X6310 | 22 USC 1627(a) | Libyan Claims Settlement Fund |
| Fiscal Service | 20X6311 | 98 Stat. 1876 | Kennedy Center Revenue Bond |
| Fiscal Service | 20X6312 | 22 USC 1627 | Iranian Claims Settlement Fund |
| Fiscal Service | 20X6314 | 22 USC 1644g | German Democrat Settlement Fund |
| Fiscal Service | 20X6315 | 22 USC 1645h | Vietnam Claims Settlement Fund |
| Fiscal Service | 20X6501.018 | 31 USC 3513 | Small Escrow Amounts |
| Fiscal Service | 20X6720 | 31 USC 3513 | SM DIF Account for Dep. & Check Adj. |
| Fiscal Service | 20X6830 | 104 Stat. 1061 | Net Interest Payments to/from State |
| Fiscal Service | 20X6999 | 31 USC 3513 | Accounts Payable, Check Issue UNDDR |
| IRS | 20X6737 | 90 Stat. 269-270 | Internal Revenue Collections for Northern Mariana Island |
| IRS | 20X6738 | 31 USC 3513 | Coverover Withholdings-U.S. Virgin Islands |
| IRS | 20X6740 | 31 USC 3515 | Coverover Withholdings-Guam |
| IRS | 20X6741 | 31 USC 3513 | Coverover Withholdings-American Samoa |
| OAS | 20X6317.001 | 22 USC 2431 | Belize Escrow, Debt Reduction |

Unclaimed monies were authorized by 31 USC 5119, which authorized the Fiscal Service to collect unclaimed monies on behalf of the public. Other fiduciary activities by the Department as listed above are included in All Other Fiduciary Funds.

**Schedule of Fiduciary Activity**

| (in millions) | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | **Unclaimed Monies - Fiscal Service** | **All Other Fiduciary Funds** | **Total Fiduciary Funds** | Unclaimed Monies - Fiscal Service | All Other Fiduciary Funds | Total Fiduciary Funds |
| **Fiduciary Net Assets, Beginning of the Year** | **$ 509** | **$ 343** | **$ 852** | $ 451 | $ 413 | $ 864 |
| Increases: | | | | | | |
| Contributions to Fiduciary Net Assets | **48** | **316** | **364** | 59 | 243 | 302 |
| Investment Earnings | **-** | **1** | **1** | - | 1 | 1 |
| **Total Increases** | **48** | **317** | **365** | 59 | 244 | 303 |
| Decreases: | | | | | | |
| Disbursements to and on behalf of beneficiaries | **(6)** | **(505)** | **(511)** | (1) | (314) | (315) |
| **Total Decreases** | **(6)** | **(505)** | **(511)** | (1) | (314) | (315) |
| Net Increase (Decrease) in Fiduciary Assets | **42** | **(188)** | **(146)** | 58 | (70) | (12) |
| **Fiduciary Net Assets, End of Year** | **$ 551** | **$ 155** | **$ 706** | $ 509 | $ 343 | $ 852 |

**Schedule of Fiduciary Net Assets**

| (in millions) | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | **Unclaimed Monies - Fiscal Service** | **All Other Fiduciary Funds** | **Total Fiduciary Funds** | Unclaimed Monies - Fiscal Service | All Other Fiduciary Funds | Total Fiduciary Funds |
| **Fiduciary Assets** | | | | | | |
| Cash and Cash Equivalents | **$ 551** | **$ 145** | **$ 696** | $ 509 | $ 328 | $ 837 |
| Investments | **-** | **18** | **18** | - | 17 | 17 |
| **Total Fiduciary Assets** | **551** | **163** | **714** | 509 | 345 | 854 |
| Less: Fiduciary Liabilities | **-** | **(8)** | **(8)** | - | (2) | (2) |
| **Total Fiduciary Net Assets** | **$ 551** | **$ 155** | **$ 706** | $ 509 | $ 343 | $ 852 |

# 27. Commitments and Contingencies

## Legal Contingencies

The Department is a party in various administrative proceedings, legal actions, and claims, which may ultimately result in settlements or decisions adverse to the U.S. government. These contingent liabilities arise in the normal course of operations and their ultimate disposition is unknown. The Department discloses contingent liabilities where the conditions for liability recognition have not been met and the likelihood of unfavorable outcome is more than remote. The Department does not accrue for possible losses related to cases where the potential loss cannot be estimated or the likelihood of an unfavorable outcome is less than probable.

In some cases, a portion of any loss that may occur may be paid by the Department's Judgment Fund, which is separate from the operating resources of the Department. For cases related to the *Contract Disputes Act of 1978* and awards under federal anti-discrimination and whistle-blower protection acts, the Department must reimburse the Judgment Fund from future appropriations.

In the opinion of the Department's management and legal counsel, based on information currently available, the expected outcome of other legal actions, individually or in the aggregate, will not have a materially adverse effect on the Department's consolidated financial statements, except for the pending legal actions described below which may have a materially adverse impact on the consolidated financial statements depending on the outcomes of the cases.

### Pending Legal Actions

- *Tribal Trust Fund Cases:* Numerous cases have been filed in the U.S. District Courts in which Native American Tribes seek a declaration that the United States has not provided the tribes with a full and complete accounting of their trust funds, and seek an order requiring the U.S. government to provide such an accounting. In addition, there are a number of other related cases seeking damages in the U.S. Court of Federal Claims, which do not name the Department as a defendant. During fiscal year 2013, a number of tribal trust fund case settlements were paid from the Judgment Fund for an aggregate amount totaling $405 million. The U.S. government is currently in discussion with counsel representing most of the remaining plaintiff tribes with tribal trust fund cases pending against the United States about the feasibility of an out-of-court settlement. Plaintiff tribes in several of the pending cases have chosen to pursue active litigation, rather than settlement discussion, and the U.S. government is vigorously litigating those cases. The Department is unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.
- *James X. Bormes v. United States of America:* The complaint alleges that the U.S. government willfully violated certain provisions of the Fair and Accurate Credit Transaction Act P.L. 108-159 in that the transaction confirmation received by the complainant from Pay.gov improperly included, among other things, the expiration date of a credit card used in a transaction. The complaint does not state the amount of damages sought on behalf of the class beyond asserting that each class member would be entitled to $100 to $1,000 in statutory damages. In a letter sent to the Department of Justice, the plaintiff proposed a fund of $30 million for just the Illinois class members.

  In July 2009, the U.S. District Court for the Northern District of Illinois granted the U.S. government's motion to dismiss this case for lack of an unequivocal waiver of sovereign immunity. In November 2010, the U.S. Court of Appeals for the Federal Circuit reversed the District Court's decision and directed that the case be remanded back to the District Court for further proceedings. The U.S. government's petition for a rehearing of that decision was denied by the Federal Circuit in March 2011. In January 2012, the U.S. Supreme Court granted the U.S. government's petition for a writ of certiorari. The case was argued in October 2012 and, in November 2012, the U.S. Supreme Court reversed the lower court decision and remanded the case back to the U.S. Court of Appeals for the Seventh Circuit. The parties have completed the appellate briefing and the oral argument occurred on September 27, 2013. The parties are awaiting the Seventh Circuit's decision. The Department is unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.

- *GSE Related Cases:* A number of cases were filed in the U.S. Court of Federal Claims and the U.S. District Court for the District of Columbia in which the plaintiffs allege, among other things, that the U.S. government took their property and contractual rights as preferred and common stockholders when the third amendments to the SPSPAs between the Department and each GSE were executed in August 2012 (Note 8). One case also alleges that the U.S. government took plaintiffs' property and contractual rights when the GSEs were placed into conservatorship and entered into the SPSPAs with the Department in September 2008. In the Court of Federal Claims, the plaintiffs seek just compensation (damages) from the U.S. government. In the District Court, the plaintiffs seek to set aside the third amendments to the SPSPAs as well as damages. The Department is unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.

- *IRS 501(c)(4) Cases:* Two cases were filed in U.S. District Court in which the plaintiffs seek actual and punitive damages in connection with IRS' alleged unlawful requests for information and unreasonable delays in processing the plaintiffs' applications for tax exempt status. The Department is unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.

- *Other Legal Actions:* The Department is also involved in employment related legal actions (e.g., matters alleging discrimination and other claims before federal courts, the Equal Employment Opportunity Commission, the Merit Systems Protection Board, etc.) for which an unfavorable outcome is reasonably possible, but for which an estimate of potential loss cannot be determined at this time. It is not expected that these cases will have a material adverse effect on the Department's financial position or results.

## OTHER COMMITMENTS AND CONTINGENCIES

### Loan Commitments

The Department, through FFB, makes loan commitments with federal agencies, or private sector borrowers whose loans are guaranteed by federal agencies, to extend them credit for their own use (refer to Notes 1L and 3). As of September 30, 2013 and 2012, the Department had loan commitments totaling $73.6 billion and $86.2 billion, respectively.

### Multilateral Development Banks

The Department, on behalf of the United States, has subscribed to capital for certain MDBs, portions of which are callable under certain limited circumstances to meet the obligations of the respective MDB. There has never been, nor is there anticipated, a call on the U.S. commitment for these subscriptions. As of September 30, 2013 and 2012, U.S. callable capital in MDBs was as follows (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Inter-American Development Bank | **$** | **36,437** | $ | 32,786 |
| International Bank for Reconstruction and Development | | **33,585** | | 31,805 |
| Asian Development Bank | | **13,456** | | 11,027 |
| European Bank for Reconstruction and Development | | **3,055** | | 3,055 |
| African Development Bank | | **2,534** | | 2,053 |
| North American Development Bank | | **1,275** | | 1,275 |
| Multilateral Investment Guarantee Agency[1] | | **315** | | 315 |
| **Total** | **$** | **90,657** | $ | 82,316 |

*(1) Both fiscal years 2013 and 2012 include commitments of $22 million for the undisbursed portion of the subscription to paid-in capital investments.*

Amounts included in the above table do not include amounts for which the Department may be liable to pay if future congressional action is taken to fund executed agreements between the Department and certain MDBs.

### Terrorism Risk Insurance Program

The *Terrorism Risk Insurance Act* (TRIA), signed into law in November 2002, was enacted to address market disruptions resulting from terrorist attacks on September 11, 2001. TRIA helps to ensure available and affordable commercial property and casualty insurance for terrorism risk, and simultaneously allows private markets to stabilize. The authority to pay claims under the Terrorism Risk Insurance Program (TRIA Program) is activated upon the certification of an "act of terrorism" by the Secretary in concurrence with the Secretary of State and the Attorney General. If a certified act of terrorism occurs, insurers may be eligible to receive reimbursement from the U.S. government for insured losses above a designated deductible amount. Insured losses above this amount will be shared between insurance companies and the U.S. government. TRIA also gives the Department authority to recoup federal payments made under the TRIA Program through policyholder surcharges under certain circumstances, and contains provisions designed to manage litigation arising from or relating to a certified act of terrorism. There were no claims under TRIA as of September 30, 2013 or 2012.

### Exchange Stabilization Agreement

The North American Framework Agreement (NAFA), signed by the Department in 1994, includes the Exchange Stabilization Agreement (ESA) with Mexico. The Department, through the ESF, has a standing swap line for $3.0 billion with Mexico under the NAFA and its implementing ESA. The amounts and terms (including the assured source of repayment) of any borrowing under NAFA and ESA will have to be negotiated and agreed to before any actual drawing can occur. The ESA does provide sample clauses that state that transactions shall be exchange rate neutral for the ESF, and shall bear interest based on a then current rate tied to U.S. Treasury bills. There were no drawings outstanding on the ESF swap line as of September 30, 2013 and 2012. The Department renewed the ESA through December 14, 2014.

### New Arrangements to Borrow

The Supplemental Appropriations Act of 2009 (P.L. 111-32) provided the authorization and appropriations for an increase in the United States' participation in the New Arrangements to Borrow (NAB). Because the U.S. financial participation in the IMF is denominated in SDRs, P.L. 111-32 authorized and appropriated up to the dollar equivalent of SDR 75 billion to implement this commitment. The United States agreed in May 2010 that its participation in the NAB would increase from SDR 6.6 billion to SDR 69.1 billion, pursuant to IMF Executive Board Decision No. 14577-(10/35). Total U.S. participation in the NAB of SDR 69.1 billion was equivalent to $106.0 billion and $106.5 billion as of September 30, 2013 and 2012, respectively. Refer to Notes 11 and 12 for more information on the NAB.

### Commitment to GSEs

The SPSPA agreements between the Department and each GSE, which have no expiration date, provide for the Department to disburse funds to the GSEs if, at the end of any quarter, the FHFA determines that the liabilities exceed its assets. At September 30, 2013 and 2012, the Department projected a maximum remaining potential commitment to the GSEs of $258.1 billion and $282.3 billion, respectively. Refer to Note 8 for a full description of the SPSPA agreements and related contingent liability.

# REQUIRED SUPPLEMENTAL INFORMATION (UNAUDITED – SEE ACCOMPANYING AUDITORS' REPORT)

## INTRODUCTION

This section provides the Required Supplemental Information as prescribed by accounting standards.

## OTHER CLAIMS FOR REFUNDS

The Department has estimated that $4.3 billion may be payable as other claims for tax refunds. This estimate represents amounts (principal and interest) that may be paid for claims pending judicial review by the federal courts or internally, by Appeals. The total estimated payout (including principal and interest) for claims pending judicial review by the federal courts is $0.8 billion and by appeals is $3.5 billion.

The Department made an administrative determination to accept the position that certain medical residents who received stipends be exempted from FICA taxes for periods before April 1, 2005. At September 30, 2013 and 2012, the IRS estimated unpaid refund claims of approximately $0.1 billion and $2.4 billion, respectively.

In accordance with federal accounting standards, the amounts of these claims have not been recorded as a liability in the consolidated financial statements because certain administrative processes have not been completed as of September 30, 2013.

## IRS FEDERAL TAXES RECEIVABLE, NET

In accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*, some unpaid tax assessments do not meet the criteria for financial statement recognition. Under Internal Revenue Code Section 6201, the Department is authorized and required to make inquiries, determinations, and assessments of all taxes which have not been duly paid (including interest, additions to the tax, and assessable penalties) under the law. Unpaid assessments result from taxpayers filing returns without sufficient payment, as well as from tax compliance programs such as examination, under-reporter, substitute for return, and combined annual wage reporting. The Department also has authority to abate the paid or unpaid portion of an assessed tax, interest, and penalty. Abatements occur for a number of reasons and are a normal part of the tax administration process. Abatements may result in claims for refunds or a reduction of the unpaid assessed amount.

Under federal accounting standards, unpaid assessments require taxpayer or court agreement to be considered federal taxes receivable. Assessments not agreed to by taxpayers or the courts are considered compliance assessments and are not considered federal taxes receivable. Due to the lack of agreement, these compliance assessments are less likely to have future collection potential than those unpaid assessments that are considered federal taxes receivable.

Assessments with little or no future collection potential are called write-offs. Write-offs principally consist of amounts owed by deceased, bankrupt, or defunct taxpayers, including many failed financial institutions liquidated by the FDIC and the former RTC. Write-offs have little or no future collection potential, but statutory provisions require that these assessments be maintained until the statute for collection expires.

Although compliance assessments and write-offs are not considered receivables under federal accounting standards, they represent legally enforceable claims of the U.S. government.

The components of the total unpaid assessments at September 30, 2013 and 2012, were as follows (in millions):

| | | **2013** | | 2012 |
|---|---|---|---|---|
| Total Unpaid Assessments | **$** | **374,000** | $ | 364,000 |
| Less: Compliance Assessments | | **(85,000)** | | (87,000) |
| Write Offs | | **(130,000)** | | (125,000) |
| **Gross Federal Taxes Receivable** | | **159,000** | | 152,000 |
| Less: Allowance for Doubtful Accounts | | **(124,000)** | | (113,000) |
| **Federal Taxes Receivables, Net** | **$** | **35,000** | $ | 39,000 |

To eliminate double counting, the compliance assessments reported above exclude trust fund recovery penalties assessed against officers and directors of businesses involved in the non-remittance of federal taxes withheld from their employees. The penalties totaled $2.0 billion as of September 30, 2013 and 2012. The related unpaid assessments of those businesses are reported as taxes receivable or write-offs, but the Department may also recover portions of those businesses' unpaid assessments from any and all individual officers and directors against whom a trust fund recovery penalty is assessed.

### ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

As an agent of the U.S. government and as authorized by 26 USC, the TTB collects excise taxes from alcohol, tobacco, firearms, and ammunition industries. In addition, special occupational taxes are collected from certain tobacco businesses. During fiscal years 2013 and 2012, TTB collected approximately $22.9 billion and $23.4 billion in taxes, interest, and other revenues, respectively. Federal excise taxes are also collected on certain articles produced in Puerto Rico and the Virgin Islands, and imported into the United States. In accordance with 26 USC 7652, such taxes collected on rum imported into the United States are "covered over" or paid into the treasuries of Puerto Rico and the Virgin Islands.

Substantially all of the taxes collected by TTB, net of related refund disbursements, are remitted to the General Fund. The Department further distributes this revenue to Federal agencies in accordance with various laws and regulations. The firearms and ammunition excise taxes are an exception. Those revenues are remitted to the Fish and Wildlife Restoration Fund under provisions of the *Pittman-Robertson Act of 1937*.

### DEFERRED MAINTENANCE

In fiscal years 2013 and 2012, the Department had no material amounts of deferred maintenance costs to report on vehicles, buildings, and structures owned by the Department.

Deferred maintenance applies to owned PP&E. Deferred maintenance is maintenance that was not performed when it should have been, or was scheduled to be, and is put off or delayed for a future period. Maintenance is defined as the act of keeping capitalized assets in an "acceptable condition" to serve their required mission. It includes preventive maintenance, normal repairs, replacement of parts and structural components, and other activities needed to preserve the asset so that it continues to provide acceptable services and achieves its expected useful life. Maintenance excludes activities aimed at expanding the capacity or significantly upgrading the assets to a different form than it was originally intended (i.e., activities related to capitalized improvements, modernization, and/or restoration).

Logistic personnel use condition assessment surveys and/or the total life-cycle cost methods to determine deferred maintenance and acceptable operating condition of an asset. Periodic condition assessments, physical inspections, and review of manufacturing and engineering specifications, work orders, and building and other structure logistics reports can be used under these methodologies. Heritage assets held by the Department are generally in acceptable physical condition, and there is no deferred maintenance on heritage assets.

## STATEMENT OF BUDGETARY RESOURCES DISAGGREGATED BY TREASURY REPORTING ENTITY

The following tables provide the Statement of Budgetary Resources for the fiscal years ended September 30, 2013 and 2012 disaggregated by Treasury reporting entity rather than by Treasury major budget account, since Treasury manages its budget at the reporting entity level.

### Fiscal Year 2013 Statement of Budgetary Resources Disaggregated by Sub-organization Accounts

| (in millions): | Bureau of Engraving & Printing | Bureau of the Fiscal Service[a] | Departmental Offices[b] | Fin. Crimes Enforcement Network | Internal Revenue Service |
|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | | | | | |
| Unobligated balance brought forward, October 1 | $ 51 | $ 453 | $ 336,295 | $ 34 | $ 980 |
| Recoveries of prior year unpaid obligations | - | 43 | 15,259 | 4 | 134 |
| Other changes in unobligated balance | - | (6) | (26,674) | (1) | (72) |
| Unobligated balance from prior year budget authority, net | 51 | 490 | 324,880 | 37 | 1,042 |
| Appropriations (discretionary and mandatory) | - | 434,829 | 58,105 | 105 | 11,553 |
| Borrowing authority (discretionary and mandatory) | - | - | 576 | - | - |
| Spending authority from offsetting collections (discretionary and mandatory) | 664 | 536 | 17,931 | 3 | 126 |
| **Total Budgetary Resources** | $ 715 | 435,855 | $ 401,492 | $ 145 | $ 12,721 |
| **STATUS OF BUDGETARY RESOURCES** | | | | | |
| Obligations incurred | $ 656 | $ 435,022 | $ 34,646 | $ 101 | $ 11,731 |
| Unobligated balance, end of year : | | | | | |
| Apportioned | 20 | 784 | 273,045 | 42 | 637 |
| Exempt from apportionment | - | 6 | 17,894 | - | 7 |
| Unapportioned | 39 | 43 | 75,907 | 2 | 346 |
| Total unobligated balance brought forward, end of year | 59 | 833 | 366,846 | 44 | 990 |
| **Total Status of Budgetary Resources** | $ 715 | $ 435,855 | $ 401,492 | $ 145 | $ 12,721 |
| **CHANGE IN OBLIGATED BALANCE** | | | | | |
| Unpaid obligations, gross, brought forward, October 1 | $ 117 | $ 996 | $ 249,770 | $ 36 | $ 1,672 |
| Obligations incurred | 656 | 435,022 | 34,646 | 101 | 11,731 |
| Outlays, gross | (723) | (435,403) | (37,125) | (110) | (11,972) |
| Recoveries of prior year unpaid obligations | - | (43) | (15,259) | (4) | (134) |
| Unpaid obligations, gross, end of year | 50 | 572 | 232,032 | 23 | 1,297 |
| Uncollected Payments: | | | | | |
| Uncollected payments from federal sources, brought forward, October 1 | (55) | (34) | (852) | (7) | (41) |
| Change in uncollected customer payments from federal sources | (9) | (60) | 81 | 4 | 11 |
| Uncollected customer payments from federal sources, end of year | (64) | (94) | (771) | (3) | (30) |
| **Obligated balance, End of Year (Net)** | (14) | 478 | 231,261 | 20 | 1,267 |
| **Obligated Balance, Start of Year (Net)** | $ 62 | $ 962 | $ 248,918 | $ 29 | $ 1,631 |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | | | |
| Budget authority, gross (discretionary and mandatory) | $ 664 | $ 435,365 | $ 76,612 | $ 108 | $ 11,679 |
| Actual offsetting collections (discretionary and mandatory) | (687) | (476) | (46,141) | (6) | (137) |
| Change in uncollected customer payments from federal sources (discretionary and mandatory) | (9) | (60) | 81 | 4 | 11 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ (32) | $ 434,829 | $ 30,552 | $ 106 | 11,553 |
| Outlay, gross (discretionary and mandatory) | $ 723 | $ 435,403 | $ 37,125 | $ 110 | 11,972 |
| Actual offsetting collections (discretionary and mandatory) | (687) | (476) | (46,141) | (6) | (137) |
| Outlays, net (discretionary and mandatory) | 36 | 434,927 | (9,016) | 104 | 11,835 |
| Distributed offsetting receipts | - | (39,401) | (111,272) | - | (731) |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ 36 | $ 395,526 | $ (120,288) | $ 104 | $ 11,104 |

*(a) Includes the combined financial information of the BPD and FMS operating bureaus which merged effective October 2012 (Note 1A). The salaries and other administrative expenses of the legacy BPD and FMS bureaus will continue to be funded separately until Congress enacts legislation to fund these costs through a single appropriation.*

*(b) Of the $401 billion of Total Budgetary Resources for Departmental Offices, GSE and OFS had $260 billion and $38 billion, respectively. The remainder is spread throughout other offices.*

## Fiscal Year 2013 Statement of Budgetary Resources Disaggregated by Sub-organization Accounts

| (in millions): | U.S. Mint | Office of the Comptroller of the Currency | Alcohol and Tobacco Tax and Trade Bureau | Budgetary | Non-Budgetary |
|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | | | | | |
| Unobligated balance brought forward, October 1 | $ 694 | $ 1,087 | $ 4 | $ 320,785 | $ 18,813 |
| Recoveries of prior year unpaid obligations | 42 | - | 2 | 7,876 | 7,608 |
| Other changes in unobligated balance | (42) | - | (1) | (3,366) | (23,430) |
| Unobligated balance from prior year budget authority, net | 694 | 1,087 | 5 | 325,295 | 2,991 |
| Appropriations (discretionary and mandatory) | - | - | 95 | 504,687 | - |
| Borrowing authority (discretionary and mandatory) | - | - | - | - | 576 |
| Spending authority from offsetting collections (discretionary and mandatory) | 3,961 | 1,005 | 6 | 10,091 | 14,141 |
| **Total Budgetary Resources** | $ 4,655 | $ 2,092 | $ 106 | $ 840,073 | $ 17,708 |
| **STATUS OF BUDGETARY RESOURCES** | | | | | |
| Obligations incurred | $ 4,159 | $ 1,016 | $ 100 | $ 471,734 | $ 15,697 |
| Unobligated balance, end of year: | | | | | |
| Apportioned | 496 | - | 2 | 274,291 | 735 |
| Exempt from apportionment | - | 1,076 | - | 18,983 | - |
| Unapportioned | - | - | 4 | 75,065 | 1,276 |
| Total unobligated balance brought forward, end of year | 496 | 1,076 | 6 | 368,339 | 2,011 |
| **Total Status of Budgetary Resources** | $ 4,655 | $ 2,092 | $ 106 | $ 840,073 | $ 17,708 |
| **CHANGE IN OBLIGATED BALANCE** | | | | | |
| Unpaid obligations, gross, brought forward, October 1 | $ 276 | $ 284 | $ 22 | $ 142,307 | $ 110,866 |
| Obligations incurred | 4,159 | 1,016 | 100 | 471,734 | 15,697 |
| Outlays, gross | (4,195) | (1,077) | (103) | (473,187) | (17,521) |
| Recoveries of prior year unpaid obligations | (42) | - | (2) | (7,876) | (7,608) |
| Unpaid obligations, gross, end of year | 198 | 223 | 17 | 132,978 | 101,434 |
| Uncollected Payments: | | | | | |
| Uncollected payments from federal sources, brought forward, October 1 | (6) | (5) | (4) | (186) | (818) |
| Change in uncollected customer payments from federal sources | - | 1 | 1 | (59) | 88 |
| Uncollected customer payments from federal sources, end of year | (6) | (4) | (3) | (245) | (730) |
| **Obligated balance, End of Year (Net)** | 192 | 219 | 14 | 132,733 | 100,704 |
| **Obligated Balance, Start of Year (Net)** | $ 270 | $ 279 | $ 18 | $ 142,121 | $ 110,048 |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | | | |
| Budget authority, gross (discretionary and mandatory) | $ 3,961 | $ 1,005 | $ 101 | $ 514,778 | $ 14,717 |
| Actual offsetting collections (discretionary and mandatory) | (3,985) | (1,007) | (7) | (10,088) | (42,358) |
| Change in uncollected customer payments from federal sources (discretionary and mandatory) | - | 1 | 1 | (59) | 88 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ (24) | $ (1) | $ 95 | $ 504,631 | $ (27,553) |
| Outlay, gross (discretionary and mandatory) | $ 4,195 | $ 1,077 | $ 103 | $ 473,187 | $ 17,521 |
| Actual offsetting collections (discretionary and mandatory) | (3,985) | (1,007) | (7) | (10,088) | (42,358) |
| Outlays, net (discretionary and mandatory) | 210 | 70 | 96 | 463,099 | (24,837) |
| Distributed offsetting receipts | - | $ - | $ - | $ (151,404) | $ - |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ 210 | 70 | 96 | 311,695 | (24,837) |

## Fiscal Year 2012 Statement of Budgetary Resources Disaggregated by Sub-organization Accounts

| (in millions): | Bureau of Engraving & Printing | Bureau of the Fiscal Service | Departmental Offices[1] | Fin. Crimes Enforcement Network | Internal Revenue Service |
|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | | | | | |
| Unobligated balance brought forward, October 1 | $ 26 | $ 407 | $ 366,022 | $ 34 | $ 885 |
| Recoveries of prior year unpaid obligations | - | 27 | 13,164 | 1 | 105 |
| Other changes in unobligated balance | - | (7) | (40,845) | (1) | (96) |
| Unobligated balance from prior year budget authority, net | 26 | 427 | 338,341 | 34 | 894 |
| Appropriations (discretionary and mandatory) | - | 379,246 | 37,903 | 111 | 12,175 |
| Borrowing authority (discretionary and mandatory) | - | - | 11,019 | - | - |
| Spending authority from offsetting collections (discretionary and mandatory) | 730 | 505 | 28,422 | 8 | 144 |
| **Total Budgetary Resources** | $ 756 | $ 380,178 | $ 415,685 | $ 153 | $ 13,213 |
| **STATUS OF BUDGETARY RESOURCES** | | | | | |
| Obligations incurred | $ 705 | $ 379,725 | $ 79,390 | $ 119 | $ 12,233 |
| Unobligated balance, end of year: | | | | | |
| Apportioned | 22 | 409 | 229,800 | 32 | 602 |
| Exempt from apportionment | - | 6 | 22,593 | - | 6 |
| Unapportioned | 29 | 38 | 83,902 | 2 | 372 |
| Total unobligated balance brought forward, end of year | 51 | 453 | 336,295 | 34 | 980 |
| **Total Status of Budgetary Resources** | $ 756 | $ 380,178 | $ 415,685 | $ 153 | $ 13,213 |
| **CHANGE IN OBLIGATED BALANCE** | | | | | |
| Unpaid obligations, gross, brought forward, October 1 | $ 140 | $ 920 | $ 268,670 | $ 27 | $ 1,776 |
| Obligations incurred | 705 | 379,725 | 79,390 | 119 | 12,233 |
| Outlays, gross | (728) | (379,622) | (85,126) | (109) | (12,232) |
| Recoveries of prior year unpaid obligations | - | (27) | (13,164) | (1) | (105) |
| Unpaid obligations, gross, end of year | 117 | 996 | 249,770 | 36 | 1,672 |
| Uncollected Payments: | | | | | |
| Uncollected payments from federal sources, brought forward, October 1 | (40) | (43) | (1,010) | (9) | (52) |
| Change in uncollected customer payments from federal sources | (15) | 9 | 158 | 2 | 11 |
| Uncollected customer payments from federal sources, end of year | (55) | (34) | (852) | (7) | (41) |
| **Obligated balance, End of Year (Net)** | 62 | 962 | 248,918 | 29 | 1,631 |
| **Obligated Balance, Start of Year (Net)** | $ 100 | $ 877 | $ 267,660 | $ 18 | $ 1,724 |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | | | |
| Budget authority, gross (discretionary and mandatory) | $ 730 | $ 379,751 | $ 77,344 | $ 119 | $ 12,319 |
| Actual offsetting collections (discretionary and mandatory) | (715) | (514) | (161,078) | (10) | (156) |
| Change in uncollected customer payments from federal sources (discretionary and mandatory) | (15) | 9 | 158 | 2 | 11 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ - | $ 379,246 | $ (83,576) | $ 111 | 12,174 |
| Outlay, gross (discretionary and mandatory) | $ 728 | $ 379,622 | $ 85,126 | $ 109 | 12,232 |
| Actual offsetting collections (discretionary and mandatory) | (715) | (514) | (161,078) | (10) | (156) |
| Outlays, net (discretionary and mandatory) | 13 | 379,108 | (75,952) | 99 | 12,076 |
| Distributed offsetting receipts | - | (39,894) | (33,243) | - | (744) |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ 13 | $ 339,214 | $ (109,195) | $ 99 | $ 11,332 |

(1) Of the $416 billion of Total Budgetary Resources for Departmental Offices, GSE and OFS had $242 billion and $68 billion, respectively. The remainder is spread throughout other offices

## Fiscal Year 2012 Statement of Budgetary Resources Disaggregated by Sub-organization Accounts

| (in millions): | U.S. Mint | Office of the Comptroller of the Currency | Alcohol and Tobacco Tax and Trade Bureau | Budgetary | Non-Budgetary |
|---|---|---|---|---|---|
| **BUDGETARY RESOURCES** | | | | | |
| Unobligated balance brought forward, October 1 | $ 413 | $ 1,163 | $ 4 | $ 340,384 | $ 28,570 |
| Recoveries of prior year unpaid obligations | 51 | - | 1 | 2,818 | 10,531 |
| Other changes in unobligated balance | (77) | - | - | (3,542) | (37,484) |
| Unobligated balance from prior year budget authority, net | 387 | 1,163 | 5 | 339,660 | 1,617 |
| Appropriations (discretionary and mandatory) | - | - | 100 | 429,535 | - |
| Borrowing authority (discretionary and mandatory) | - | - | - | - | 11,019 |
| Spending authority from offsetting collections (discretionary and mandatory) | 3,413 | 1,001 | 7 | 9,727 | 24,503 |
| **Total Budgetary Resources** | $ 3,800 | $ 2,164 | $ 112 | $ 778,922 | $ 37,139 |
| **STATUS OF BUDGETARY RESOURCES** | | | | | |
| Obligations incurred | $ 3,106 | $ 1,077 | $ 108 | $ 458,137 | $ 18,326 |
| Unobligated balance, end of year | | | | | |
| Apportioned | 670 | - | - | 227,587 | 3,948 |
| Exempt from apportionment | - | 1,087 | - | 23,692 | - |
| Unapportioned | 24 | - | 4 | 69,506 | 14,865 |
| Total unobligated balance brought forward, end of year | 694 | 1,087 | 4 | 320,785 | 18,813 |
| **Total Status of Budgetary Resources** | $ 3,800 | $ 2,164 | $ 112 | $ 778,922 | $ 37,139 |
| **CHANGE IN OBLIGATED BALANCE** | | | | | |
| Unpaid obligations, gross, brought forward, October 1 | $ 346 | $ 251 | $ 23 | $ 148,351 | $ 123,802 |
| Obligations incurred | 3,106 | 1,077 | 108 | 458,137 | 18,326 |
| Outlays, gross | (3,125) | (1,044) | (108) | (461,363) | (20,731) |
| Recoveries of prior year unpaid obligations | (51) | - | (1) | (2,818) | (10,531) |
| Unpaid obligations, gross, end of year | 276 | 284 | 22 | 142,307 | 110,866 |
| Uncollected Payments: | | | | | |
| Uncollected payments from federal sources, brought forward, October 1 | (7) | (7) | (2) | (201) | (969) |
| Change in uncollected customer payments from federal sources | 1 | 2 | (2) | 15 | 151 |
| Uncollected customer payments from federal sources, end of year | (6) | (5) | (4) | (186) | (818) |
| **Obligated balance, End of Year** | 270 | 279 | 18 | 142,121 | 110,048 |
| **Obligated Balance, Start of Year (Net)** | $ 339 | $ 244 | $ 21 | $ 148,150 | $ 122,833 |
| **BUDGET AUTHORITY AND OUTLAYS, NET** | | | | | |
| Budget authority, gross (discretionary and mandatory) | $ 3,413 | $ 1,001 | $ 107 | $ 439,262 | $ 35,522 |
| Actual offsetting collections (discretionary and mandatory) | (3,414) | (1,003) | (5) | (9,743) | (157,152) |
| Change in uncollected customer payments from federal sources (discretionary and mandatory) | 1 | 2 | (2) | 15 | 151 |
| **Budget Authority, Net (Discretionary and Mandatory)** | $ - | $ - | $ 100 | $ 429,534 | $ (121,479) |
| Outlay, gross (discretionary and mandatory) | $ 3,125 | $ 1,044 | $ 108 | $ 461,363 | $ 20,731 |
| Actual offsetting collections (discretionary and mandatory) | (3,414) | (1,003) | (5) | (9,743) | (157,152) |
| Outlays, net (discretionary and mandatory) | (289) | 41 | 103 | 451,620 | (136,421) |
| Distributed offsetting receipts | - | - | - | (73,881) | - |
| **Agency Outlays, Net (Discretionary and Mandatory)** | $ (289) | $ 41 | $ 103 | $ 377,739 | $ (136,421) |

PART 3:

# Other Information

(UNAUDITED)

# SECTION A: SCHEDULE OF SPENDING

**Schedule of Spending (Unaudited)**
**For Year Ended September 30, 2013**
**(In Millions)**

The following Schedule of Spending (SOS) presents an overview of the funds available for the Department to spend and how the Department spent these funds as of and for the fiscal year ended September 30, 2013. The financial data used to populate this schedule is the same underlying data used to populate the Department's Statement of Budgetary Resources (SBR). Accordingly, the budgetary financial information in this schedule is presented on a combined basis rather than on a consolidated basis. Specifically, the SOS presents Total Resources (or "Total Budgetary Resources" per the SBR), Amount Available but Not Agreed to be Spent (or "Unobligated balance, end of year – Apportioned and Exempt from Apportionment" per the SBR), and "Amount Not Available to be Spent" (or "Unobligated balances, end of year – Unapportioned" per the SBR).

| | | 2013 | | 2012 |
|---|---|---|---|---|
| **What Money is Available to Spend?** | | | | |
| Total Resources | $ | 857,781 | $ | 816,061 |
| Less: Amount Available but Not Agreed to be Spent | | (294,009) | | (255,227) |
| Less: Amount Not Available to be Spent | | (76,341) | | (84,371) |
| **Total Amounts Agreed to be Spent** | $ | **487,431** | $ | **476,463** |
| | | | | |
| **How was the Money Spent/Issued?** | | | | |
| Interest and Dividends[1] | $ | 427,946 | $ | 372,178 |
| Grants, Subsidies, and Contributions[2] | | 24,590 | | 37,885 |
| Personnel Compensation and Other Related Benefits | | 11,254 | | 11,588 |
| Investments and Loans[3] | | 7,201 | | 40,716 |
| Other Contractual Services | | 4,079 | | 9,882 |
| Other | | 12,359 | | 4,214 |
| **Total Amounts Agreed to be Spent** | $ | **487,431** | $ | **476,463** |
| | | | | |
| **Who did the Money go to?** | | | | |
| Federal | $ | 201,954 | $ | 182,013 |
| Non-Federal | | 285,477 | | 294,450 |
| **Total Amounts Agreed to be Spent** | $ | **487,431** | $ | **476,463** |

[1] *Interest and Dividends is primarily comprised of Interest on the Public Debt and interest expense related to credit reform activities.*

[2] *Grants, Subsidies, and Contributions are primarily comprised of cash payments to States, other political subdivisions, corporations, associations, and individuals; credit reform program related subsidies; and contributions to foreign countries.*

[3] *Investments and Loans primarily include investments made in connection with loans issued for credit reform and non-credit reform activities. The fiscal year 2012 amount includes $18.5 billion of liquidity payments made to the Government Sponsored Enterprises under the Senior Preferred Stock Purchase Agreements as of the fiscal year ended September 30, 2012 (Note 8). There were no payments to the GSEs for the fiscal year ended September 30, 2013.*

# SECTION B: TAX GAP AND TAX BURDEN

## TAX GAP

Reducing the tax gap is at the heart of IRS's enforcement and service programs. The tax gap is the difference between the tax (not interest and penalties) imposed on taxpayers by law for a given tax year and what they actually pay on time. The tax gap arises from three types of noncompliance: not filing required tax returns on time or at all (the nonfiling gap), underreporting the correct amount of tax on timely filed returns (the underreporting gap), and not paying on time the full amount reported on timely filed returns (the underpayment gap). Of these three components, only the underpayment gap is observed; the nonfiling gap and the underreporting gap must be estimated. The tax gap, about $450 billion based on updated tax year 2006 estimates, is defined as underpayments net of overpayments of true tax liability. However, it excludes illegal economic activity. IRS limits its estimates of the tax gap to tax due on legal-sector activity only. The tax gap is not synonymous with the so- called "underground economy," though there is some overlap. The underground economy is made up of activities that are not very visible to tax and other government authorities. Some of these activities are legal-sector and some are illegal-sector activities. While some of the tax gap arises from legal-sector income generated by underground economy participants, some of it arises from noncompliance that is completely unrelated to the underground economy – such as claiming the wrong filing status or overstating exemptions or tax credits. Therefore, while there is substantial overlap between the tax gap and the underground economy, it is best to maintain the distinction between these two concepts.

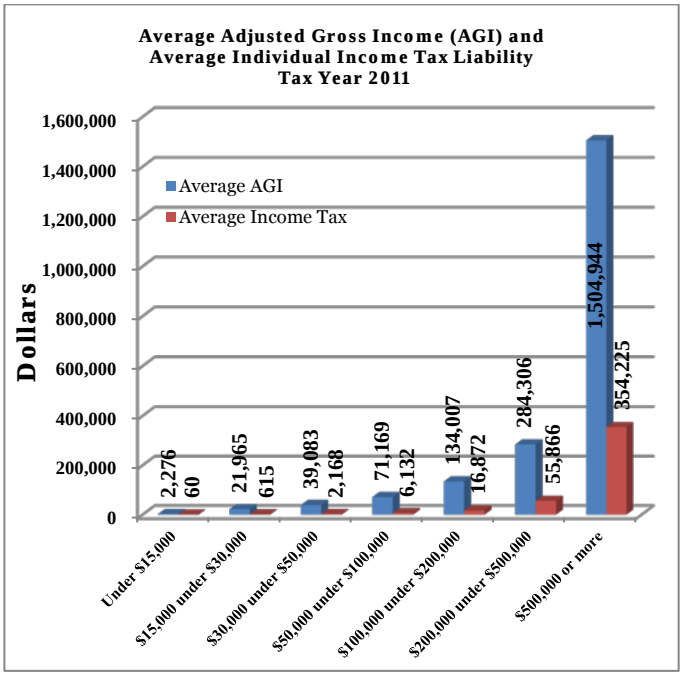
The underreporting gap accounts for 84 percent of the gross tax gap, with the remainder divided between the nonfiling gap (6 percent) and the underpayment of reported tax liability (10 percent). The IRS remains committed to finding ways to increase compliance and reduce the tax gap, while minimizing the burden on the vast majority of taxpayers who pay their taxes accurately and on time.

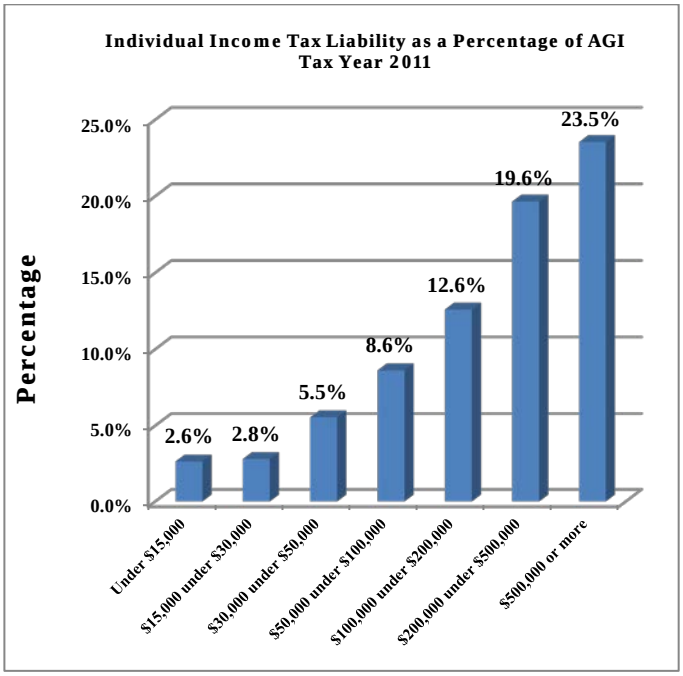
Each instance of noncompliance by a taxpayer at the time the tax is due contributes to the tax gap, whether or not the IRS detects it, and whether or not the taxpayer is even aware of the noncompliance. Obviously, some of the tax gap arises from intentional (willful) noncompliance, and some of it arises from mistakes caused by not applying sufficient due diligence to meet the tax obligation fully.

The collection gap is the cumulative amount of tax, penalties, and interest that has been assessed over many years, but has not been paid by a certain point in time, and which the IRS expects to remain uncollectible. In essence, it represents the difference between the total balance of unpaid assessments and the net taxes receivable reported on the IRS's balance sheet. The tax gap and the collection gap are related and overlapping concepts, but they have significant differences. The collection gap is a cumulative balance sheet concept for a particular point in time, while the tax gap is like an income statement item for a single year. Moreover, the tax gap estimates include all noncompliance, while the collection gap includes only amounts that have been assessed (a small portion of all noncompliance).

## TAX BURDEN

The Internal Revenue Code (IRC) provides for progressive rates of tax, whereby higher incomes are generally subject to higher rates of tax. The following graphs and charts present the latest available information on reported income tax and adjusted gross income (AGI) for individuals by reported AGI level and for corporations by size of reported assets. For individuals, the information illustrates, in percentage terms, the reported tax burden borne by various reported AGI levels. For corporations, the information illustrates, in percentage terms, the reported tax burden borne by these entities by various sizes of their reported total assets. The graphs are only representative of more detailed data and analysis available from the IRS's Statistics of Income Division.

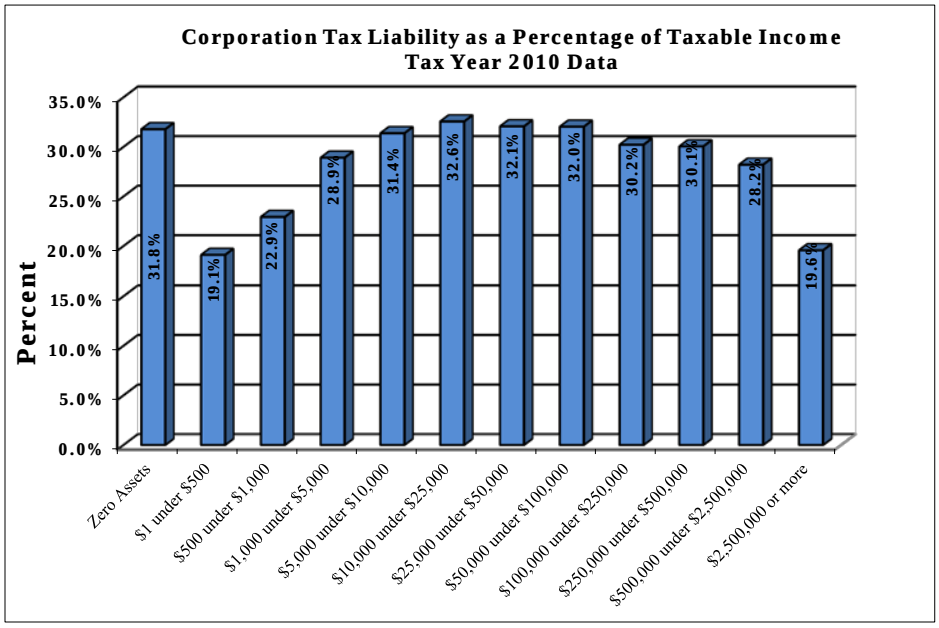



## INDIVIDUAL INCOME TAX LIABILITY

### Tax Year 2011

| Adjusted gross income (AGI) | Number of taxable returns (in thousands) | AGI (in millions) | Total income tax (in Millions) | Average AGI per return (in whole dollars) | Average income tax per return (in whole dollars) | Income tax as a percentage of AGI |
|---|---|---|---|---|---|---|
| Under $15,000 | 38,456 | $ 87,540 | $ 2,304 | $ 2,276 | $ 60 | 2.6% |
| $15,000 under $30,000 | 31,078 | 682,619 | 19,113 | 21,965 | 615 | 2.8% |
| $30,000 under $50,000 | 25,504 | 996,783 | 55,287 | 39,083 | 2,168 | 5.5% |
| $50,000 under $100,000 | 30,876 | 2,197,423 | 189,342 | 71,169 | 6,132 | 8.6% |
| $100,000 under $200,000 | 14,756 | 1,977,406 | 248,968 | 134,007 | 16,872 | 12.6% |
| $200,000 under $500,000 | 3,802 | 1,080,932 | 212,403 | 284,306 | 55,866 | 19.6% |
| $500,000 or more | 898 | 1,351,440 | 318,094 | 1,504,944 | 354,225 | 23.5% |
| **Total** | **145,370** | **$ 8,374,143** | **$ 1,045,511** | - | - | - |




### CORPORATION TAX LIABILITY

#### Tax Year 2010

| Total Assets (in Thousands) | Income subject to tax (in Millions) | Total income tax after credits (in Millions) | Percentage of income tax after credits to taxable income |
|---|---|---|---|
| Zero Assets | $ 15,068 | $ 4,789 | 31.8% |
| $1 under $500 | 6,167 | 1,178 | 19.1% |
| $500 under $1,000 | 3,231 | 741 | 22.9% |
| $1,000 under $5,000 | 10,274 | 2,970 | 28.9% |
| $5,000 under $10,000 | 6,890 | 2,162 | 31.4% |
| $10,000 under $25,000 | 10,312 | 3,358 | 32.6% |
| $25,000 under $50,000 | 9,900 | 3,175 | 32.1% |
| $50,000 under $100,000 | 12,955 | 4,150 | 32.0% |
| $100,000 under $250,000 | 23,640 | 7,143 | 30.2% |
| $250,000 under $500,000 | 29,057 | 8,732 | 30.1% |
| $500,000 under $2,500,000 | 109,072 | 30,770 | 28.2% |
| $2,500,000 or more | 785,609 | 153,801 | 19.6% |
| **Total** | **$ 1,022,175** | **$ 222,969** | - |

# SECTION C: MANAGEMENT AND PERFORMANCE CHALLENGES IDENTIFIED BY THE INSPECTORS GENERAL AND THE SECRETARY'S RESPONSES

In accordance with the *Reports Consolidation Act of 2000*, the Inspectors General issue Semiannual Reports to Congress that identify specific management and performance challenges facing the Department. At the end of each fiscal year, the Treasury Office of Inspector General (OIG) and Treasury Inspector General for Tax Administration (TIGTA) send an update of these management challenges to the Secretary and cite any new challenges for the upcoming fiscal year. The Special Inspector General for TARP does not provide the Secretary with a semiannual report or annual update on management and performance challenges. This section contains the management and performance challenges letters from OIG and TIGTA and the Secretary's responses describing actions taken and planned to address the challenges.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

November 14, 2013

# INFORMATION MEMORANDUM FOR SECRETARY LEW

**FROM:** Eric M. Thorson
Inspector General

**SUBJECT:** Management and Performance Challenges Facing the Department of the Treasury (OIG-CA-14-004)

In accordance with the Reports Consolidation Act of 2000, we are providing you with our perspective on the most serious management and performance challenges facing the Department of the Treasury.

In assessing the Department's most serious challenges, we are mindful of two factors affecting Treasury. The first, which we reported last year, is the sluggish economic recovery despite the efforts of the Administration and Congress. The second is the Nation's budget deficit. In my memoranda for each of the last 2 years, we acknowledged that in looking for ways to address the deficit, cuts to programs and operations were likely although the extent and specific nature of any cuts were unknown. This situation remains the same today. The results of the last national election brought little clarity to the direction the Federal Government will take in addressing these matters, as evidenced by the recent government shutdown and the uncertainties surrounding the future debt ceiling debate. While a significant number of issues related to the future of programs like Social Security and Medicare have once again been put off, problems would be exacerbated if the Government were to default on its obligations. The polarized political environment in which the Federal Government has been operating since 2010, with the repeated cycle of budget and debt ceiling stopgaps, has resulted in more waste and inefficiency. At the same time, more incidents of imprudent use of funds, such as certain conference spending by the General Services Administration, Internal Revenue Service, and the Department of Veterans Affairs, were brought to light. While the Department has implemented strong controls over spending for things like conferences, it is imperative that senior leaders and front-line managers remain ever vigilant when spending the funds that have been entrusted to them.

As I have also noted previously, Treasury has, in recent years, had to administer additional responsibilities intended to support and improve the country's economy. To do so, in nearly every case, the Department had to start up and administer these new responsibilities with thin staffing and resources. That situation remains the case. Like last year, we cannot emphasize enough to the Department's stakeholders the critical importance that Treasury is resourced sufficiently to maintain a strong control environment.

This year we are reporting four challenges, which are repeated from last year.

- Continued Implementation of Dodd-Frank (in our prior year memorandum, we referred to this challenge as "Transformation of Financial Regulation" but have renamed it as many aspects of Dodd-Frank Wall Street Reform and Consumer Protection Act have been implemented and are maturing)
- Management of Treasury's Authorities Intended to Support and Improve the Economy
- Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement
- Gulf Coast Restoration Trust Fund Administration

In addition to the above challenges, we are continuing to report our elevated concerns about three matters – cybersecurity, currency and coin production, and the need to document key activities and decisions. We close our memorandum this year with observations about the Bureau of the Fiscal Service (Fiscal Service) and its Do Not Pay Initiative.

## 2013 Management and Performance Challenges

### Challenge 1: Continued Implementation of Dodd-Frank

In response to the need for financial reform, Congress passed Dodd-Frank in July 2010. Among other things, Dodd-Frank established the Financial Stability Oversight Council (FSOC), which you chair as the Treasury Secretary. FSOC's mission is to identify risks to financial stability that could arise from the activities of large, interconnected financial companies; respond to any emerging threats to the financial system; and promote market discipline. FSOC and its Federal agency members must continue to work in order to meet all of FSOC's responsibilities. That said, FSOC accomplished much over the last year. For example:

Annual reporting – As required, FSOC issued its third annual report in July 2013. The report contained recommendations to (1) further reforms to address structural vulnerabilities in key markets, (2) take steps to address reform of the housing finance market, (3) identify alternative interest rate benchmarks, (4) heighten risk management and supervisory attention in specific areas, (5) monitor the impact of the low interest rate environment, (6) ensure enhanced capital planning and robust capital for financial institutions, and (7) ensure implementation and coordination on financial regulatory reform.

Designation of nonbank financial institutions for consolidated supervision – FSOC designated two companies for additional supervision by the Board of Governors of the Federal Reserve System (FRB) in July 2013. After considering an appeal, FSOC designated one additional company in September 2013. FSOC continues to review other nonbank financial institutions for potential designation.

Money Market Reform – In November 2012, FSOC issued for public comment proposed recommendations to the Securities and Exchange Commission (SEC) to address the structural susceptibility of money market funds to investor runs. FSOC's proposed recommendations state that if SEC moves forward with meaningful structural reforms of money market funds before FSOC finalizes its recommendation, FSOC expects not to issue a

final recommendation. In this regard, SEC posted a money market fund reform proposal in the Federal Register on June 19, 2013, with comments due by September 17, 2013.

Risk Monitoring and Regulatory Coordination – FSOC has considered issues such as sovereign fiscal developments in Europe and the U.S., the multi-billion dollar trading losses by JPMorgan Chase, the state of mortgage foreclosures in the U.S., the failure of MF Global, the impact of Superstorm Sandy on financial markets, weaknesses in the setting process of the London Interbank Offered Rate (LIBOR),[1] and risks to financial stability arising from cybersecurity vulnerabilities. To facilitate this risk monitoring process, FSOC established the Systemic Risk Committee which serves as a forum for member agency staff to identify and analyze potential risks that may extend beyond the jurisdiction of any one agency.

The Council of Inspectors General on Financial Oversight (CIGFO), also established by Dodd-Frank and which I chair, facilitates the sharing of information among member inspectors general with a focus on reporting our concerns that may apply to the broader financial sector and ways to improve financial oversight. Accordingly, CIGFO is an important source of independent analysis to FSOC. As required, CIGFO met quarterly and issued its third annual report in July 2013. CIGFO also established its second Working Group in January 2013. The Working Group assessed the rules, procedures, and practices established by FSOC and its members to determine which financial market utilities (FMU)[2] should be designated as systemically important. The Working Group determined that FSOC carried out the designation activities as established by Dodd-Frank and the FSOC FMU Committee carried out its activities in the designation process as intended by FSOC. However, the Working Group noted that the FMU Committee did not have a designated chairperson and did not keep records of its meetings. Also, the Working Group found that FSOC continues to evaluate whether to consider for designation foreign-based FMUs; retail FMUs; or payment, clearing, and settlement activities conducted by financial institutions, but had not made any such designations at the time of the review. In addition, the Working Group found FSOC relied on the respective regulators of the designated FMUs to monitor their activities and report updates to FSOC. However, there was no agreement or process established in writing by FSOC that defined the nature, frequency, and communication of such updates. The Working Group's July 2013 report made five recommendations to FSOC to address these matters. Going forward, CIGFO will continue to review FSOC operations and its efforts to oversee the U.S. financial system.

Dodd-Frank also established two offices within Treasury: the Office of Financial Research (OFR) and the Federal Insurance Office (FIO).[3] OFR is the data collection, research and analysis arm of FSOC. Last year, we reviewed the stand-up of OFR. In our report on that review, we noted among other things that OFR had not yet developed performance measures for the office. We are currently conducting a review to assess the design and implementation of performance

1 LIBOR is the interest rate at which banks can borrow unsecured funds from other banks in London wholesale money markets, as measured by daily surveys of the British Bankers' Association. LIBOR is used to set rates on mortgages, student loans, car loans, credit cards, and some complex financial derivatives.

2 FMUs are systems that provide the essential infrastructure for transferring, clearing, and settling payments, securities, and other financial transactions among financial institutions or between financial institutions and the system. FSOC may designate an FMU as systemically important under Title VIII of Dodd-Frank if a failure or a disruption to the functioning of the FMU could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system.

3 Dodd-Frank also established two other offices within Treasury – the Offices of Minority and Women Inclusion (OMWI) at Departmental Offices and at the Office of the Comptroller of the Currency. We are currently conducting a review of OMWI at Departmental Offices.

measures by OFR. FIO is charged with monitoring the insurance industry, including identifying gaps or issues in the regulation of insurance that could contribute to a systemic crisis in the insurance industry or financial system. We are currently reviewing the stand-up of FIO. We do note, however, that FIO has not completed or submitted two reports required by Dodd-Frank.

1. A report on how to modernize and improve the system of insurance regulation in the U.S. – Due 18 months after enactment (January 27, 2012), now late by nearly 22 months

2. A report describing the breadth and scope of the global reinsurance market and the critical role such a market plays in supporting insurance in the U.S. – Due September 30, 2012, now late by nearly 14 months

The other regulatory challenges that we discussed last year still remain. Specifically, since September 2007, 130 financial institutions supervised by the Office of the Comptroller of the Currency (OCC) or the former Office of Thrift Supervision (OTS) have failed, with estimated losses to the Deposit Insurance Fund of approximately $36.1 billion. While we expect that bank failures will continue, we note the number of failures has dramatically decreased since 2010. Unless there is an unanticipated significant disruption to the financial markets, the rate of bank failures should remain low. Although many factors contributed to the economic crisis, our failed bank reviews generally found that OCC and the former OTS did not identify early or force timely correction of unsafe and unsound practices by numerous failed institutions under their supervision.

Furthermore, in 2010, the unprecedented speed at which servicers foreclosed on defaulted mortgages revealed flaws in the processing of those foreclosures. In response, the federal banking regulators completed a review of foreclosure practices at major mortgage servicers. The review found deficiencies in the servicers' foreclosure processes and, as a result, the federal banking regulators issued formal enforcement actions against 14 mortgage servicers and 2 third-party providers subject to the review. Among other things, the enforcement actions required the servicers to implement an independent foreclosure review (IFR) process using independent consultants to determine financial injury to affected borrowers. We reviewed OCC's oversight of the servicers' efforts to comply with the enforcement actions. We found that OCC had developed a framework to monitor the servicers' efforts and oversee the foreclosure review process. However, we found areas where OCC oversight needed strengthening. Specifically, OCC had not performed comprehensive direct testing of individual independent foreclosure reviews to assess whether independent consultants were performing the reviews objectively, consistently, and in compliance with OCC guidance. In addition, improvements were needed in the documentation of various aspects of OCC oversight.[4] Subsequent to our review, OCC negotiated a change to the terms of the enforcement actions with 11 of the 12 servicers under OCC supervision because the foreclosure reviews were taking longer than anticipated and delaying compensation to affected borrowers. We are currently reviewing OCC's oversight of the servicers' compliance with the amended enforcement actions.

As we have stated in the past, the intention of Dodd-Frank is most notably to prevent, or at least minimize, the impact of a future financial sector crisis on the U.S. economy. To accomplish this, Dodd-Frank has placed great responsibility with Treasury and with the Secretary. This management challenge from our perspective is to maintain an effective FSOC process supported

4 Office of Inspector General (OIG), *Safety and Soundness: Improvement Needed in OCC's Oversight of Foreclosure Related Consent Orders* (OIG-13-049; Sep. 9, 2013)

by OFR and FIO within Treasury and to build a streamlined banking regulatory structure that timely identifies and appropriately responds to emerging risks. This is especially important in times of economic growth and financial institution profitability, when such government action is generally unpopular. As the regulatory framework prescribed by Dodd-Frank is institutionalized and matures, we will reassess our reporting of it as a management challenge in future years..

**Challenge 2: Management of Treasury's Authorities Intended to Support and Improve the Economy**

Congress provided Treasury with broad authorities to address the recent financial crisis under the Housing and Economic Recovery Act (HERA) and the Emergency Economic Stabilization Act (EESA) enacted in 2008, the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the Small Business Jobs Act of 2010. As we stated last year, to a large extent Treasury's program administration under these acts has matured, but challenges remain in managing Treasury's programs and its outstanding investments. Additionally, the long-term impact on small business lending resulting from investment decisions under Small Business Jobs Act programs is still not clear. Our discussion of this challenge will begin with this act and then address the others for which Treasury is responsible.

Management of the Small Business Lending Fund and State Small Business Credit Initiative

Enacted in September 2010, the Small Business Jobs Act created within Treasury a $30 billion Small Business Lending Fund (SBLF) to assist financial institutions and provided $1.5 billion to Treasury to allocate to eligible state programs through the State Small Business Credit Initiative (SSBCI). These represent key initiatives of the Administration to increase lending to small businesses, and thereby support job creation. Both programs were slow to disburse funds, with Treasury approving the majority of SBLF and SSBCI applications during the last quarter of fiscal year 2011. Because the majority of applicants waited until near the application deadlines to apply, Treasury encountered significant delays in implementing the two programs. As a result, Treasury was rushed in making a number of SBLF investment decisions to meet the funding deadlines, and disbursed the initial installment of SSBCI funds without establishing clear oversight obligations of participating states. Now that Treasury has completed the approval process for these two programs, the challenge is to exercise sufficient oversight to ensure that funds are used appropriately, SBLF dividends owed Treasury are paid, and programs achieve intended results.

SBLF – As of September 2011, Treasury had disbursed more than $4 billion to 332 financial institutions across the country. Of the institutions funded, approximately 41 percent used SBLF funds to refinance securities issued under the Troubled Asset Relief Program's Capital Purchase Program. Institutions receiving investments under the SBLF program pay dividends to Treasury at rates that decrease as the institutions increase their qualified small business lending activity. During the first 4½ years of Treasury's investment, participating institutions initially pay dividends to Treasury of up to 5 percent, but that rate may be reduced to as low as 1 percent based on institutions' self-reported increases in small business lending. Institutions are under no obligation to make dividend payments as scheduled or to pay off previously missed payments before exiting the program. There are provisions for increased restrictions as dividends are missed, including a prohibition against an institution paying dividends on common stock and a provision for Treasury to appoint one or two members to

the bank's board of directors. The effectiveness of these measures, however, can be affected if the institution's regulator has already restricted it from making dividend payments.

Treasury faces challenges in measuring program performance and ensuring that the SBLF program meets its intended objective of increasing lending to small businesses. The intent of the authorizing legislation was to stimulate lending to small businesses, but participating institutions are not required to report how they use Treasury's investments and are under no obligation to increase their small business lending. Further, although participating institutions must report their small business lending activity, there is no way to isolate the impact of SBLF from other factors that could affect lending to determine program impact. Once participating institutions commingle SBLF disbursements with other funds, it is difficult to track how the funds are used. Additionally, Treasury does not verify that small business lending reported by participating institutions meet SBLF requirements and should be included when measuring performance and making dividend rate adjustments.

SSBCI – As of September 30, 2013, Treasury had disbursed approximately $912 million of the $1.4 billion in SSBCI funding awarded to 56 participating states, territories, and municipalities. Treasury disburses the funds in thirds, with each successive third transferred after a state certifies that it has used 80 percent of its last transfer. States have been slow to use their SSBCI funding as many either had to establish small business lending programs to be able to use their funds and/or redirect funds transferred midstream to better performing programs than those originally designated.

Primary oversight of the use of SSBCI funds is the responsibility of each participating state. The states may use funds awarded for programs that partner with private lenders to extend credit to small businesses. Such programs may include those that finance loan loss reserves and provide loan insurance, loan guarantees, venture capital funds, and collateral support. States must report quarterly and annually on their use of funds and certify quarterly that their programs approved for SSBCI funding comply with program requirements.

However, Treasury will face challenges in holding states accountable for the proper use of funds as it has not clearly communicated what is prohibited and has frequently changed program guidelines, making it difficult for states to ensure the proper use of funds. Treasury also has not appropriately addressed how self-reported, non-compliant transactions will be remedied. Current program guidance suggests that if a state self-reports a misuse of funds, the funds are not subject to an OIG audit or recoupment.

As a result, Treasury will have difficulty finding states to be in default of program requirements and holding them accountable.

Management of Recovery Act Programs

Since the Recovery Act was enacted in 2009, Treasury has been responsible for overseeing an estimated $150 billion of funding and tax relief for programs that provided payments for specified energy property in lieu of tax credits and payments to states for low-income housing projects in lieu of tax credits; grants and tax credits through the Community Development Financial Institutions (CDFI) Fund; economic recovery payments to Social Security beneficiaries and others; and payments to U.S. territories for distribution to their citizens. While funding for non-Internal Revenue Service (IRS) programs is coming to a close, Treasury must continue to oversee approximately $25 billion to recipients under Treasury's payments in lieu of tax credit programs – to persons for specified energy properties and to states for low-income housing projects. That is, management must continue to ensure award compliance of approximately 93,000 recipients over an extended period of time (5 years from the date of award for the specified energy properties and 15 years from the date of award for low-income housing projects). Additionally, our Office of Investigations had several open matters involving claims for low-income housing projects and specified energy properties.

Management of the Housing and Economic Recovery Act and the Emergency Economic Stabilization Act

Through several HERA and EESA programs, Treasury injected much needed capital into financial institutions and businesses.

Under HERA, Treasury supported the financial solvency of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which continue to operate under the conservatorship of the Federal Housing Finance Agency. To cover the losses of the two government sponsored enterprises (GSE) and maintain a positive net worth, Treasury purchased senior preferred stock, and as of September 30, 2013, invested $187 billion in the two GSEs. Although the GSEs did not require Treasury's support in fiscal year 2013, their futures are still uncertain and further assistance may be required. If such support is needed, the current funding capacity available to Fannie Mae is $117.6 billion and available to Freddie Mac is $140.5 billion.

Through the Housing Finance Agency Initiative supporting state and local finance agencies, Treasury purchased $15.3 billion of securities issued by Fannie Mae and Freddie Mac backed by state and local Housing Finance Agency bonds (New Issue Bond Program) and committed $8.2 billion for a participation interest in the obligations of Fannie Mae and Freddie Mac (Temporary Credit and Liquidity Program). Treasury received payments of principal and interest on its securities, and as of September 30, 2013, holds an investment of approximately $9.3 billion. Additionally, several state and local housing agencies opted out of the Temporary Credit and Liquidity Program reducing Treasury's commitment to about $2.0 billion. Treasury must continue to monitor the underlying assets of its investment in the Housing Finance Agency Initiative to ensure the accuracy of mortgage principal, interest, and fees collected.

As required by Dodd-Frank, Treasury and the Department of Housing and Urban Development conducted a study on ending the conservatorship of Fannie Mae and Freddie Mac and minimizing the cost to taxpayers. The report on this study was presented to the Congress in

February 2011.[5] Regarding the long-term structure of housing finance, the report provided three options for increased privatization without recommending a specific option. Since this report, other legislation has been proposed in the Congress to address housing finance reform, but a legislative solution that all can agree on is still in a formative stage. Accordingly, it is difficult to predict what lies ahead for winding down the Fannie Mae and Freddie Mac conservatorships and reforming housing finance.

In addition to SBLF and SSBCI, the Small Business Jobs Act of 2010 provided Treasury with authority to guarantee the full amounts of bonds and notes issued for community and economic development activities not to exceed 30 years. Under this authority, Treasury may issue up to 10 guarantees of no less than $100 million each, but may not exceed $1 billion in total aggregate guarantees in any fiscal year. As the program administrator, CDFI Fund was tasked with establishing regulations and implementing the program by September 27, 2012. CDFI Fund experienced challenges in standing up the program and missed the program's statutory implementation date. The program, along with regulations, was eventually established in June 2013. Treasury received guarantee authority of $500 million in fiscal year 2013, and as of September 30, 2013, guaranteed $325 million of bonds to be issued in fiscal year 2014. The guarantee program is authorized through fiscal year 2014. As with any new program, successful implementation will depend on a strong internal control structure and senior management involvement and support at the front end. Our office plans to assess the CDFI Fund's administration of this program in 2014.

### Challenge 3: Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement

As we have reported in the past, ensuring criminals and terrorists do not use our financial networks to sustain their operations and/or launch attacks against the U.S. continues to be a challenge. Treasury's Office of Terrorism and Financial Intelligence (TFI) is dedicated to disrupting the ability of terrorist organizations to fund their operations. TFI brings together intelligence gathering and analysis, economic sanctions, international cooperation, and private-sector cooperation to identify donors, financiers, and facilitators supporting terrorist organizations, and disrupt their ability to fund them. Enhancing the transparency of the financial system is one of the cornerstones of this effort. Treasury carries out its responsibilities to enhance financial transparency through the Bank Secrecy Act (BSA) and the USA Patriot Act. The Financial Crimes Enforcement Network (FinCEN) is the Treasury bureau responsible for administering BSA.

Over the past decade, TFI has made progress closing the vulnerabilities that allowed money launderers and terrorists to use the financial system to support their activities. Nonetheless, significant challenges remain. One challenge is to ensure the continued cooperation and coordination of all the organizations involved in its anti-money laundering and combating terrorist financing efforts. A large number of federal and state entities participate with FinCEN to ensure compliance with BSA, including the four federal banking agencies, IRS, the Securities and Exchange Commission, the Department of Justice, and state regulators. Many of these entities also participate in efforts to ensure compliance with U.S. foreign sanction programs administered by Treasury's Office of Foreign Assets Control (OFAC).

5 Department of the Treasury and the Department of Housing and Urban Development, *Reforming America's Housing Finance Market - A Report To Congress* (Feb. 2011)

Neither FinCEN nor OFAC have the resources or capability to maintain compliance with their programs without significant help from these other organizations. Accordingly, to be effective, Treasury must establish and maintain working relationships with these entities. To this end, FinCEN signed memoranda of understanding with 73 federal and state regulators to ensure that information is exchanged between FinCEN and the entities charged with examining for BSA compliance. While important to promote the cooperation and coordination needed, it should be noted that these instruments are nonbinding and carry no penalties for violations, and their overall effectiveness has not been independently assessed.

In light of these challenges, in November 2012, the Department established a new anti-money laundering (AML) task force composed of federal policymakers, regulators, and law enforcement agencies to examine and strengthen the U.S. AML framework. The objective of the task force was to develop recommendations to address any gaps, redundancies, and inefficiencies in the legal and regulatory foundation, examination function, and enforcement efforts of the AML framework. During 2013, the AML task force was in the early stages of data gathering and analysis.

Last year, financial institutions filed approximately 18.7 million BSA reports, including nearly 1.8 million suspicious activity reports (SAR). While the number of SARs has been increasing since 2001, that alone does not necessarily indicate everything that is going well. Our audits have found problems with the quality of the data reported. Other audits have also identified gaps in the regulatory examination programs of the bank regulators and examining agencies.

More recently, vulnerabilities in certain very large institutions' monitoring of transactions for money laundering and terrorist financing were revealed. For example, in 2013, OCC filed a consent cease and desist order against JP Morgan Chase and Company for critical deficiencies found in its BSA program with respect to submitting SARs, monitoring transactions, conducting customer due diligence and risk assessment, and implementing adequate systems of internal controls and independent testing. Also, as a result of a critical congressional report on OCC's oversight of HSBC's BSA program in July 2012, the Comptroller of the Currency has taken actions to enhance its supervision of BSA compliance.

These include issuing a supervisory memorandum instructing examiners to consider BSA/AML examination findings in a safety and soundness context when assigning the "management" component of a bank's CAMELS rating.[6] OCC also plans to issue guidance for examiners to cite violations when a bank fails to meet any one of the statutory minimum requirements for a BSA/AML program.[7] In addition, OCC created a large bank review team, a Major Matters Supervision Review Committee, and an internal bank supervision appeals program for its examiners.

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6 Federal banking agencies use the CAMELS rating system to evaluate the soundness of financial institutions on a uniform basis and to identify institutions requiring special supervisory attention or concern. A financial institution is assigned a composite rating based on ratings on six components: Capital adequacy, quality of Assets, the capability of the board of directors and Management, the quality and level of Earnings, the adequacy of Liquidity, and Sensitivity to market risk.

7 At a minimum, a BSA program must reasonably provide (1) a system of internal controls, (2) independent testing, (3) the designation of individual(s) responsible for managing the BSA program, and (4) the training of appropriate personnel.

OCC took these actions in an effort to ensure that OCC takes timely actions for financial institutions with multiple Matters Requiring Attention[8] or BSA/AML program violations.

FinCEN needs to continue its efforts with regulators and examining agencies to ensure that financial institutions establish effective BSA compliance programs and file accurate and complete BSA reports. Furthermore, FinCEN needs to complete work to issue anti-money laundering regulations, as it determines appropriate, for some non-bank financial institutions such as vehicle dealers, pawnbrokers, travel agents, finance companies, and real estate closing and settlement services, as well as financial services intermediaries, such as investment advisors.

FinCEN also faces the continuing challenge to enhance financial transparency to strengthen efforts to combat financial crime. One area that has FinCEN's attention is clarifying and strengthening customer due diligence requirements and associated supervisory expectations. This includes a possible requirement that institutions identify beneficial ownership of their accountholders so that the true identities of their customers are not hidden. FinCEN issued an advance notice of proposed rulemaking in March 2012 to address this.

FinCEN's BSA Information Technology (IT) Modernization Program, which began in 2008 and is scheduled for completion in 2014, is being built to ensure efficient management, safeguarding, and use of BSA information. On a positive note, we completed four audits of the program pursuant to a Congressional directive in which we concluded that FinCEN is generally meeting schedule and cost milestones, and had an appropriate oversight structure in place. As a result of a 2013 reorganization, FinCEN did redefine some requirements and priorities. As the program moves closer to completion, FinCEN plans to engage users to address their concerns and suggested enhancements. FinCEN also plans to ensure that users are adequately trained to use the new system.

We note that FinCEN continues to have a difficult challenge in dealing with money service businesses (MSB). To that end, FinCEN has taken steps to improve MSB examination coverage and compliance. For example, in past years FinCEN finalized new rules and increased enforcement designed to ensure MSBs comply with BSA requirements, including registration and report filing requirements. However, ensuring MSBs register with FinCEN has been an ongoing challenge. Furthermore, while IRS serves as the examining agency for MSBs, it has limited resources to inspect MSBs or identify unregistered MSBs. FinCEN engaged the states to participate in joint MSB examinations with IRS and for outreach programs aimed at these nonbank institutions. FinCEN, IRS, and the states need to work together to ensure that MSBs operating in this country are identified, properly registered, and in compliance with all applicable laws and regulations.

FinCEN has also been concerned with MSBs that use informal value transfer systems and with MSBs that issue, redeem, or sell prepaid access through physical means (cards or other devices) or non-physical means (codes, electronic serial numbers, mobile identification numbers, or personal identification numbers). MSBs using informal value transfers have been identified in a number of attempts to launder proceeds of criminal activity or finance terrorism. Similarly, prepaid access can make it easier for some to engage in money laundering or terrorist financing.

8 Matters Requiring Attention are practices that (1) deviate from sound governance, internal control, and risk management principles, which may adversely impact the bank's earnings or capital, risk profile, or reputation, if not addressed; or (2) result in substantive noncompliance with laws and regulations, internal policies or processes, OCC supervisory guidance, or conditions imposed in writing in connection with the approval of any application or other request by a bank.

In September 2010, FinCEN notified financial institutions to be vigilant and file SARs on MSBs that may be inappropriately using informal value transfers when they use financial institutions to store currency, clear checks, remit and receive funds, and obtain other financial services. In 2011, FinCEN issued a final rule applying customer identification, recordkeeping, and reporting obligations to providers and sellers of prepaid access, and continues to issue clarifying guidance for institutions to implement the requirements. Ensuring institutions properly implement these rules and maintain compliance will be a continuing challenge.

To detect possible illicit wire transfer use of the financial system, FinCEN also proposed a regulatory requirement for certain depository institutions and MSBs to report cross-border electronic transmittals of funds. FinCEN determined that establishing a centralized database will greatly assist law enforcement in detecting and ferreting out transnational organized crime, multinational drug cartels, terrorist financing, and international tax evasion. Ensuring financial institutions, particularly MSBs, comply with the cross-border electronic transaction reporting requirements, as well as managing this new database, is another significant challenge for FinCEN. It should be noted that this system cannot be fully implemented until FinCEN completes work on its BSA IT Modernization Program.

Other matters of concern are on the horizon. One concern is the increasing use of mobile devices for banking, internet banking, internet gaming, and peer-to-peer transactions. FinCEN, OFAC, and other regulatory agencies will need to make sure that providers of these services ensure transactions conform to BSA requirements. Monitoring the transactions of tomorrow may prove to be increasingly difficult for Treasury. In this regard, in March 2013, FinCEN issued guidance on virtual currencies[9] and regulatory responsibilities to provide clarity for businesses and individuals engaged in this expanding field of financial activity. FinCEN's rules defined certain businesses or individuals which use convertible virtual currencies or make a business of exchanging, accepting, and transmitting them as MSBs. MSBs have registration requirements and a range of anti-money laundering, recordkeeping, and reporting responsibilities under FinCEN's regulations.

Given the criticality of this challenge to the Department's mission, we continue to consider anti-money laundering and combating terrorist financing as inherently high-risk. In this regard, we have on-going BSA-related audits of FinCEN's programs for MSB compliance and for information sharing under section 314 of the USA Patriot Act, FinCEN's and OFAC's use of Reports of Blocked Transactions as SARs, and OCC's BSA and USA Patriot Act examinations and enforcement actions. We are also reviewing OFAC's licensing program (where OFAC may grant exceptions to a sanction program as allowed under law) and performing a case study review of its Libyan sanctions program. We plan to complete these audits in fiscal year 2014.

9 Bitcoins are an example of a virtual currency. These consist of a series of numbers created automatically on a set schedule and traded anonymously between digital addresses or "wallets." Certain exchange firms buy or sell Bitcoins for legal tender at a rate that fluctuates with the market. Congress and regulators continue their efforts to determine the legality, legitimacy, and regulatory framework for virtual currencies such as Bitcoins.

**Challenge 4: Gulf Coast Restoration Trust Fund Administration**

In response to the *Deepwater Horizon* oil spill, Congress enacted the Resources and Ecosystems Sustainability, Tourist Opportunities, and Revived Economies of the Gulf Coast States Act of 2012 (RESTORE Act). This law established within Treasury the Gulf Coast Restoration Trust Fund and requires Treasury to deposit in the Trust Fund 80 percent of administrative and civil penalties paid by responsible parties for the *Deepwater Horizon* oil spill. The funds are to be distributed for environmental and economic restoration activities affecting the Gulf Coast states (Alabama, Florida, Louisiana, Mississippi, and Texas). While the total amount that will eventually be deposited into the Trust Fund is unknown at this time, estimates range from $5 billion to $21 billion. The Trust Fund has already received a deposit of approximately $323 million, part of a $1 billion settlement with the Transocean defendants. Litigation is ongoing with other defendants.

Under the RESTORE Act, money from the Trust Fund is allocated as five components:

- Direct Component (35 percent) – administered by Treasury for allocation in equal shares to the Gulf Coast states for ecological and economic restoration of the Gulf Coast region

- Council-selected Restoration Component (30 percent) – administered by the Gulf Coast Ecosystem Restoration Council[10] for allocation to Gulf Coast states and federal agencies, pursuant to a comprehensive plan approved by the council, to undertake projects and programs using the best available science that would restore and protect the Gulf Coast region's natural resources, ecosystems, fisheries, marine and wildlife habitats, beaches, and coastal wetlands

- Spill Impact Component (30 percent) – administered by the Gulf Coast Ecosystem Restoration Council for allocation to the Gulf Coast states for eligible oil spill restoration activities, pursuant to the council's approval of the states' plans to improve the ecosystems or economy of the Gulf Coast region, using a regulatory formula

- National Oceanic and Atmospheric Administration (NOAA) Science Program Component (2.5 percent) – administered by NOAA for its Gulf Coast Ecosystem Restoration Science, Observation, Monitoring, and Technology Program. This program is to carry out research, observation, and monitoring to support the long-term sustainability of the ecosystem, fish stocks, fish habitat, and the recreational, commercial, and charter fishing industry in the Gulf of Mexico

- Centers of Excellence Research Grants Program Component (2.5 percent) – administered by Treasury for allocation in equal shares to the Gulf Coast states for competitive grant awards to nongovernmental entities and consortia in the Gulf Coast region, including public and private institutions of higher education, to establish centers for excellence to conduct Gulf Coast region research

10 The Gulf Coast Ecosystem Restoration Council consists of the following members, or designees: (1) at the federal level, the Secretaries of the Interior, Army, Commerce, Agriculture, the head of the department in which the Coast Guard is operating (currently the Secretary of Homeland Security), and the Administrator of the Environmental Protection Agency; and (2) at the state level, the Governors of Alabama, Florida, Louisiana, Mississippi, and Texas.

The RESTORE Act prescribes how funds will be distributed and gives the Secretary of the Treasury the authority to withhold funds if certain conditions in the Act are not met, including the following of procurement rules and regulations.

The RESTORE Act gives Treasury many responsibilities. The act also authorizes our office to conduct, supervise, and coordinate audits and investigations of projects, programs and activities funded under this legislation. Neither Treasury nor our office was provided specific funding in the act for carrying out our respective responsibilities. What makes the administration of the RESTORE Act so challenging is that (1) regulations and associated policies and procedures need to be established and put into place before the receipts of the Trust Fund can be used; (2) the numerous entities and councils that are to receive and further allocate funding are still establishing their own policies and procedures; and (3) the need for cooperation and coordination by these entities and councils to ensure funds are spent in an appropriate manner.

Treasury was required, in consultation with the Departments of the Interior and Commerce, to develop policies and procedures to administer the Trust Fund by January 2, 2013. Treasury's Office of the Fiscal Assistant Secretary published the draft procedures, in the form of regulations, in the Federal Register for comment on September 6, 2013; over 8 months after the procedures were to be finalized. We have been meeting with the Fiscal Assistant Secretary's staff and providing our perspectives on controls as the procedures to administer the Trust Fund are being developed. We are also actively engaged in coordinating with affected federal, state, and local government entities to ensure effective oversight of programs established by the act.

**Matters of Concern**

Although we are not reporting these as management and performance challenges, we want to highlight some areas of growing concern – cybersecurity, currency and coin production, and documenting key activities and decisions.

Cybersecurity

Treasury's systems are interconnected and critical to the core functions of government and the Nation's financial infrastructure. Cybersecurity remains a constant area of concern and potential vulnerability for Treasury's internal systems. Our audits in this area have found deficiencies across Treasury in the areas of vulnerability and patch management, password management, system security configurations, and users' susceptibility to social engineering attacks. In addition, cyberthreats continue to grow and are increasingly more sophisticated, posing an ongoing challenge to the confidentiality, integrity, and availability of systems. Accordingly, Treasury management must continuously monitor Treasury's systems for vulnerabilities and ensure all employees and others connected to those systems maintain a heightened awareness of their roles in protecting these critical assets.

The cyber attacks facing banking institutions continue to evolve at an accelerated rate, ranging from distributed denial of service attacks on bank websites to phishing attacks to fraudulent wire payments. Organized hacking groups leverage known and new vulnerabilities and use different methods to make attacks hard to detect and even harder to prevent. Criminal groups and nation-states are constantly seeking to steal information, commit fraud, disrupt, degrade, or deny access to information systems that can strain bank resources and cause financial, operational, or reputational harm. A successful, widespread attack on the banking industry would shake confidence in the banking system.

As a result, an economic and national security challenge for which Treasury must be prepared is providing leadership to financial institutions in particular, and the financial sector in general, to strengthen awareness and preparedness against cyberthreats. Given the evolving environment, Treasury will need to continue to strengthen partnerships and coordination among law enforcement, financial institutions, regulators, and private entities in the financial sector, to address these threats.

Currency and Coin Production

On October 8, 2013, after a 1½ year delay, FRB began supplying financial institutions with the redesigned, NexGen $100 Note that incorporates new security features to deter counterfeiters and help businesses and consumers tell whether a note is genuine. The original scheduled introduction of this new note, in February 2011, was missed after creasing was detected in some of the finished notes. In January 2012, we reported on deficiencies with the Bureau of Engraving and Printing (BEP) NexGen $100 Note production process, project management, and the need to complete a comprehensive cost-benefit analysis for the disposition of the 1.4 billion finished NexGen $100 notes printed in 2010 but not accepted by FRB. The notes now being supplied to banks were produced after the production problems with the 1.4 billion notes were identified and sufficiently resolved; BEP and FRB still need to decide on a course of action for the 1.4 billion finished notes, which are currently held in BEP vaults.

Another matter related to currency redesign that should be kept in mind is meaningful access to U.S. currency for blind and visually impaired individuals. In response to a court ruling on that matter, several methods were discussed that Treasury plans to use to provide such access. Among them, the inclusion of raised tactile features and high-contrast numerals that would help distinguish denominations of U.S. currency notes. The lessons learned with the NexGen $100 Note production process underscore the need for sound and comprehensive project management as BEP undertakes this redesign effort.

Challenges continue to exist with coin production. For example, the cost of producing penny and nickel coins were double their face value because metal prices have resulted in higher production costs for the past 7 years. To meet the demands of managing a retail business, the U.S. Mint has also identified the need to replace its 12-year old Integrated Retail Information System with a new e-commerce system which fully integrates order management.

In the future, the impact of alternative payment systems and other technological advances – such as stored value cards, the Internet, and smartphones – to BEP's and the Mint's respective business models and practices must be considered. Accordingly, it is imperative that BEP and the Mint factor this into their business model and future planning and interactions with their customer, FRB.

Documenting Key Activities and Decisions

In last year's letter I cited two audits by my office that highlighted lapses by the Department in maintaining a complete and concurrent record of key activities and decisions. One audit involved the selection of financial agents for Treasury's investment in Fannie Mae and Freddie Mac mortgage backed securities. The other audit involved Treasury's consultative role with the Department of Energy's Solyndra loan guarantee. More recently, as mentioned in Challenge 1, we found that documentation of OCC's oversight of foreclosure-related

consent orders was lacking.[11] Maintaining proper documentation is a fundamental tenet of government accountability and transparency. Maintaining proper documentation is also in the best long-term interest of Treasury and its component offices and bureaus if actions are later questioned, as they have been. In this regard, appropriate documentation can be as simple as contemporaneous notes providing a record of why decisions were made, the way they were made, and how the government satisfied itself that the decisions were the best course. Also adding to the documentation challenge is the fact that federal retirements along with the associated institutional knowledge in this last year are markedly higher. Accordingly, it becomes even more important that actions and their context are documented for reference. We do note that Treasury has issued policy that addresses documentation requirements, such as Treasury Directive Publication 80-05, *Records and Information Management Program*. In our view, this is a matter of Treasury management personnel needing to remain aware and vigilant.

In my memorandum last year, we reported on risks associated with the consolidation of the former Financial Management Service and the former Bureau of the Public Debt into Fiscal Service, noting that comprehensive planning and the involvement of senior management were key. Fiscal Service has now been stood up for over a year although certain planned restructuring of functions and employee relocations are delayed (along with the anticipated cost savings) in response to Congressional concerns about the impact to Treasury's Maryland operations. I want to close this year with a comment about the Fiscal Service Do Not Pay Initiative. In light of the continuing and unacceptable problem of improper payments (estimated at $108 billion for fiscal year 2012 alone) and the extreme pressures on the federal budget, the Federal Government has intensified efforts to reduce improper payments in major federal programs. The Do Not Pay Initiative is a chief component of these efforts. In August 2013, pursuant to the Improper Payments Elimination and Recovery Improvement Act of 2012, the Office of Management and Budget (OMB) issued guidance, "Protecting Privacy while Reducing Improper Payments with the Do Not Pay Initiative." The OMB guidance details Treasury's responsibilities, which include hosting a working system for the Do Not Pay Initiative that allows agencies to perform pre-award eligibility, prepayment, and post-payment reviews. Other Treasury responsibilities include entering into computer matching agreements, developing memoranda of understanding with agencies, ensuring records are complete, accurate, and current, complying with the Privacy Act, and periodically reporting to OMB. This will be a major and important undertaking by Fiscal Service and Treasury. We have audit work under way in this area and look forward to working with the Department in our oversight role to ensure the success of Do Not Pay.

We would be pleased to discuss our views on the management and performance challenges and the other matters in this memorandum in more detail.

cc: Nani A. Coloretti

Assistant Secretary for Management

11 OIG, *Safety and Soundness: Improvement Needed in OCC's Oversight of Foreclosure Related Consent Orders* (OIG-13-049; issued Sep. 9, 2013)

**DEPARTMENT OF THE TREASURY**
**WASHINGTON, D.C. 20005**

**INSPECTOR GENERAL FOR TAX ADMINISTRATION**

November 8, 2013

MEMORANDUM FOR SECRETARY LEW

FROM: J. Russell George
Inspector General

SUBJECT: Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2014

The *Reports Consolidation Act of 2000*[1] requires that the Treasury Inspector General for Tax Administration (TIGTA) summarize, for inclusion in the annual *Department of the Treasury Agency Financial Report*, its perspective on the most serious management and performance challenges confronting the Internal Revenue Service (IRS).

Each year, TIGTA evaluates IRS programs, operations, and management functions to identify the areas of highest vulnerabilities to the Nation's tax system. For Fiscal Year 2014, the top management and performance challenges, in order of priority, are:

1. Security for Taxpayer Data and IRS Employees;
2. Implementing the Affordable Care Act and Other Tax Law Changes;
3. Tax Compliance Initiatives;
4. Modernization;
5. Fraudulent Claims and Improper Payments;
6. Providing Quality Taxpayer Service Operations;
7. Human Capital;
8. Globalization;
9. Taxpayer Protection and Rights; and
10. Achieving Program Efficiencies and Cost Savings.

The IRS was faced with numerous challenges during FY 2013, including several that resulted in Congressional hearings on IRS management practices. The IRS will continue to face other pressing priorities and challenges during FY 2014. Several key provisions of the Patient Protection and Affordable Care Act (Affordable Care Act)[2] will become effective in FY 2014, and the IRS must ensure that the tax system is able to

[1] 31 U.S.C. § 3516(d) (2006).
[2] Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.

fully implement these provisions. Of utmost importance is ensuring the adequate protection of Federal tax data when it is sent to the Federal and State exchanges.

Furthermore, the continuing budget constraints present a substantial challenge to the IRS in effectively carrying out its mission. In FY 2013, the IRS budget was reduced by $618 million at mid-year, which required management to make a number of difficult decisions: among them, implementation of a hiring freeze, a reduction in customer service and enforcement, and declaration of three furlough days for IRS employees. As the IRS faces new or growing challenges with a smaller staff, it must identify and implement innovative and cost saving strategies to accomplish its mission of providing America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness for all.

The following information detailing these management and performance challenges is being provided to promote economy, efficiency, and effectiveness in the IRS's administration of the Nation's tax laws.

## SECURITY FOR TAXPAYER DATA AND IRS EMPLOYEES

As our Nation's tax collector and administrator of the Internal Revenue Code, the IRS collected over $2.5 trillion in tax revenue in FY 2012, processed over 237 million tax returns, and issued approximately $373 billion in tax refunds. In today's environment, the IRS faces the daunting task of securing its massive computer systems against the growing threat of cyberattacks. Effective information systems security is essential to ensure that data are protected against inadvertent or deliberate misuse, improper disclosure or destruction, and that computer operations supporting tax administration are secured against disruption or compromise. According to the Department of Homeland Security's U.S. Computer Emergency Readiness Team, Federal agencies reported 48,842 cyberattacks in FY 2012, an increase of about 11 percent from FY 2011.[3]

Computer security has been problematic for the IRS since 1997, when the IRS initially reported computer security as a material weakness during its annual evaluation of internal accounting and administrative controls under the *Federal Managers' Financial Integrity Act of 1982.*[4] In March 2013, the Government Accountability Office reported that the IRS is making progress in addressing information security control weaknesses.[5]

However, TIGTA continues to identify significant security weaknesses in this area that could affect the confidentiality, integrity, and availability of financial and sensitive taxpayer data.

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[3] Office of Management and Budget, Fiscal Year 2012 Report to Congress on the Implementation of The Federal Information Security Management Act of 2002 (Mar. 2013).

[4] 31 U.S.C. §§ 1105, 1113, and 3512. The *Federal Managers' Financial Integrity Act* (FMFIA) requires that agency management establish and maintain effective internal controls to achieve the objectives of 1) effective and efficient operations, 2) reliable financial reporting, and 3) compliance with applicable laws and regulations. The FMFIA also requires the head of each Executive agency to report annually to the President and Congress on the effectiveness of internal controls and to identify any material weaknesses in those controls. Reporting material weaknesses under the FMFIA is not limited to weaknesses over financial reporting.

[5] GAO-13-350, *IRS Has Improved Controls but Needs to Resolve Weaknesses* (March 2013).

Meanwhile, beyond safeguarding a vast amount of sensitive financial and personal data, the IRS must also protect approximately 100,000 employees and contractors working at more than 600 facilities throughout the country. To proactively mitigate threats made against IRS facilities and employees, the IRS is required to conduct comprehensive and timely risk assessments to identify and address vulnerabilities in physical security. TIGTA identified deficiencies in the IRS's risk assessment program and found that not all IRS facilities had a risk assessment conducted.[6] Additionally, the IRS did not implement some of the additional countermeasures that were identified by the completed risk assessments.

Physical violence, harassment, and intimidation of IRS employees pose significant challenges to the implementation of a fair and effective system of tax administration. Between FYs 2009 and 2012, TIGTA has processed over 8,600 threat-related complaints. This resulted in over 4,000 threat investigations that required the prompt response of TIGTA Special Agents to mitigate those threats and determine whether criminal prosecutions of the perpetrators making the threats were warranted.

Additionally, the ongoing public debate regarding the health care law and increased scrutiny over IRS spending and treatment of certain exempt organizations could fuel threats against the Federal Government, including IRS employees and facilities. These challenging operating conditions for the IRS underscore the need for continued vigilance in the area of physical and personnel security.

## IMPLEMENTING THE AFFORDABLE CARE ACT AND OTHER TAX LAW CHANGES

Each filing season tests the IRS's ability to implement tax law changes made by Congress. Correctly implementing late tax law changes remains a significant challenge because the IRS must often act quickly to assess the changes and determine the necessary actions to ensure that all legislative requirements are satisfied. In addition, the IRS must often create new or revise existing tax forms, publications and instructions; revise internal operating procedures; provide outreach and education to taxpayers and tax professionals; train employees; and reprogram computer systems to accurately and timely process tax returns affected by the new tax law changes. For the 2014 filing season, the IRS announced a delay of approximately one to two weeks to the start of the filing season to allow adequate time to program and test tax processing systems following the 16-day Federal Government closure.

### Affordable Care Act

The Affordable Care Act (ACA) contains an extensive array of tax law changes that will present a continuing source of challenge for the IRS in coming years. The Affordable Care Act provides incentives and tax breaks to individuals and small businesses to offset health care expenses. It also imposes penalties, administered through the tax code, for individuals and businesses that do not obtain health care coverage for themselves or their employees. The Affordable Care Act represents the largest set of tax law changes in more than 20 years.

[6] TIGTA, Ref. No. 2013-10-101, *The Physical Security Risk Assessment Program Needs Improvement* (Sept. 2013).

Starting in Calendar Year 2014, the IRS will be responsible for implementing the Advanced Premium Tax Credit,[7] as well as implementing the penalty on applicable individuals for each month they fail to have minimum essential health care coverage. These two issues have a far-reaching impact on the IRS and will require significant resources, particularly customer service resources, as taxpayers turn to the IRS with questions and issues about the Affordable Care Act. Customer service has been declining in recent years, with fewer taxpayers being served at local IRS offices and the IRS answering fewer telephone calls.[8]

The IRS's implementation plan for the ACA includes providing information on eligibility and enrollment, developing calculations for the Advanced Premium Tax Credit, reconciling Premium Tax Credits[9] with reported taxable income, and developing new ACA information collection and processing systems. These provisions require development of new computer systems, modification of existing systems, revision and/or creation of new fraud detection systems, and deployment and testing of new interagency communication portals to support ACA operations.

From FY 2010 to 2012, the IRS reported that it received $488 million from the Health Insurance Implementation Fund to implement the ACA. Although the IRS stopped receiving funds from the Health Insurance Implementation Fund at the end of FY 2012, implementation of the ACA remains an ongoing effort, and all implementation efforts in FY 2013 and beyond will be funded solely from the IRS's operating budget.

## TAX COMPLIANCE INITIATIVES

With an estimated voluntary compliance rate of approximately 83 percent,[10] a significant amount of income remains unreported and unpaid. Tax compliance initiatives include the administration of tax regulations, collection of the correct amount of tax from businesses and individuals, and oversight of tax-exempt and governmental entities.

Increasing voluntary taxpayer compliance and reducing the Tax Gap[11] are the focus of many IRS initiatives. Although the IRS reported that the Tax Gap is caused by both unintentional taxpayer errors (whether due to tax law complexity, confusion, or carelessness) and willful tax evasion or cheating, the IRS does not have sufficient data to distinguish the amounts attributable to each. The IRS also reported that a meaningful improvement in the voluntary compliance rate requires a long-term, focused effort on taxpayer service, modernization, and enforcement.

However, the budget reductions over the past three years have led to a reduction in the IRS's resources in the enforcement area, which has impacted tax compliance. Since

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[7] An Advanced Premium Tax Credit is paid in advance to a taxpayer's insurance company to help cover the cost of premiums.

[8] TIGTA, Ref. No. 2012-40-119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sept. 2012).

[9] A refundable tax credit to assist individuals and families in purchasing health insurance coverage through an Affordable Insurance Exchange.

[10] The voluntary compliance rate is an estimate of the amount of tax for a given year that is paid voluntarily and timely. The IRS reported in the *Tax Gap for Tax Year 2006 Overview (Jan. 2012)* that the voluntary compliance rate for 2006 was 83.1 percent.

[11] The IRS defines the Tax Gap as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely paid for a tax year.

Fiscal Year 2010, approximately 8,000 full-time IRS positions have been lost—about 5,000 from front-line enforcement.

The amount of enforcement revenue collected declined by nine percent in Fiscal Year 2012, from $55.2 billion to $50.2 billion. This has decreased for two straight years and is 13 percent less than the $57.6 billion collected in Fiscal Year 2010. The 13 percent reduction in enforcement revenue correlates to the 14 percent reduction in the number of IRS enforcement personnel.

In the Examination function, the combination of a decrease in the number of revenue agents and tax compliance officers and an increase in the number of corporate, partnership, and S corporation examinations has contributed, in part, to a reduction in the number of individual tax returns examined. Two factors contributing to the increase in partnership and S corporation examinations are the growth in the number of these filings and the compliance risk these tax returns pose.

IRS filing statistics show that partnerships and S corporations are the fastest growing segments of all tax returns filed. For example, the IRS estimates that S corporations will file nearly 5.7 million returns in Processing Year (PY) 2015, which is a 26 percent increase over S corporation returns filed in PY 2011.

In terms of compliance risk and potential fraud or abuse, both partnerships and S corporations provide shareholders and partners with opportunities to structure transactions improperly to reduce the income taxes they would otherwise owe. In Calendar Year 2000, the IRS published guidance on 10 transactions that would likely trigger an audit because they purportedly abuse the tax law, represent a significant loss of tax revenue, and undermine the public's confidence in the tax system. As of January 2012, the list of such abusive transactions had expanded to 34, several of which involve partnerships and/or S corporations.

TIGTA reported in 2012 that examiners are recommending a considerable amount of adjustments to items reported on the returns. For example, in FY 2011, examiners closed 5,310 audits of partnership returns and recommended approximately $728 million in adjustments to items reported on the returns. This indicates that examiners recommended an average of $137,000 in adjustments for each return audited. TIGTA also reported that the number of partnership and S corporation examinations that result in no adjustments (no-change) is high. According to the IRS, a high number of no-change examinations means it is spending significant resources on unproductive examinations and unnecessarily burdening compliant taxpayers.

The following three sections will examine tax compliance challenges the IRS faces affecting businesses and individuals, tax-exempt entities, and tax return preparers.

### Businesses and Individuals

The IRS estimated the gross Tax Gap for Tax Year 2006 to be approximately $450 billion. This estimate is the best approximation of noncompliance the IRS can provide. However, TIGTA found that the IRS could improve its Tax Gap

estimates.[12] Specifically, there are no estimates for nonfiling of tax returns related to corporate, employment, or excise taxes. In addition, the reliability and accuracy of the tax information that is reported on corporate tax returns could be improved.

The underreporting of taxes, which comprises four major components (individual income tax, employment tax, corporate income tax, and estate and excise taxes), was estimated at $376 billion and accounted for the largest portion (approximately 84 percent) of the Tax Gap. The underpayment of taxes was approximately 10 percent, and the nonfiling of taxes was approximately six percent. The IRS will need to address the following impediments to more effectively address the Tax Gap:

- **Information Reporting.** The availability of third-party income and withholding information at the time tax returns are processed would encourage voluntary compliance and would prevent the issuance of billions of dollars in fraudulent tax refunds.

- **Taxpayer Service.** Ensuring high-quality service to taxpayers can help encourage those taxpayers who wish to comply with tax laws but do not understand their tax obligations. However, tax law changes and funding priorities have recently affected the IRS's ability to provide quality taxpayer service.

- **Enforcement.** Devoting additional resources to enforcement would enable the IRS to contact the millions of potentially noncompliant taxpayers it identifies but cannot currently contact due to resource limitations.

- **Compliance Checks.** Expanding compliance checks before the IRS issues refunds would involve matching information returns to tax returns during, rather than after, the tax filing season. TIGTA reported that the IRS designed new identity theft screening filters for the 2012 filing season that improved the IRS's ability to identify false tax returns before the tax return was processed; however, more needs to be done in this area.[13]

- **External Parties.** Leveraging external resources, such as paid tax return preparers and whistleblowers, can help improve tax compliance because paid preparers' actions have an enormous impact on the IRS's ability to effectively administer tax laws, and whistleblowers provide the IRS with information on suspected noncompliance.

- **Modernization.** 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.

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[12] TIGTA, Ref. No. 2013-IE-R008, *the Internal Revenue Service Needs to Improve the Comprehensiveness, Accuracy, Reliability, and Timeliness of the Tax Gap Estimate* (Aug. 2013).
[13] TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).

### Tax-Exempt Entities

The IRS's use of inappropriate methods for selecting and reviewing applications for tax-exempt status became a top concern for both Congress and the public in 2013 and has resulted in congressional hearings and investigations. The IRS will continue to face unprecedented levels of scrutiny from a variety of stakeholders in the exempt organizations area in FY 2014.

Most organizations requesting tax-exempt status must submit an application to the IRS. The type of application submitted depends upon the type of tax-exempt organization the organization desires to be. For example, a charitable organization would request exemption under I.R.C. Section 501(c)(3),[14] whereas a social welfare organization would request exemption under I.R.C. Section 501(c)(4).[15] TIGTA found that the IRS developed and used criteria to identify potential political cases for review that inappropriately identified specific groups applying for tax-exempt status based on their names or policy positions instead of developing criteria based on tax-exempt laws and Treasury Regulations.[16] TIGTA also found that ineffective management allowed the inappropriate criteria to be developed and stay in place for more than 18 months, resulting in substantial delays in processing certain applications, and allowed unnecessary information requests to be issued.

### Tax Return Preparers

Every year, more than half of all taxpayers pay someone else to prepare their Federal income tax returns. During the 2013 Filing Season,[17] the IRS processed over 70 million individual Federal income tax returns prepared by paid tax return preparers.

TIGTA has reported on the IRS's efforts to improve oversight of the return preparer community.[18] While the IRS began implementing the new preparer requirements in FY 2011, TIGTA reported that it will take years for the IRS to implement the Return Preparer Program, including establishing all the program requirements and developing the system(s) and processes necessary to administer and oversee the program. However, this program is on hold based on a recent court ruling.[19] On January 18, 2013, the U. S. District Court for the District of Columbia ruled that the IRS did not have the authority to regulate tax preparers who had not been regulated before: namely, preparers who were not certified public accountants, attorneys, enrolled agents, or enrolled actuaries. The IRS filed a notice of appeal on February 20, 2013. After the initial ruling, the Court clarified that all paid tax return preparers are still required to obtain a preparer tax identification number from the IRS.[20] TIGTA also reported that the IRS's requirement for return

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[14] I.R.C. § 501(c)(3) (2012).
[15] I.R.C. § 501(c)(4) (2012).
[16] TIGTA, Ref. No. 2013-10-053, *Inappropriate Criteria Were Used to Identify Tax-Exempt Applications for Review* (May 2013).
[17] The period of January 1 through April 15 when most individual income tax returns are filed.
[18] TIGTA, Ref. No. 2010-40-127, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (Sept. 2010).
[19] Loving v. IRS, 2013 U.S. Dist. LEXIS 7980 (D.D.C. Jan. 18, 2013).
[20] Loving v. IRS, 2013 U.S. Dist. LEXIS 13818 (D.D.C. Feb. 1, 2013).

preparers to electronically file tax returns helped the IRS meet its goal to receive and process 80 percent of individual returns electronically, but better controls were needed to ensure preparer compliance with the new preparer regulations.[21]

## MODERNIZATION

The Business Systems Modernization Program (Modernization Program) is a complex effort to modernize IRS technology and related business processes. It involves integrating thousands of hardware and software components while replacing outdated technology and maintaining the current tax system. The IRS originally estimated that completion of the Modernization Program would take up to 15 years and incur contractor costs of approximately $8 billion. The Modernization Program was funded for $313 million in Fiscal Year 2013; the President's Budget request for Fiscal Year 2014 was $300.8 million.

The IRS's modernization efforts continue to focus on core tax administration systems designed to provide taxpayers and IRS employees with more sophisticated tools. These efforts will provide the foundation for implementing a real-time tax system and reducing improper payments and fraudulent refunds. They will also provide the technology infrastructure and architecture that will enable taxpayers and other stakeholders the capability to securely access tax account information. The complexity of these efforts continues to pose significant technological and business challenges for the IRS.

The IRS considers the Customer Account Data Engine 2 (CADE 2) program critical to the IRS's mission. It is the IRS's most important information technology investment. The CADE 2 system also provides for a centralized database of individual taxpayer accounts. Once implemented, it will allow IRS employees to view tax data online and provide timely responses to taxpayers. TIGTA found 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.[22] However, the IRS has experienced delays in the implementation of the CADE 2 database interfaces to downstream systems.[23] This has resulted in increased costs and delayed taxpayer service improvements that were to be provided by the new transactional database.

Modernization efforts also include the development of computer programs to conduct predictive analytics to reduce refund fraud.[24] The IRS is developing a new Return Review Program system to implement the IRS's new business model for a coordinated criminal and civil tax noncompliance system. TIGTA found that roles for program-level governance were not yet established for the Return Review Program and the key role of system integrator was not documented or clearly communicated.[25] As a result, it is not

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[21] TIGTA, Ref. No. 2012-40-010, *More Tax Return Preparers Are Filing Electronically, but Better Controls Are Needed to Ensure All Are Complying With the New Preparer Regulations* (Dec. 2011).
[22] TIGTA, Ref. No. 2012-20-122, *Customer Account Data Engine 2 Systems Requirements and Testing Processing Need Improvement* (Sept. 2012).
[23] TIGTA, Ref. No. 2013-20-125, *Customer Account Data Engine 2 Database Deployment Is Experiencing Delays and Increased Costs* (Sept. 2013).
[24] Computer models that analyze extremely large quantities of data to seek out data patterns and relationships that could indicate potential tax fraud schemes.
[25] TIGTA, Ref. No. 2013-20-063, *Improvements Are Needed to Ensure Successful Development and System Integration of the Return Review Program* (July 2013).

clear how the IRS will govern the systems development process for this mission-critical system, resolve enterprise-wide issues for fraud projects and programs, and resolve disputes and issues concerning fraud projects and programs.

Modernizing legacy tax administration systems to receive and process CADE 2 data and to process new legislative changes, such as the Affordable Care Act, will continue to be a major challenge for the IRS.

## FRAUDULENT CLAIMS AND IMPROPER PAYMENTS

Improper payments by Federal Government agencies have been an issue for many years, and various efforts have been made to identify, measure, and reduce them. These include laws specifically addressing improper payments, an Executive Order,[26] and guidance by certain oversight agencies, such as the Office of Management and Budget. The *Improper Payments Information Act of 2002* defines an improper payment as any payment that should not have been made or that was made in an incorrect amount (both overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements.[27] The Act requires Federal agencies, including the IRS, to estimate the amount of improper payments made each year and report to Congress on the causes of and the steps taken to reduce improper payments, as well as to address whether they have the information systems and other infrastructure needed to reduce improper payments. Erroneous and improper payments issued by the IRS generally involve improperly paid refunds, tax return filing fraud, or improper payments to vendors or contractors.

### Refundable Credits

The IRS administers numerous refundable tax credits. These refundable credits allow individual taxpayers to reduce their tax liability to below zero and thus receive a tax refund even if no income tax was withheld or paid. Two significant refundable credits are the Earned Income Tax Credit and the Additional Child Tax Credit.

The Earned Income Tax Credit remains the largest refundable credit based on the total claims paid, and it continues to be vulnerable to a high rate of noncompliance, including incorrect or erroneous claims caused by taxpayer error or resulting from fraud. TIGTA continues to report that the IRS does not have effective processes to ensure that claimants qualify for these credits at the time tax returns are processed and prior to issuance of fraudulent tax refunds. The IRS estimates that it has paid between $111 billion and $133 billion in improper Earned Income Tax Credit payments from FY 2003 through FY 2012.[28]

The Additional Child Tax Credit is also susceptible to improper claims. TIGTA found that taxpayers repeatedly claimed erroneous Additional Child Tax Credits

[26] Executive Order No. 13,520, 74 Fed. Reg. 62201 (Nov. 25, 2009), *Reducing Improper Payments and Eliminating Waste in Federal Programs.*
27 Pub. L. No. 1007-300, 116 Stat. 2350.
[28] The Department of the Treasury Performance and Accountability Reports for Fiscal Years 2003 through 2010 and the Agency Financial Report for Fiscal Years 2011 and 2012, as outlined in Office of Management and Budget Circular A-136.

after their claims were disallowed the previous year.[29] The IRS could have saved more than $108 million by reviewing claims made by taxpayers who were previously disallowed the credit.

### Fraudulent Payments

Identity theft continues to be a serious and growing problem which has a significant impact on tax administration. Identity theft for the purpose of committing tax fraud occurs when an individual uses another person's name and Taxpayer Identification Number (generally a Social Security Number) to file a fraudulent tax return to obtain a fraudulent tax refund. Incidents of identity theft affecting tax administration have continued to rise since Calendar Year 2011, when the IRS identified more than one million incidents of identity theft. During the first half of Calendar Year 2013, the IRS had identified almost 1.9 million incidents of identity theft.

TIGTA reported that undetected tax refund fraud resulting from identity theft results in significant unintended Federal outlays.[30] Specifically, TIGTA analyzed Tax Year 2011 tax returns that were 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. These tax returns had potentially fraudulent tax refunds issued totaling approximately $3.6 billion, a decrease of $1.6 billion compared to the $5.2 billion we reported for Tax Year 2010.

In addition, we expanded our Tax Year 2011 analysis to include tax returns for which the primary Taxpayer Identification Number on the return is an Individual Taxpayer Identification Number (ITIN). 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 involving an ITIN. Potentially fraudulent tax refunds issued for these undetected tax returns totaled approximately $385 million.

Although the IRS is continuing to make changes to its processes to increase its ability to detect, prevent, and track fraudulent tax returns and improve assistance to victims of identity theft, there is still work to be done.

### Contract and Other Payments

In the first half of Fiscal Year 2013, the IRS expended approximately $1.3 billion in contract spending, an area which continues to experience several risks for fraud and abuse. Previous TIGTA investigations and audits have identified millions of dollars in questioned costs and several instances of contractor fraud. During the last three fiscal years, TIGTA's criminal investigative efforts contributed to court-ordered civil settlements which required Government contractors to pay $156 million in FY 2010, $113 million in FY 2011, and $4.6 million in FY 2012 to the U.S. Treasury. These payments were the result of Federal procurement law

[29] TIGTA, Ref. No. 2012-40-105, *Expansion of Controls Over Refundable Credits Could Help Reduce the Billions of Dollars of Improperly Paid Claims* (Sept. 2012).
[30] TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From identity Theft* (July 2012).

violations that occurred with work contracted with multiple Federal agencies, including the IRS.

Additionally, TIGTA continues to identify issues with the awarding and administering of IRS contracts. TIGTA recently performed a review of the IRS's cost reimbursement contracts and found that the IRS did not comply with the majority of the new Federal Acquisition Regulations requirements for 46 of the 49 cost reimbursement contracts entered into between March 17, 2011 and June 20, 2012, totaling nearly $47 million.[31] Specifically, the IRS did not always document required information to justify the selection of cost reimbursement contracts and did not always assign acquisition workforce resources prior to award to manage these contracts. Additionally, TIGTA reported that two contracts totaling $3.6 million failed to comply with Federal Acquisition Regulations requirements regarding contractor accounting systems. In order to adequately protect government resources, the Federal Acquisition Regulations states that cost reimbursement contracts should only be awarded to contractors with an adequate accounting system.

Another TIGTA review found that while some controls are working as intended, the IRS purchase card program lacks consistent oversight to identity and address inappropriate use.[32] TIGTA identified approximately $7,000 in improper purchases, including purchases for giveaway items, purchases made for personal use, and items purchased from the restricted-purchase list.

## PROVIDING QUALITY TAXPAYER SERVICE OPERATIONS

The Department of the Treasury and the IRS recognize that the delivery of effective taxpayer service has a significant impact on voluntary tax compliance. Answering taxpayers' questions to assist them in correctly preparing their returns reduces the need to send notices and correspondence when taxpayers make errors. Taxpayer service also reduces unintentional noncompliance and shrinks the need for future collection activity.

Taxpayers have several options to choose from when they need assistance from the IRS, including telephone assistance through the toll-free telephone lines, face-to-face assistance at the Taxpayer Assistance Centers and or Volunteer Program sites, and self-assistance through IRS.gov and social media channels. The use of self-assistance options has seen the most significant growth as more taxpayers seek information and assistance through these channels.[33]

As of May 4, 2013, the IRS reported an increase of 24.7 percent in the number of visits to IRS.gov over the same period in the prior filing season. The IRS also reported an

[31] TIGTA Ref. No. 2013-10-046, *Cost-Reimbursement Contracts Did Not Fully Comply With Federal Acquisition Regulation Revisions* (April 2013).
[32] TIGTA, Ref. No. 2013-10-056, *The Purchase Card Program Lacks Consistent Oversight to Identify and Address Inappropriate Use* (June 2013).
[33] TIGTA, Ref. No. 2013-40-124, *Late Legislation Delayed the Filing of Tax Returns and Issuance of Refunds for the 2013 Filing Season* (Sept. 2013).

increase of 55.6 percent in the number of taxpayers obtaining their refund information online via the "Where's My Refund" feature found on IRS.gov. However, TIGTA identified that the "Where's My Refund" tool did not consistently provide accurate refund status information to some taxpayers that filed early in the 2013 Filing Season. The IRS reported that this issue was resolved on March 14, 2013.

The budget reductions and declining IRS resources reduced the number of taxpayers whom the IRS estimated could be assisted at Taxpayer Assistance Centers. The IRS assisted approximately 6.8 million taxpayers at its walk-in Taxpayer Assistance Centers during FY 2012 and planned to assist 6 million in FY 2013. This represents 11.8 percent fewer taxpayers than were assisted in FY 2012. The FY 2013 plan was based on the assumption of limited seasonal staff support and the continuing reduction of permanent staff as a result of the hiring freeze and buyout authority.

In addition, TIGTA reported in May 2012 that the IRS is not providing effective assistance to taxpayers who report that they have been victims of identity theft, resulting in increased burden for those victims.[34] In September 2013, TIGTA reported that taxpayers continued to face delays with some cases having significant inactivity during case processing. In addition, the IRS did not always correctly resolve tax accounts before the cases were closed.[35]

## HUMAN CAPITAL

Human capital is the Federal Government's most critical asset, making strategic management of human capital a top priority of the IRS. Continued focus by IRS management on human capital will remain important because the IRS is facing several key challenges.

First, a wave of anticipated retirements presents a critical challenge in the human capital area. More than one-third of all executives and almost 20 percent of non-executive managers are currently eligible for retirement, according to IRS data. By the end of FY 2017, nearly 70 percent of all IRS executives and nearly one-half of the IRS's non-executive managers are projected to be eligible for retirement. Overall, about 40 percent of the IRS's employees will be eligible to retire within five years. In FY 2013, the IRS experienced significant changes in its most senior executive leadership.

Further, the IRS's challenge of having the right people in the right place at the right time is made more difficult by many complex internal and external factors. Budget constraints have resulted in fewer personnel to accomplish the IRS's mission. Specifically, the IRS's workforce shrank by approximately 10,000 employees between the end of FY 2010 and the end of FY 2012. This reduction in employees possessing unique skills and institutional knowledge is particularly challenging as the number of tax returns the IRS processes continues to rise and the number of identity theft fraud cases the IRS works is also increasing. The IRS will also be required to implement provisions related to the Affordable Care Act using their own operating budget in the future, further stretching its limited resources.

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[34] TIGTA, Ref. No. 2012-40-050, *Most Taxpayers Whose identities Have Been Stolen to Commit Refund Fraud, Do Not Receive Quality Customer Service* (May 2012).
[35] TIGTA, Ref. No. 2013-40-062, *The Taxpayer Protection Program Improves Identity Theft Detection; However, Case Processing Controls Need to Be Improved* (June 2013).

TIGTA reported that outstanding corrective actions in response to human capital audits require a continued focus by IRS management.[36] For example, TIGTA has found that the IRS needs to develop an agency-wide strategy for integrating new employees into the workforce because some best practices that would help new employees become more productive were not fully implemented.

With a shrinking workforce and budget, the IRS will be challenged to successfully achieve its mission of providing America's taxpayers with top-quality service by helping them understand and meet their tax responsibilities and enforcing the law with integrity and fairness.

## GLOBALIZATION

The scope, complexity, and magnitude of the international financial system 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.[37] The numbers of taxpayers conducting international business transactions continues to grow as technological advances provide opportunities for offshore investments that were once only possible for large corporations and wealthy individuals.

As advancing technology continues to allow more cross-border transactions, the IRS is increasingly challenged by a lack of information reporting on many of them. 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 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.[38] 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) enforce the law to ensure that all taxpayers meet their obligations and (2) improve service to make voluntary compliance less burdensome.

The IRS currently faces the challenge of implementing the *Foreign Account Tax Compliance Act* (FATCA).[39] FATCA was enacted to combat tax evasion by U.S. persons holding investments in offshore accounts. Under this Act, a U.S. 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

[36] TIGTA, Ref. No. 2013-10-017, *Improvements Have Been Made to Address Human Capital Issues, but Continued Focus Is Needed* (Jan. 2013).
[37] Bureau of Economic Analysis, Department of Commerce.
[38] 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.
[39] Pub. L. No. 111-147, Subtitle A, 124 Stat 71, *96-116 (2010)(codified in scattered sections of 26 U.S.C.).

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.[40]

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.[41]

In addition, the IRS established the International Campus Compliance Unit to expand audit coverage of tax returns with international aspects and to increase compliance among international individual taxpayers. For FY 2011 through March 13, 2013, the Campus Compliance Unit conducted almost 18,000 audits and assessed approximately $36 million in additional tax. Despite its accomplishments, TIGTA found that the Campus Compliance Unit has no specific performance measures for its operations.[42]

## TAXPAYER PROTECTION AND RIGHTS

The IRS must ensure that tax compliance activities are balanced against the rights of the taxpayers to receive fair and equitable treatment. The IRS continues to dedicate significant resources and attention to implementing the taxpayer rights provisions of the *IRS Restructuring and Reform Act of 1998* (RRA 98).[43] The following audits related to taxpayer rights provisions are mandated annually: Notices of Levies; Restrictions on the Use of Enforcement Statistics to Evaluate Employees; *Fair Debt Collection Practices Act*[44] Violations; Notices of Liens; Seizures; Illegal Protestor Designations; Assessment Statute of Limitations; Collection Due Process Appeals; Denial of Requests for Information; Restrictions on Directly Contacting Taxpayers Instead of Authorized Representatives; and Separated or Divorced Joint Filer Requests.

In general, the IRS has improved its compliance with these statutory taxpayer rights provisions and is documenting its protection of taxpayer rights. However, TIGTA continues to identify the same deficiencies in the IRS's processing of collection due-process cases.[45] Specifically, TIGTA continues to identify errors relating to the

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[40] 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).
[41] 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).
[42] TIGTA, Ref. No. 2013-30-113, *The International Campus Compliance Unit Is Improving Individual Tax Compliance* (Sept. 2013).
[43] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered section 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.).
[44] 15 U.S.C. §§1601 note, 1692-1692o (2006).
[45] TIGTA Ref. No. 2013-10-103, *The Office of Appeals Continues to Experience Difficulties in the Handling of Collection Due Process Cases* (Sept. 2013).

determination of the Collection Statute Expiration Date[46] on taxpayer accounts. In addition, the Office of Appeals did not always classify taxpayer requests properly and Office of Appeals personnel do not always document their impartiality statement in hearing notification letters issued to taxpayers. These deficiencies may result in taxpayers not receiving their full rights during an appeal hearing.

In addition, TIGTA reported that the IRS used inappropriate criteria to identify and review organizations applying for tax-exempt status. This activity caused delays in the resolution of the organizations' applications, as well as their being subject to unnecessary and burdensome requests for information from the IRS.

## ACHIEVING PROGRAM EFFICIENCIES AND COST SAVINGS

Given the current economic environment and the increased focus by the Administration, Congress, and the American people on Federal Government accountability and efficient use of resources, the American people must be able to trust that their Government is taking action to stop wasteful practices and spending every tax dollar wisely. This management challenge became even more compelling in Fiscal Year 2013, when the IRS's budget fell $618 million below its Fiscal Year 2012 enacted level after application of the enacted rescission and sequestration reductions. As a result, the IRS had to reduce administrative costs, furlough employees for three days, and make difficult decisions to reduce both taxpayer service and enforcement operations.

While the IRS has taken steps to improve program effectiveness and reduce costs, progress in this area continues to be a major challenge. In January 2013, TIGTA reported that the IRS paid over $1 million during FY 2011 for aircards and BlackBerry® smartphones that were not used for periods of three months to one year.[47] Overall, process improvements could result in a cost savings totaling approximately $5.9 million over five years.

TIGTA also reported on several areas of concern associated with an August 2010 IRS conference in Anaheim, California and made recommendations to ensure that taxpayer funds are expended more efficiently in the future.[48] The Acting IRS Commissioner stated that new spending restrictions have been put in place at the IRS. The IRS has taken steps to ensure travel and conference spending is appropriate, limited, and undergoes a thorough review and approval process.

In another audit, TIGTA reported that the IRS has not identified the optimal footprint for its data centers.[49] TIGTA observed significant empty space at the IRS's Enterprise Computing Center in Detroit, Michigan. After our audit was initiated, the IRS announced plans to close this facility, which will save the IRS approximately $15 million annually.

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[46] The IRS generally has 10 years from the date of assessment to collect a liability owed by a taxpayer. The final date to collect is referred to as the Collection Statute Expiration Date.

[47] TIGTA Ref. No. 2013-10-010, *Inadequate Aircard and Blackberry Assignment and Monitoring Processes Result in Millions of Dollars in Unnecessary Access Fees* (Jan. 2013).

[48] TIGTA, Ref. No. 2013-10-037, *Review of the August 2010 Small Business/Self-Employed Division's Conference in Anaheim, California* (May 2013).

[49] TIGTA Ref. No. 2013-20-013, *The Data Center Consolidation Initiative Has Made Significant Progress, but Program Management Should Be Improved to Ensure That Goals Are Achieved* (June 2013).

## CONCLUSION

This memorandum is provided as our annual summary of the most serious major management and performance challenges confronting the IRS in FY 2014. TIGTA's *Fiscal Year 2014 Annual Audit Plan* contains our proposed reviews, which are organized by these challenges. If you have any questions or wish to discuss our views on the challenges in greater detail, please contact me at (202) 622-6500.

cc: Deputy Secretary

Acting Assistant Secretary for Management and Chief Financial Officer

Acting Commissioner of Internal Revenue

**MANAGEMENT'S RESPONSE TO THE**
**MANAGEMENT AND PERFORMANCE CHALLENGES IDENTIFIED BY THE**
**TREASURY INSPECTOR GENERAL**
**AND**
**TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION**

In their memoranda dated November 14 and 8, 2013, the Treasury Inspector General (IG) and the Treasury Inspector General for Tax Administration (TIGTA), respectively, identified the major challenges facing management. The Department of the Treasury concurs with the IG and the TIGTA on these challenges. These challenges do not necessarily indicate deficiencies in performance; rather, some represent inherent risks that must be monitored continuously. Moving forward, Treasury will continue to address these issues proactively. The following tables summarize the major management and performance challenges facing the Department of the Treasury, and provide information on the actions taken by Treasury in fiscal year 2013 and planned for fiscal year 2014 and beyond. The IG's matters of concern are also addressed below.

Jacob J. Lew
Secretary of the Treasury
December 16, 2013

**RESPONSE TO OIG**

| OIG CHALLENGE NO. 1 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Continued Implementation of Dodd-Frank** | • Maintain an effective Financial Stability Oversight Council process supported by the Office of Financial Research and Federal Insurance Office within Treasury<br>• Build a streamlined banking regulatory structure that timely identifies and strongly responds to emerging risks |

**Financial Stability Oversight Council (FSOC)**

*Fiscal Year 2013 Accomplishments*

- Held 13 meetings of the FSOC to discuss and analyze emerging market developments and financial regulatory issues
- Continued to monitor for potential risks to U.S. financial stability, with a focus on significant financial market developments and structural issues within the financial system
- Designated an initial set of certain nonbank financial companies for supervision by the Federal Reserve and enhanced prudential standards
- Monitored the eight financial market utilities designated in 2012 for enhanced risk-management standards and supervision
- Continued to build out the FSOC's institutional framework and strengthened coordination and cooperation among members and member agencies

*Actions Planned or Underway*

- Continue to consult with the Federal Reserve on developing rules establishing enhanced risk-management standards
- Continue identification of specific nonbank financial companies for supervision by the Federal Reserve and enhanced prudential standards
- Coordinate issuance of final regulations implementing the Volcker Rule with identical rule text among the five rule-writing agencies
- Continue monitoring for potential risks to U.S. financial stability, with a focus on significant financial market developments and structural issues within the financial system
- Continue to implement operational improvements to existing processes and procedures related to the work of the FSOC

**Office of Financial Research (OFR)**

*Fiscal Year 2013 Accomplishments*

- The OFR Director was confirmed by the Senate in January 2013
- Completed and published a study of the asset management industry as requested by the FSOC
- Provided analytical and data-related support to the FSOC and its member agencies to continue the analysis related to nonbank financial company designations and to support the FSOC's annual report
- Provided FSOC staff an enhanced Financial Stability Monitor – a dashboard of improved financial stability metrics and indicators
- Was selected to chair the Global Legal Entity Identifier Committee
- Established Regulatory Oversight Committee Board of Directors for the administration of Legal Entity Identifiers
- Held two Financial Research Advisory Committee (FRAC) meetings; the FRAC provided the OFR recommendations in August 2013
- The Federal Reserve Bank of Cleveland and the OFR jointly sponsored a conference on May 30 - 31, 2013, at the Federal Reserve Board in Washington, D.C.; the event focused on the data and tools needed for measuring potential threats to financial stability
- Hosted second OFR/FSOC conference in December 2012 on "Assessing Financial Intermediation: Measurement and Analysis"
- Procured critical infrastructure to build the OFR Long-Term Analytic Environment
- Released eight Research Working Papers to the public
- The OFR Director testified before the House Financial Services Subcommittee on Oversight and Investigations on "Who is Too Big to Fail? GAO's Assessment of the Financial Stability Oversight Council and the Office of Financial Research" on March 14, 2013
- Issued the first OFR Early-concept Grants for Exploratory Research (EAGER) grant in conjunction with the National Science Foundation to promote and support research related to financial stability
- Submitted second Annual Report to Congress on Human Capital Planning
- Increased staff from 100 to approximately 180 by the end of fiscal year 2013
- Implemented organizational performance measures and published them in the fiscal year 2014 budget
- Improved the content and presentation of the OFR website
- Continued to create operational policies and procedures as needed

*Actions Planned or Underway*

- Issue second Annual Report to Congress, containing improved analysis and tools for monitoring threats to U.S. financial stability
- Complete acquisition of repo data
- Complete analysis of Form PF data
- Develop additional monitoring tools for use by the FSOC
- Provide support for the FSOC's annual report
- Provide support for the FSOC's nonbank designation process
- Provide support for the FSOC's monitoring of threats by developing a Financial Stability Monitor
- Provide support for the FSOC by collecting data as appropriate
- Complete the third OFR Annual Report to Congress on Human Capital Planning
- Continue to build staff toward steady-state level
- Host the third annual OFR/FSOC conference in January 2014
- Host the next FRAC meeting in 2Q14
- Complete the build-out of the OFR Long-Term Analytic Environment and migrate data
- Publish additional working papers
- Issue more EAGER grants
- Complete the revised OFR Strategic Plan
- Drive efforts to support the global issuance and acceptance of Legal Entity Identifiers

**Federal Insurance Office (FIO)**

*Fiscal Year 2013 Accomplishments*

- Contributed expertise, policy support, and leadership in the FSOC
- The Director of FIO became chair of the International Association of Insurance Supervisors (IAIS) Technical Committee and has served in that capacity throughout 2013
- Led work at the IAIS through chairmanship of the Technical Committee, participation in the development of Global Systemically Important Insurers and other work streams, including leadership on technical and substantive work streams leading to a Common Framework for the Supervision of Internationally Active Insurance Groups
- Initiated, participated in, and assumed leadership and technical engagement with the European Union – U.S. Project
- Enhanced bilateral relationships with U.S. regulatory agencies in matters concerning insurance oversight and supervision
- Assisted the Secretary of the Treasury in administering the Terrorism Risk Insurance Program, including advising on matters relating to the events in Boston
- Convened the Federal Advisory Committee on Insurance to discuss contemporary insurance issues
- Contributed to the Hurricane Sandy Task Force and collected data from state regulators regarding insured losses
- Hosted the Federal Government Insurance Forum
- Participated in the Organization for Economic Cooperation and Development Insurance and Private Pension Committee meetings
- Established the Insurance Supervisory Forum for North America

- Prepared and released reports

*Actions Planned or Underway*

- Release the Modernization Report and effectuate its recommendations
- Produce and release reports on pertinent issues affecting the domestic and international insurance markets
- Enter into bilateral memoranda of understanding (MOUs) with major emerging markets
- Continue to build on FIO's current international leadership role and expand opportunities for FIO's involvement in relevant international supervisory bodies
- Build resources and staff capacity

**Office of the Comptroller of the Currency (OCC)**

*Fiscal Year 2013 Accomplishments*

- Adopted final capital rule that establishes an integrated capital framework that addresses shortcomings revealed by the financial crisis and implements the Basel III regulatory capital reforms; the rule increases the quantity and quality of regulatory capital held by banks and addresses section 939A of the Dodd-Frank Act by removing references to credit ratings from OCC's regulations dealing with topics other than capital requirements replacing it with a new non-ratings based creditworthiness; for the largest, most internationally active banks, the rule includes a new minimum supplementary leverage ratio that takes into account off-balance-sheet exposures, a countercyclical buffer, and additional capital charges and standards for derivatives exposures
- Published a proposed capital rule to strengthen the leverage ratio standards for the largest, most systemically significant U.S. banking organizations
- Adopted a final rule to implement the company-run stress tests for banks with assets greater than $10 billion and issued proposed supervisory guidance for implementation of those rules for banks with consolidated assets of between $10 billion and $50 billion
- Issued supervisory guidance and tools to assist community banks in conducting stress tests
- Issued re-proposed rule to implement the Dodd-Frank Act risk retention requirements
- Published a final rule amending the lending limit rule to apply to certain credit exposures arising from derivative transactions and securities financing transactions, in response to a Dodd-Frank Act revision in the statutory definition of loans and extensions of credit to include certain exposures arising from derivative, repurchase and securities transactions
- Issued a final rule for appraisals on higher-risked mortgages and a proposed rule to exempt a subset of higher-priced mortgage loans from those requirements
- With the other federal banking agencies, issued updated supervisory risk management guidance for leveraged lending
- Issued a revised *Commercial Real Estate Lending* booklet to the *Comptroller's Handbook;* updated guidance includes prudent loan workouts, management of concentrations, stress testing, updated interagency appraisal guidelines, and statutory and regulatory developments in environmental risk management and discussions of statutes and regulations governing federal savings associations
- Adopted a final rule on short-term investment funds (STIFs); the rule adds safeguards to address the risk of loss to a STIF's principal, including measures governing the nature of a STIF's investments, ongoing monitoring of its mark-to-market (MTM) value and forecasting potential changes to its MTM value under adverse conditions, greater transparency and regulatory reporting, and procedures to protect fiduciary accounts from undue dilution of their participating interests in the event the STIF loses its ability to maintain stable net asset value
- Issued proposed guidance on supervisory concerns and expectations for deposit advanced products
- Issued proposed interagency risk management guidance on the use of social media
- Adopted an interagency statement implementing section 612 of the Dodd-Frank Act restrictions on conversions for troubled financial institutions

- Issued *Semi-annual Risk Perspectives Reports* that provide the industry and other interested parties the OCC's perspectives on issues that pose threats to the safety and soundness of those financial institutions regulated by the OCC
- Continued active participation in the FSOC and its various operating committees
- Reached settlements with 11 mortgage servicers that will provide $3.2 billion in payments to eligible borrowers and $5.3 billion in other foreclosure prevention assistance; the settlements effectively ended requirements that these servicers conduct an independent foreclosure review required by Consent Orders issued in April 2011
- Conducted a nationwide call for federally chartered community banks on cybersecurity
- Established the position of Technical Expert for Critical Infrastructure within the OCC's Operational Risk area under the Chief National Bank Examiner's department
- Established, under the Comptroller's leadership as chairman of the Federal Financial Institutions Examination Council, a cyber-working group

*Actions Planned or Underway*

- Continue to conduct on-site supervisory assessments of national banks and federal savings associations, focusing on the quality of corporate governance, risk management practices, adequacy of loan-loss reserves, capital, and liquidity
- Continue to perform individual bank examinations on a variety of other activities aimed at identifying and responding to systemic trends and emerging risks that could adversely affect asset quality or the availability of credit at national banks and federal savings associations and the banking system, and fair access to financial services
- Continue to integrate OCC national bank and Office of Thrift Supervision federal savings association rules under OCC regulations
- Monitor and assess the effectiveness of national bank and federal savings association mortgage servicers' loan modification and foreclosure actions, including compliance with outstanding enforcement actions and agreements
- Issue proposed rulemaking to implement the Basel liquidity reforms
- Work closely within Treasury and with other federal financial regulatory agencies to implement the remaining Dodd-Frank Act reforms, and to monitor and respond to emerging risks to the stability of the U.S. financial system

| OIG CHALLENGE NO. 2 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Management of Treasury's Authorities Intended to Support and Improve the Economy** | • Protect the taxpayer from unnecessary risk associated with the implementation and administration of programs intended to support and improve the economy, including the provisions of the:<br>- *Small Business Jobs Act of 2010*<br>- *American Recovery and Reinvestment Act of 2009*<br>- *Housing and Economic Recovery Act of 2008*<br>- *Emergency Economic Stabilization Act of 2008* |

**Small Business Lending Fund (SBLF)**

*Fiscal Year 2013 Accomplishments*

- In total, the SBLF invested $4.03 billion in 332 community banks and Community Development Loan Funds (CDLFs)
- In fiscal year 2013, the SBLF program office continued its fiscal year 2012 focus on investment management, operations, compliance and controls, and outreach and reporting activities
- Specifically, the SBLF program office focused on the following activities:
  - Investment Management: SBLF monitored the SBLF investment portfolio and made recommendations to senior Treasury officials on decisions related to investment performance and activities
  - Operations: SBLF managed the program's data and information in connection with participant reporting, dividend and interest payments, and capital repayments
  - Compliance and Controls: SBLF monitored participant conformance with program terms, including lending data, certification requirements, and other requirements provided for by the SBLF Securities Purchase Agreement; SBLF also developed and executed internal control procedures for processes across SBLF program office functions
  - Reporting and Outreach: SBLF continued its outreach and reporting efforts in fiscal year 2013. These activities included reporting to Congress on the program's transactions, costs, and the participants' use of funds, correspondence, and publishing the results of the program's first annual lending survey; as of June 30, 2013, SBLF participants have increased small business lending by $10.4 billion over a $36.5 billion baseline

*Actions Planned or Underway*

- For fiscal year 2014 and forward, the SBLF program office plans to continue its focus on investment management, operations, compliance and controls, and reporting and outreach:
  - Investment Management: SBLF plans to continue to monitor the SBLF investment portfolio and make recommendations to senior Treasury officials on decisions related to investment performance and activities
  - Operations: SBLF plans to continue to manage the program's data and information in connection with participant reporting, dividend and interest payments, and capital repayments
  - Compliance and Controls: SBLF plans to continue to execute a compliance program to monitor participant conformance with program terms, including lending data, certification requirements, and other requirements provided for by the SBLF Securities Purchase Agreement; SBLF also plans to continue executing internal control procedures for processes across SBLF program office functions
  - Reporting and Outreach: SBLF plans to continue its outreach and reporting efforts; these activities include reporting to Congress on the program's transactions, costs, and the participants' use of funds, correspondence, and publishing the results of the program's second annual lending survey

**State Small Business Credit Initiative (SSBCI)**

*Fiscal Year 2013 Accomplishments*

- Received, tested, and transferred a cumulative $911,781,402 to States as they qualified for subsequent disbursements on their allocations ($379,143,821 in fiscal year 2013)
- Conducted on-site compliance reviews or training sessions in 12 States
- Evaluated and approved 21 formal modifications to States' Approved SSBCI Programs
- Organized two national conferences of state SSBCI officials hosted by the Chicago Federal Reserve Bank and the Dallas Federal Reserve Bank
- Participated in three webinars organized by industry trade associations
- Convened three working groups of State SSBCI Officials to discuss and publish best practices in Collateral Support Programs, Loan Participation Programs and Loan Guarantee Programs
- Published Summary of States' Quarterly Reports (Quarter Ending June 2013)
- Published Summary of States' 2012 Annual Reports
- Published consultants' study of SSBCI state-sponsored venture capital programs
- Coordinated responses to eight audits of states, one audit on the effectiveness of SSBCI, and one management alert from the Office of Special Inspector General for the SBLF, as well as an overall program audit by the Government Accountability Office

*Actions Planned or Underway*

- Continue to receive, test, and process requests for subsequent disbursements
- Continue to evaluate and respond to requests for modifications to Approved SSBCI Programs
- Organize at least one national conference of state officials
- Convene two working groups of State SSBCI officials to discuss and publish best practices
- Continue to publish Quarterly and Annual Reports
- Publish consultants' study of SSBCI lending programs
- Continue to coordinate responses to audits of states conducted by the Office of Special Inspector General for the SBLF

**OCC**

*Fiscal Year 2013 Accomplishments*

- Issued a *Community Development Investments* electronic newsletter, titled "The State Small Business Credit Initiative," describing how national banks and federal savings associations can implement the Department of Treasury's SSBCI to increase the amount of credit available for small businesses

*Actions Planned or Underway*

- Issue *Community Development Investments* electronic newsletters to support and improve the economy

**Management of Recovery Act Programs**

*Fiscal Year 2013 Accomplishments*

- Managed the low income housing and specified energy property programs, including the extension of the specified energy property program by one year under Section 707 of the Job Creation Act, by supplementing a small core staff in Departmental Offices with support from Treasury bureaus
- Continued to review incoming applications for the energy program and make timely awards
- Continued an interagency agreement for the energy program with the Department of Energy to assist with the technical aspects of the energy program
- Continued an annual reporting process for the low-income housing program to ensure projects funded

under the program remain qualified

- Provided follow-up and support as necessary to Recovery Act Community Development Financial Institutions (CDFI) Program and Native American CDFI Assistance Program awardees with remaining federal reporting requirements in fiscal year 2013, to ensure timely data reporting to Federal Reporting.gov (100 percent on-time rate was achieved for fiscal year 2013)
- Conducted five site visits and 13 desk reviews on Recovery Act awards as of year-end which brings the total number of awards that have undergone detailed reviews of underlying data to 23
- Closely monitored spend-down of remaining Recovery Act CDFI award funds, to ensure all funds were expended by September 30, 2013; also monitored submission of final reports to Federal Reporting.gov by remaining Recovery Act CDFI Program and Native American CDFI Assistance Program awardees

*Actions Planned or Underway*

- Continue the compliance monitoring programs related to the low-income housing and specified energy property programs
- Continue to coordinate with IRS's compliance initiative project regarding the energy program
- Continue assessment of staffing needs
- Receive final Assistance Agreement compliance reports from awardees for which performance period ended in fiscal year 2013; reconcile final compliance reports with reports submitted under Federal Reporting.gov
- Conduct desk reviews or site visits for remaining 46 Recovery Act awards
- Close out all 69 Recovery Act awards

**Management of the Housing and Economic Recovery Act and the Emergency Economic Stabilization Act**

*Fiscal Year 2013 Accomplishments*

- New Issue Bond Program (NIBP)
  - Concluded the period for which State and local Housing Finance Agencies (HFAs) could use program funds to finance new single family or multifamily mortgages
  - Managed the prompt return of unused NIBP funds to Treasury well in advance of the final deadline
- Temporary Credit and Liquidity Program (TCLP)
  - Concluded the process of granting a three-year extension of TCLP for six HFAs that elected to extend their participation, conditioned on these HFAs submitting plans for Treasury's approval for reducing balances of bonds covered by TCLP
  - Managed the reduction of Treasury's exposure to risk under TCLP from $3.6 to $2.0 billion during the year, with the number of participating HFAs falling from six to four
- Continued to manage the wind-down of remaining Troubled Asset Relief Program (TARP) investments in a manner that balanced the desire to exit investments as soon as practicable with maximizing returns for taxpayers:
  - Cumulatively collected 96.2 percent of the $420.1 billion in program funds disbursed under TARP (100.4 percent if non-TARP American International Group (AIG) shares are included)
  - Continued to wind down some of our remaining Capital Purchase Plan investments through repurchases by banks, asset sales, and restructurings
  - Substantially completed the wind-down of all of the TARP credit market programs, including remaining investments under the Public Private Investment Program and the Term Asset Backed Securities Loan Facility
  - Made considerable progress in the wind down of the Automotive Industry Financing Program (AIFP) with the sale of 399 million shares of GM stock during fiscal year 2013, and with announcements by Ally Financial of a series of transactions that resulted in Ally repaying Treasury approximately $6 billion on November 20, 2013
  - Exited all remaining holdings in AIG

- Continued to implement the housing programs funded under TARP, which are designed to prevent avoidable foreclosures; these efforts have directly helped more than1.2 million people avoid foreclosure and indirectly helped millions more by setting new standards throughout the mortgage servicing industry

*Actions Planned or Underway*

- Manage the wind down of the HFA Initiative
- NIBP – Continue to collect data on the performance of the collateral underlying NIBP bonds, and to use this data to monitor and manage Treasury's risks
- TCLP – Continue to monitor performance of four remaining HFAs in implementing approved plans for reducing TCLP balances, and to encourage HFAs to achieve faster reductions as market conditions permit
- Continue to manage the wind-down of the remaining TARP investments in a manner that balances the desire to exit as soon as practicable with maximizing returns for the taxpayers:
  - Continue to wind down our remaining Capital Purchase Program investments through repurchases by banks, asset sales, and restructurings
  - Continue to sell GM common stock through pre-arranged written trading plans and underwritten offerings, subject to market conditions
  - Actively seek to monetize OFS's Ally Financial investment
- Continue to implement the housing programs funded under TARP, which are designed to prevent avoidable foreclosures

| OIG CHALLENGE NO. 3 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act (BSA) Enforcement** | • Prevent and detect money laundering and terrorist financing<br>• Promote U.S. and international financial systems that are safe and transparent<br>• Ensure continued cooperation and coordination of all organizations involved in anti-money laundering and combatting terrorist financial efforts<br>• Create safeguards over the use of BSA information |

**FinCEN**

*Fiscal Year 2013 Accomplishments*

- Imposed a $500 million penalty against HSBC as part of a joint enforcement action with several federal and state agencies resulting in a $1.9 billion overall enforcement action, the largest combined BSA and anti-money laundering (AML) penalty ever imposed against any financial institution
- Completed the majority of the components of the BSA IT Modernization Program, including deploying FinCEN Query to approximately 10,000 users, mandating electronic filing of all Title 31 reports, and introducing the ability to view automated alerts based on established business rules
- Completed the transition of financial institutions from legacy forms to new, electronic reporting formats through the BSA E-Filing system
- Realigned resources to establish the FinCEN Resource Center, an information operations hub for FinCEN that ensures consistent, efficient service to financial institutions, law enforcement, and regulators, as well as our foreign partners; thus far, the FRC has responded to more than 26,000 inquiries from financial institutions regarding proper electronic filing of BSA Reports, including money services businesses (MSBs) registration requirements; processed more than 270 314(a) requests from law enforcement, 4,000 314(b) registrations from financial institutions, and 1,700 activity reports for regulatory field examiners; and reviewed over 8,000 FinCEN Query searches to network agencies working identical cases

- Led a significant multilateral effort, in cooperation with the Mexican Financial Intelligence Unit (FIU), the Spanish FIU, and the member governments and FIUs of the Organization of American States-Inter-American Drug Abuse Control Commission to develop and adopt a set of principles and best practices across the Western Hemisphere FIUs for ensuring the confidentiality of FIU information in a manner consistent with established Egmont principles and practices
- Continued to enhance the sharing of information derived from compliance examinations through entering into an additional 73 MOUs with federal and state regulators
- Issued guidance clarifying that certain administrators or exchangers of virtual currency are subject to FinCEN regulations as money transmitters, subjecting them to requirements including, but not limited to, registering with FinCEN, adopting an anti-money laundering program, and reporting suspicious activities
- Conducted strategic analytical studies and published reports on emerging money laundering trends and vulnerabilities, including assessments related to mortgage fraud, elder financial exploitation, depository institution insider abuse, 314(b) program usage, and the accounting profession, and issued analytical reports to state regulatory authorities overall BSA filing trends within their jurisdictions
- Realigned resources to increase staffing and revitalize enforcement efforts in all areas under FinCEN's compliance and enforcement authority, including MSBs and non-bank financial institutions

*Actions Planned or Underway*

- Continue cooperative efforts with Federal and State regulatory agencies, pursuing MOUs with additional state insurance regulators, and promoting greater leveraging of resources between the IRS and state regulatory agencies on non-bank financial institution examinations – including implementation of compliance strategies for industries that have been recently subject to FinCEN's regulations
- Finalize existing rulemaking proposals and develop new regulations, as warranted, to address AML risks or gaps in the AML framework
- Implement the final components of the BSA IT Modernization Program and transition to an operations and maintenance environment
- Continue to issue guidance and actionable advisories to financial institutions, regulators, and law enforcement on compliance and emerging money laundering trends and risks
- Publish analytic products identifying networks, schemes, and failed institutions or jurisdictions involved in illicit financial activities and develop new analytic processes to streamline recurring analytic reports to provide faster turnarounds to customers
- Continue to exercise enforcement authorities where appropriate to ensure compliance with the BSA and combat money laundering in all sectors of the financial services industry

**OCC**

*Fiscal Year 2013 Accomplishments*

- Examined national banks and federal savings associations to combat money laundering and terrorist financing, and to protect the integrity of the U.S. financial system through banks' compliance with the Bank Secrecy Act/Anti-Money Laundering (BSA/AML), and USA PATRIOT Act laws and regulations, taking enforcement actions when appropriate
- Imposed a $500 million civil money penalty against HSBC Bank USA, N.A., McLean, Virginia, the largest penalty ever assessed by the OCC, based on the bank's violating the BSA and its underlying regulations, and the bank's failure to fully comply with a cease and desist order issued in October 2010 addressing these violations
    - The order required the bank to take comprehensive corrective actions to improve its BSA compliance program, while deferring the OCC's decision on assessing a penalty
    - OCC announced that it has issued a separate cease and desist order to address deficiencies in the bank's enterprise-wide compliance program
    - OCC entered into an agreement with the bank pursuant to the requirements of the Gramm-Leach-Bliley Act

- o OCC penalty was part of a coordinated action with the U.S. Department of Justice, the Board of Governors of the Federal Reserve System, the Financial Crimes Enforcement Network, the Office of Foreign Assets Control, and the New York County District Attorney's Office

- Issued a cease and desist order, by consent, against JPMorgan Chase, N.A.; JPMorgan Bank and Trust Company, N.A.; and Chase Bank USA, N.A., for deficiencies in the banks' overall program for BSA/AML compliance
- Imposed a $10 million civil money penalty against TCF National Bank, Sioux Falls, S.D., for violations of the BSA comprising late and inadequate filing of Suspicious Activity Reports (SARs), following a cease and desist order issued in 2010 that directed the bank to correct deficiencies in its BSA and anti-money laundering programs
- Emphasized training, staffing, recruitment, policies, and interagency coordination to continually improve the BSA/AML supervision program
- Continued to work closely with the Treasury's Office of Terrorism and Financial Intelligence, FinCEN and Office of Foreign Assets Control to promote the implementation of sound international anti-money laundering and counter terrorist financing standards
- Revised approach to citing BSA/AML violations in order to provide more flexibility for individual pillar violations to be cited, and identified steps to more promptly obtain a holistic view of a bank's BSA/AML compliance

*Actions Planned or Underway*

- Continue examination, enforcement activities, and cooperative efforts with FinCEN and other federal banking agencies

| OIG CHALLENGE NO. 4 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Gulf Coast Restoration Trust Fund Administration** | • Monitor regulations and associated policies and procedures that need be established<br>• Coordinate with many entities/councils that are to receive and further allocate funding, and need to establish policies and procedures<br>• Use Treasury's existing resources to administer its responsibilities for the Trust Fund |

*Fiscal Year 2013 Accomplishments*

- Posted notice of and published Treasury's *The Resources and Ecosystems Sustainability, Tourism Opportunities and Revived Economy of the Gulf Coast Act of 2011* (RESTORE Act) proposed regulations for comment
- Launched a Treasury RESTORE Act website that includes links to the proposed regulation, statute, Gulf Coast Ecosystem Restoration Council's Comprehensive Plan and to grantees websites
- Hired a contractor to assist in the development of grant application forms, application procedures, application review process and compliance parameters for Treasury's RESTORE Act grant programs
- Implemented an investment strategy for the Gulf Coast Restoration Trust Fund concurred to by the Gulf Coast Ecosystem Restoration Council and the National Oceanic Atmospheric Administration
- Represented Treasury at weekly conference calls and monthly meetings of the Gulf Coast Ecosystem Restoration Council executive committee
- Met with federal agencies who sit on the Gulf Coast Ecosystem Restoration Council to evaluate resource needs and provide input on RESTORE grant programs
- Utilized resources from the Fiscal Service to investigate grants management systems
- Assisted the Fiscal Service in implementing Trust Fund investments

*Actions Planned or Underway*

- Hire three full time employees for the RESTORE Act
- Comment period for proposed regulations began in early November; release of final regulation anticipated in the second quarter fiscal year 2014
- Target date for the Fiscal Service to execute an interagency agreement for a grants management system set for late December 2013 and complete set up in the second quarter fiscal year 2014
- Continue to engage IT support for reporting functions to be added to RESTORE Act website
- Target date to execute an interagency agreement or contract for subject matter experts to assist in grant application review is third quarter fiscal year 2014
- Target date for standard grant award agreement set for the second quarter of fiscal year 2014
- Target date to announce launch of program with accompanying application forms, procedures, and guidance is set for second quarter fiscal year 2014
- Target date for receipt of first grantee applications set for the third quarter of fiscal year 2014
- Target date for first awards to grantees anticipated in the fourth quarter of fiscal year 2014

| **Matters of Concern No. 1** | **SUMMARY OF MAJOR ISSUES** |
|---|---|
| **Cybersecurity** | • Build on existing partnerships among financial institutions, regulators, and private entities in the financial sector<br>• Identify and respond to emerging cyber threats against financial institutions and the broader financial sector |

*Fiscal Year 2013 Accomplishments*

- Clarified roles and responsibilities within the partnership system of the sector coordinating council (Financial Services Sector Coordinating Council for Critical Infrastructure Protection, FSSCC); the sector communications utility (Financial Services Information Sharing and Analysis Center, FS-ISAC); and the regulatory committee (Financial and Banking Information Infrastructure Committee)
- Implemented an information-sharing platform, to exchange sensitive information between the financial sector and the defense industrial base (Global Information Sharing Framework)
- Partnered with Department of Homeland Security (DHS), the intelligence community and law enforcement to build cyber-intelligence capabilities focused on protecting the financial services sector
- Began working with key sector partners to adapt a defense industrial base sensors program [Defense Enhanced Cybersecurity Services (DECS)] to serve institutions within the financial services sector
- Encouraged the sector to focus on extending communications networks beyond IT specialists to executives at various levels including Chief Executive Officers, Chief Information Officers, Chief Information Security Officers
- Stood up the Financial Sector Cyber Intelligence Group (CIG) within Treasury to provide timely and actionable cyber threat information to the financial sector
- Provided substantial input on key Administration cybersecurity proposals, including Executive Order 13636 - Improving Critical Infrastructure Cybersecurity and Presidential Policy Directive (PPD)-21 Critical Infrastructure Security and Resilience
- Re-aligned and updated Treasury's Cyber Critical Infrastructure Protection policies to address rapidly evolving federal requirements, including the 2013 Presidential Directive to protect the most essential information systems from potential adversaries
- Convened classified discussions with Chief Executive Officers, Chief Information Officers and Chief Information Security Officers from over 150 financial service firms and their service providers to identify and address emerging threats
- Collaborated with private and public sector partners to assess the emerging risks associated with the Internet Corporation for Assigned Names and Numbers proposal to delegate new financial Internet suffixes,

including ".bank", ".mortgage", ".insurance", and ".retirement"

- Coordinated government and industry responses to attacks on individual institutions of the financial services sector
- Executed requests for Technical Assistance and Memoranda of Understanding to deploy government resources in defense of critical infrastructure
- Achieved continuous monitoring of Treasury systems covering 83 percent of the IT assets supporting Treasury unclassified systems, up from 65 percent at the end of fiscal year 2011
- Introduced a performance element in Bureau CIO performance plans to encourage the application of critical patches to at least 75 percent of applicable systems within 30 days of patch release; as result, 60 percent of the Treasury bureaus accomplished this goal
- Continued to improve Treasury's network security to reduce the impact of social engineering and other attempts to expose Treasury IT systems to malicious software; as a result, 99 percent of Treasury network traffic was routed through a Trusted Internet Connection, where advanced analytic and defensive capabilities (including DHS monitoring with EINSTEIN technologies) help to block known and potential threats from entering Treasury's IT environment
- Met the Treasury goal of 99 percent of users with a network account received cybersecurity awareness training, and 99 percent of users with significant security responsibilities met Treasury requirements for completing specialized, role-based security training
- OCC held a webinar on cyber threats and vulnerabilities to raise awareness for community banks, part of its continuing outreach effort to raise awareness by federally chartered banks and national savings associations of the growing operational risks from cyber-attacks; the webinar addressed current threats and vulnerabilities on how the OCC and other government entities are partnering to address these threats; and practical advice for community bankers on protecting their banks and customers
- OCC created and filled a new position, Senior Infrastructure Officer
- OCC held a series of briefings for banks, third-party service providers, and bank examiners
- OCC issued an alert on denial-of-service attacks and updated examiner handbooks, procedure, and training materials to ensure that as threats evolve all banks and thrifts can identify cyber risks and strengthen their risk management and control systems

*Actions Planned or Underway*

- Continuing to encourage the private sector and other government agencies to ramp up their respective efforts to bolster cybersecurity for the safety of their businesses as well as the entire U.S. financial system, including continued engagement from Treasury staff and senior management, including Assistant Secretaries, Under Secretaries, the Deputy Secretary, and the Secretary
- Enhancing access, staffing and automation at the sector communications utility (FS-ISAC)
- Partnering with Department of Homeland Security (DHS) to adapt the defense industrial base sensors program (DECS) to meet the needs of the financial sector;
- Continuing to partner with DHS, the intelligence community and law enforcement to enhance cyber-intelligence capabilities dedicated to protecting the financial sector
- Continue to work with the FSSCC and FS-ISAC, enlisting the trade associations to extend effective crisis management and communications to firms of all sizes
- Coordinating Private Sector Clearance Program with DHS for the Financial Services sector
- Fully operationalizing the Financial Sector Cyber Intelligence Group within Treasury to provide timely and actionable cyber threat information to the financial sector
- Supporting the implementation of Executive Order 13636 - Improving Critical Infrastructure Cybersecurity and PPD-21 Critical Infrastructure Security and Resilience
- Supporting and institutionalizing the integration of financial services-specific efforts with DHS' cross-sector activities

- Continuing to provide input on the potential risk of domain name expansion (e.g. ".bank")
- Continuing to address individual incidents and patterns of attack
- Engaging in the planning and execution of preparedness exercises led by government and industry to identify and assess sector vulnerabilities
- Continuing to provide Treasury users annual cybersecurity awareness training to Treasury network users
- Accelerating transition to a logical access control model that requires users to authenticate their identities using the Personal Identity Verification card when accessing Treasury systems
- OCC (as the Chair of the Federal Financial Institutions Examination Council) which spearheaded the formation of an interagency working group charged with coordinating with intelligence, law enforcement, and homeland security officials to fight existing and emerging threats; the working group will consider ways to improve coordination of supervisory policies relating to cybersecurity and infrastructure resilience and whether additional legislative authority is needed to stop security threats

| **Matters of Concern No. 2** | **SUMMARY OF MAJOR ISSUES** |
|---|---|
| **Currency and Coin Production** | • Oversee issues related to the Bureau of Engraving and Printing's (BEP) redesign of NexGen $100 note while engaging in sound and comprehensive project management<br>• Oversee the U.S. Mint's costs associated of producing penny, nickel coins, and the suspended production of the dollar coins |

*Fiscal Year 2013 Accomplishments*

***Coin Production***

- The U.S. Mint delivered an alternative coinage materials report to Congress in fiscal year 2013 that provided an assessment for both metal and production costs; no formal recommendations were made to change the current metallic content of circulating coins and the U.S. Mint is continuing to conduct R&D
- The U.S. Mint has implemented strategies that have dramatically reduced costs over the past three years (fiscal year 2009 – fiscal year 2012); as a result U.S. Mint reduced its non-metal plant operating costs by $14.5 million (more than seven percent) from $200.3 million in fiscal year 2009 to $185.8 million in fiscal year 2012; the U.S. Mint also reduced selling, general, and administrative costs by $31.8 million (nearly 18 percent) from $179.5 million in fiscal year 2009 to $147.7 million in fiscal year 2012

**Currency Production**

- The BEP worked with its currency paper supplier, Crane & Company, and other BEP stakeholders, including the Federal Reserve Board, Department of the Treasury, and the U.S. Secret Service to resolve the creasing issue and completed production validation testing for the NexGen $100 note

*Actions Planned or Underway*

***Coin Production***

- The next biennial report to Congress on alternative coinage materials will be delivered in December 2014

**Currency Production**

- The Board of Governors of the Federal Reserve System announced that the date of issuance for the NexGen $100 note will be issued in the first quarter 2014
- The increasing complexity of U.S. currency note design demands the highest degree of cutting edge research and development, state-of-the-art production technology, and best-in-class quality and process control; the production challenges associated with the NexGen $100 note highlighted the need for a fundamental re-engineering of process control and quality assurance at BEP; and the BEP is implementing a Currency Quality Assurance Program which is intended to be a strategic re-alignment that will position BEP for more efficient currency production and provide long-term cost reductions related to spoilage and reduced currency redesign cycle time

| **Matters of Concern No. 3** | **SUMMARY OF MAJOR ISSUES** |
|---|---|
| **Documenting Key Activities and Decisions** | Promote an effective records management program to ensure Treasury management personnel remain aware and vigilant |

*Fiscal Year 2013 Accomplishments*

- The Do Not Pay Program published its system of records notice, TREASURY/Fiscal Service.023, *Do Not Pay Payment Verification Records*, after receiving OMB approval following its review to ensure consistency with OMB M 13-20, *Protecting Privacy while Reducing Improper Payments with the Do Not Pay Initiative* (guidance required under the *Improper Payment Elimination and Recovery Improvement Act of 2012* (IPERIA), 31 U.S.C. § 3321 note, Pub. L. 112-248)
- Implementation of the Enterprise Content Management (ECM) program was a top priority for Treasury in 2013; as ECM is a set of web-based tools that electronically capture, store, search, collaborate, and manage records; and successful deployment of the ECM platform has delivered significant tools and resources to facilitate effective records management such as e-Records Management and Digitization
- Ensured compliance with Federal records regulations, Treasury's Office of Treasury Records conducted reviews of each bureau records management program, documented findings, and made recommendations to improve the effectiveness and efficiency in the respective programs

*Actions Planned or Underway*

- Continued support for Treasury program offices in configuring and utilizing the ECM Records Center program, to ensure consistent and efficient management of unstructured electronic records
- Review and overhaul of Departments Orders and Directives Process—the primary method by which Treasury-wide policy is codified; this process improvement initiative is focused on providing proactive support to Treasury programs in establishing and regularly review and updating, Treasury Orders and Directives in each office's area of expertise
- Review and updating of proactive accessible records and digitization strategy, to prioritize digitization of high-value and high-demand records, reduce paper records stores in accordance with National Archives and Records Administration (NARA) guidance, and ensure digitized record stores are maintained in compliance with accessibility requirements
- Continuing to update the Department's policy for records management, in conformance with new guidance from NARA, to address the retention and disposition of electronic media (email) and use and retention of social media communications and web 2.0 technologies

**RESPONSE TO TIGTA**

| TIGTA CHALLENGE NO. 1 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Security for Taxpayer Data and IRS Employees** | Promote measures for appropriate physical security and protection of financial, personal, and other information |

*Fiscal Year 2013 Accomplishments*

- For fiscal year 2013, IRS performed a self-assessment of its internal controls for systems that impact the financial statements and demonstrated that management, technical, and operational controls are in place and effective to secure the IRS information; on June 28, 2013, the Financial and Management Controls Executive Steering Committee voted unanimously to downgrade the internally-carried information security material weakness to a significant deficiency
- Identified, mitigated, and responded to more than 1,300 cyber incidents and blocked over 5,800 websites to prevent access to malicious or compromised sites
- Eliminated 3,119 fraudulent domestic websites including 2,790 fraudulent malware websites
- Masked social security numbers (SSNs) using a two-dimensional (2D) barcode on 12 additional nonpayment notices, for a total of 58 nonpayment notices and 106 payment notices, affecting 20.4 million and 97.3 million annual taxpayer notices, respectively
- Developed additional levels of security to the existing e-Auth system for IRS online applications, such as third-party identification data, which required taxpayers to prove who they are before accessing the IRS application; nearly 175,000 callers leveraged the third party ID proofing process
- Developed a Non-filers Identification Proofing and Authentication process for first-time filers for whom the IRS has no identification data using a combination of IRS and third party proofing, which standardized security services in Affordable Care Act applications and enhanced the ability to securely deliver services to customers via IRS.gov
- Implemented a process to ensure that Physical Security and Emergency Preparedness (PSEP) Office inventory records include all relevant information, such as the date facilities are open and closed as well as the dates risk assessments should be performed

*Actions Planned or Underway*

- Launch the third phase of the SSN Elimination project to mask SSNs on payment notices, beginning with four notices of installment agreements impacting an estimated 33 million notices annually
- Upgrade technology to improve identity theft filters and taxpayer authentication procedures
- Update the Physical Security Internal Revenue Manual to distinguish which risk assessments are the responsibility of Federal Protective Services and which are the responsibility of PSEP

| TIGTA CHALLENGE NO. 2 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Implementing the Affordable Care Act and Other Tax Law Changes** | Effectively implement new tax provisions, including tax-related health care provisions of the *Patient Protection and Affordable Care Act* (ACA), and other tax law changes |

**Affordable Care Act (ACA)**

*Fiscal Year 2013 Accomplishments*

- Experienced successful testing and rollout of Treasury and IRS-led systems related to the ACA
- Published Healthcare Law Online Resources (Pub. 5093), which provided links to Internet resources available from IRS federal agency partners, including the Department of Health and Human Services (HHS), the Department of Labor and the Small Business Administration (SBA)

- Created a new ACA web page, which explains the tax benefits and responsibilities for individuals, families, and employers, as well as provides information regarding taxpayers' health insurance choices and how they may affect tax returns filed in 2015
- Launched two new IT services for Marketplace exchanges, providing both income and family size data and an optional computation service for exchanges to determine the maximum Advance Premium Tax Credit
- Developed an ACA speaker's cadre that included speakers throughout the IRS who manage stakeholder outreach and education requests related to ACA tax law implementation during the 2013 Health Insurance Marketplace pre-enrollment and enrollment period
- Conducted separate ACA discussions at an IRS Nationwide Tax Forum providing information on health care-related tax provisions for individuals and businesses, details about provisions that may affect taxpayers in 2013, and a preview of provisions beginning in 2014
- Published 34 items of regulations and other guidance on ACA tax provisions including Hospital Insurance Tax on High Income Taxpayers (9015), Net Investment Income Tax (1402), and Industry Fees (Patient-Centered Outcomes Research Trust Fund, and Health Insurance Providers)
- Worked closely with HHS and the states on tax data safeguarding issues including education, correct and complete documentation, and on site validation reviews for, HHS data services Hub, Federally-Facilitated Marketplace, and State Marketplace, Medicaid and Children's Health Insurance Program agencies
- Collaborated with HHS, the SBA and other partners to provide live and virtual outreach to individuals, employers, states, insurers, tax professionals, and other third parties

*Actions Planned or Underway*

- Complete development of an ACA awareness module, including key acronyms, for customer-facing managers and employees
- Respond to requests to verify income and family size and requests to calculate the Advance Premium Tax Credit
- Continue implementation of ACA mid-horizon provisions
- Continue working with federal and state agencies on implementation including outreach, guidance, information technology, and safeguarding of federal tax data
- Continue preparing for Exchange-related tax provisions taking effect in 2014 and impacting 2015 filing season (customer service, IT systems and business processes, and compliance)
- Continue ACA outreach to stakeholders including individuals, employers, states, insurers, tax professionals, and other third parties
- Coordinate new ACA IT requirements as modules are developed or enhanced
- Determine the impact and update related guidance resulting from the Defense of Marriage Act judicial actions
- Ensure ACA requirements are met under e-Authorization Release 3 by aligning release schedules and supporting new modules as they are developed or enhanced

| TIGTA CHALLENGE NO. 3 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Tax Compliance Initiatives** | Improve compliance and fairness in the application of the tax laws |

**Businesses and Individuals**

*Fiscal Year 2013 Accomplishments*

- Developed a three-pronged approach to Improve Individual Tax Identification Number (ITIN) compliance

by:

- Manually reviewing returns involving new ITIN applications that claim Additional Child Tax Credit (ACTC) and/or American Opportunity Tax Credit (AOTC), if discrepancies are found, the returns are selected for audit
- Selecting ITIN returns that already have existing ITINs and appear to be claiming ACTC for potential audit
- Freezing potential refunds and auditing the returns of cases that meet the specific criteria

- Identified over 1,000 amended returns using a new screening criteria for Form 1040X (Amended Income Tax Return) where ITIN filers increased the number of dependents and claimed additional ACTC/AOTC
- Completed and posted on the web the final lesson for Virtual Small Business Tax Workshop (VSBTW) relating to "Hiring People Who Live in the U.S. but who aren't U.S. Citizens," which included closed captioning in English; as these online workshops focus on providing taxpayers information to help them understand and meet their federal tax obligations
- Continued to focus on a comprehensive and aggressive strategy to identify and combat tax-related identity theft, which consisted of: preventing refund fraud caused by identity theft; investigating and initiating criminal recourse against perpetrators of refund fraud caused by identity theft; and assisting taxpayers victimized by identity theft; fiscal year 2013 efforts included:
  - Issued Identity Protection PINs to more than 770,000 taxpayers who had been victimized by identity theft, compared to 250,000 in fiscal year 2012
  - Increased the staff dedicated to refund fraud prevention and assisting taxpayers victimized by identity theft victim assistance to over 3,000 employees, more than twice the number of employees in fiscal year 2012

*Actions Planned or Underway*

- Conduct outreach efforts via direct contact and social media to market the Visual Small Business Tax Workshop (VSBTW) and establish relationships with organizations that represent small business owners in industries that frequently hire people who live in the U.S. but are not U.S. citizens
- Proceed with VSBTW translations for Chinese, Korean, Portuguese, Russian, Polish, French Creole, and Arabic
- Implement closed captioning for new VSBTW for Spanish, Chinese, and Vietnamese
- Collaborate with state and federal correctional agencies to reduce and deter inmate tax fraud by signing agreements to exchange information
- Continue the Corporate (Form 1120) reporting compliance study
- Continue to refine and expand the tax processing filters used to detect and prevent the issuance of fraudulent tax refunds resulting from identity theft

**Tax-Exempt Entities**

Fiscal Year *2013 Accomplishments*

- Revised the relevant Internal Revenue Manual (IRM) sections related to promoter investigations in the tax-exempt arena facilitating abusive tax transactions
- Issued 30-day report titled "Charting a Path Forward at the IRS: Initial Assessment and Plan of Action" outlining corrective actions to address TIGTA recommendations and other critical management challenges
- Installed new leadership at all five levels of the senior executive managerial chain that had responsibility over the activities identified in the TIGTA report to ensure accountability
- Offered an expedited option to organizations applying for IRC § 501(c)(4) exemption whose applications, as of May 28, 2013, had been pending 120 days or more since their original filing date
- Improved the screening criteria for applications for tax-exempt status by eliminating the "Be on the

Lookout" or BOLO lists

- Issued guidelines and instructions to Exempt Organizations (EO) personnel requiring screening assessments to be based on activity, not names or labels
- Enhanced training for EO personnel in the proper ways to review applications to determine the extent of political campaign activities
- Led seven promoter investigations related to tax-exempt entities where retirement plans were accommodating parties to abusive transactions and where a promoter required a monetary donation to an associated charity for services rendered to individuals; four retirement plans and three charitable organizations were involved in these abusive transactions
- Supported the newly formed Security and Exchange Commission (SEC), Office of Municipal Securities, by meeting with officials to discuss market trends and observations, legislative and regulatory developments, compliance issues and projects, and possible opportunities for additional collaboration pursuant to a memorandum of understanding between the IRS and SEC
- Completed 163 out of 330 examinations of retirement plans detected through an advanced data mining application that compared past audit analytics to current return information in the Risk Modeling II project
- Revised Forms 5300, 5310, and 5307 relating to applications for determination letters for qualified employee plans; the changes to the determination letter filing included eliminating elective demonstrations regarding coverage and nondiscrimination requirements and limiting the use of the Form 5307 to employers that have made limited modifications to a pre-approved volume submitter plan

*Actions Planned or Underway*

- Identify gaps and make improvements to the exempt organizations examination program
- Issue guidance on how to measure the "primary activity" of IRC § 501(c)(4) social welfare organizations
- Establish a robust Enterprise Risk Management Program
- Conduct a comprehensive, agency-wide review of compliance selection criteria
- Work with the National Taxpayer Advocate to increase taxpayers' awareness of mechanisms at their disposal for resolving issues with the IRS
- Re-engineer the determination process for organizations seeking tax-exempt status and publish these procedures publicly
- Evaluate the determination letter process for employee retirement plans for areas of improvement, specifically related to alleviating the determination backlog and improving case processing times
- Develop procedures to better document the reason(s) applications are chosen for review by the team of specialists (e.g., evidence of specific political campaign intervention in the application file or specific reasons the Exempt Organizations function may have for choosing to review the application further based on past experience)
- Develop training or workshops to be held before each election cycle including, but not limited to, the proper ways to identify applications that require review of political campaign intervention activities
- Develop training or workshops to be held before each election cycle including, but not limited to: (a) what constitutes political campaign intervention versus general advocacy (including case examples) and (b) the ability to refer for follow-up those organizations that may conduct activities in a future year which may cause them to lose their tax-exempt status
- Provide oversight to ensure that potential political cases, some of which have been in process for three years, are approved or denied expeditiously

**Tax Return Preparers**

*Fiscal Year 2013 Accomplishments*

- Issued corrective action letters to 4,200 professional credentialed (CPAs, Attorneys, and Enrolled Agents) return preparers in fiscal year 2013 who were noncompliant due to nonpayment of a federal individual or business tax liability or the failure to file a required federal individual or business tax return, up from 500 in fiscal year 2012
- Verified the personal tax compliance of approximately 920,000 registered Preparer Tax Identification Number holders and found that 97 percent were compliant; monitored the tax obligations of the remaining 3 percent and treated the noncompliance based on program policy, which resulted in compliance from more than 2,200 return preparers
- Developed risk models using National Research Program (NRP) data to select preparers for treatment tests
- Implemented a study to compare the effectiveness of treatments for noncompliant preparers who prepare inaccurate tax returns to improve return accuracy

*Actions Planned or Underway*

- Analyze results of the controlled testing study comparing the effectiveness of different treatments

| TIGTA CHALLENGE NO. 4 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Modernization** | Improve taxpayer service and efficiency of operations |

*Fiscal Year 2013 Accomplishments*

- Transferred data from the CADE 2 database demonstrating the ability to feed data to downstream systems, which enabled robust data accuracy, a sustainable database system, and operational performance to facilitate future use
- Delivered transcripts to third parties in seconds compared to days via electronic delivery to secure mailboxes using the Proof of Concept (PoC) application; however, the PoC was deactivated due to a low participation level of the Send My Transcript Proof of Concept, which also resulted in discontinuing plans to add more Income Verification Express Services vendors and financial institutions
- Established the Revenue Protection Technology (RPT) Governance Board and the RPT Executive Steering Committee to provide enterprise-wide governance to oversee the Return Review Program (RRP)
- Developed and included the system integrator roles and responsibilities in the RRP Project Management plan

*Actions Planned or Underway*

- Deploy CADE 2 2014 Database Implementation to integrate testing and Data Assurance activities into the Annual Integrated Filing Season test
- Convert the Martinsburg and Memphis Computing Centers into a new benchmarkable format, which integrates the best methods of data center strategy, planning, operation, and continuous improvement
- Relocate Detroit Computing Center infrastructure and equipment to appropriate IRS facilities

| TIGTA CHALLENGE NO. 5 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Fraudulent Claims and Improper Payments** | Effective use of taxpayer funds |

**Refundable Credits**

*Fiscal Year 2013 Accomplishments*

- Identified multiple submission and processing issues regarding Form 8867 (Paid Preparer's Earned Income Credit Checklist) during filing season 2013, which required additional review of the Tax Year 2012 returns to effectively and accurately identify the noncompliant returns
- Stood up a new Automated Questionable Credit (AQC) operation, assembled two operational groups, and conducted multiple phases of training
- Selected 7,265 returns claiming children age 24 and over as disabled qualifying children using pre-refund examination filters to address erroneous EITC claims
- Implemented additional controls to identify and stop erroneous claims for refundable credits before refunds are issued including freezing and verifying claims for the Additional Child Tax Credit on all returns for which the EITC is frozen

*Actions Planned or Underway*

- Analyze AQC case results and recommend rule changes to improve selection criteria

**Fraudulent Payments**

*Fiscal Year 2013 Accomplishments*

- Initiated the Entity Fabrication Pilot focusing on taxpayers who used false information documents to claim fraudulent refunds
- Updated the electronic fraud detection system to identify fabricated business entities with false Form W-2 filings as "suspicious"
- Conducted 368 audits for the Multi-DUPTIN audit program and coordinated with Submission Processing and other IRS offices to resolve processing of returns with questionable Taxpayer Identification Numbers (TINs) for dependency exemptions
- Implemented clustering filters to detect additional ID Theft cases with suspicious criteria such as duplicate use of addresses and bank account information, resulting in over 392,000 returns selected and preventing over $1.2 billion in refunds

*Actions Planned or Underway*

- Update filters, codes, and finalize treatment stream to identify fraudulent filings based on Entity Fabrication pilot results
- Implement new programming, processes, and coding for false information documents
- Develop and implement processes to mark or exclude false Forms W-2 from the automated verification process

**Contract and Other Payments**

*Fiscal Year 2013 Accomplishments*

- Implemented processes and procedures requiring the inclusion of an overhead rate on reimbursable agreements
- Developed and updated policies and procedures to reflect the new Federal Acquisition Regulation (FAR) revisions for cost-reimbursement contracts
- Established better controls regarding invoice payments, by requiring on-line training for Contracting Officer's Representatives, invoice approvers and their managers
- Required all contract specialists and Federal Acquisition Certification for Contracting Officer Representatives enter training and certification data in the Federal Acquisition Institute Training Application System, which is verified quarterly
- Reinforced controls over contract invoice review, approval, and payment processes which included: implementing a quarterly receipt & acceptance review process to verify that end users maintained the proper

R&A documentation required before making payment

- Implemented a review process to identify potential personal and/or inappropriate purchase card transactions

*Actions Planned or Underway*

- Develop and document an IRS-wide approach to identify, track, and monitor the adequacy of its acquisition workforce
- Provide training on recent FAR revisions resulting from the Duncan Hunter National Defense Authorization Act to those acquisition personnel involved in the award and administration of cost-reimbursement contracts

| TIGTA CHALLENGE NO. 6 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Providing Quality Taxpayer Service Operations** | Improve taxpayer service |

*Fiscal Year 2013 Accomplishments*

- Deployed Virtual Service Delivery (VSD) in 14 new Taxpayer Account Centers locations for walk-in customers
- Tested VSD technology with taxpayers in pilot sites and determined that virtual face-to-face conferences could be held successfully between employees and taxpayers
- Launched IRS2Go V3, a new version of the IRS2Go Smartphone application, which provided the application in Spanish for the first time and included minor updates to existing functionality; IRS2Go is available for both iOS and Android devices and has been downloaded by over 2.5 million users
- Increased the number of employees dedicated to preventing refund fraud and assisting taxpayers victimized by identity theft and updated and broadened the scope of the training for employees
- Completed the second and final phase of the TIN Matching re-engineering effort to resolve system integration, capacity, and maintenance issues and resulted in fewer maintenance and delivery issues, and reduced downtime
- Enhanced the MeF system, which successfully processed all Form 1040 electronic returns received within five minutes during non-peak periods and within two hours during peak periods
- Refined procedures to ensure appropriate indicators are recorded on taxpayer accounts to document both the opening and closures of identity theft investigations
- Delivered quality taxpayer service despite limited resources under severe budget constraints as a result of appropriations cuts, including sequestration

*Actions Planned or Underway*

- Leverage new and existing partners to provide taxpayers expanded access via alternate filing methods such as Facilitated Self Assistance and virtual VITA
- Evaluate capacity data to determine options to optimize VSD in support sites and identify locations for expansion
- Implement VSD technology as a permanent part of Campus operations

| TIGTA CHALLENGE NO. 7 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Human Capital** | Enable the IRS to achieve its mission |

*Fiscal Year 2013 Accomplishments*

- Implemented an Entrance On Duty System 2, which reduced administrative burden on the new hires and HR Staff by automating the collection of numerous prescreening and onboarding forms
- Emphasized the recruitment of veterans and persons with disabilities:
  - Established and posted the Disability, Schedule A, and Veteran Plans that outline goals, objectives, resources, tools and support available to managers

- Promoted the use of Veteran Hiring Authorities through IRS-wide communications
- Marketed the Treasury Veterans' Newsletter
- Launched a marketing campaign, called Veterans Employment Month, highlighting veterans' accomplishments, which resulted in an increase of 1000 unique hits to the IRS Careers veteran hiring website
- Expanded the CareerConnector to improving hiring and to track applicant and workforce data

- Increased virtual recruitment efforts such as implementing the Schedule A disability portal for applicants applying for positions under the disability hiring authority initiative
- Increased Geographic Leadership Communities (GLCs) throughout the nation; thirty-two GLCs, comprised of cross-functional groups (executives, senior managers, and frontline managers) hosted developmental opportunities and skill-building workshops across the country

*Actions Planned or Underway*

- Finalize the IRS drug free workplace program plan, including the testing designated positions list

| TIGTA CHALLENGE NO. 8 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Globalization** | Increase the outreach efforts to foreign governments on cross-border transactions |

*Fiscal Year 2013 Accomplishments*

- Partnered with the Department of the Treasury's Office of Terrorist Financing and Financial Crimes (TFFC) to address global money laundering
- Began implementing the Foreign Account Tax Compliance Act (FATCA) by conferring with more than 80 countries to gather information about foreign accounts held by U.S. taxpayers via Tax Information Exchange Agreements:
  - Signed Model 1 Agreements, Agreement to Improve International Tax Compliance and to Implement FATCA, with seven countries: Denmark, Ireland, Germany, Mexico, Norway, Spain, and the United Kingdom
  - Signed two Model 2 Agreements, Agreement for Cooperation to Facilitate the Implementation of FATCA, with two countries: Japan and Switzerland
- Collected $5.5 billion in back taxes, interest, and penalties from 38,000 taxpayers by implementing strategic enforcement efforts and the offshore voluntary disclosure programs, which since inception, gave 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
- Joined the Treasury's Working Group on Terrorist Financing and Charities, an interagency working group that reviews the abuse of the charitable sector for the diversion of funds for the financing of terrorist activities
- Developed bi-lateral working initiatives with the Department of the Treasury's TFFC aimed at identifying and addressing threats presented by all forms of illicit finance to the international financial system
- Collaborated with the Treasury Executive Office for Asset Forfeiture on the emerging issue of Third-Party Money Launderers involved in domestic and global money laundering

*Actions Planned or Underway*

- Collaborate with the Department of Treasury's working group on Terrorist Financing and Charities to revise guidance
- Enhance the case management system to identify the initiation and completion of criminal investigations of global money laundering schemes that are used by third party money launderers
- Initiate criminal investigations of third party money launderers involved in domestic and global money laundering schemes
- Develop systems, technology and processes to implement FATCA
- Continue FATCA implementation by signing Intergovernmental Agreements to exchange tax information with additional countries

- Conduct a study to determine if the automated penalty-setting process should be expanded to other types of income tax and international information reporting returns
- Evaluate the current performance measures and International Campus Compliance Unit (CCU) inventory results to determine how best to enhance the performance measures specific to work performed by CCU examiners

| TIGTA CHALLENGE NO. 9 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Taxpayer Protection and Rights** | Apply the tax laws fairly |

*Fiscal Year 2013 Accomplishments*

- Trained 35,000 employees to detect the characteristics of identity theft cases and assist taxpayers who are victims of identity theft
- Worked with victims to resolve and close more than 565,000 ID theft cases
- Engaged federal and state agencies to participate in an identity theft data exchange to address identity theft and refund fraud; began transmission of the data to two participating states, California and New York, resulting in sharing over 575,000 records of identity theft victims
- Prevented fraudulent refunds of over $3.3 million as the result of referrals through the State Suspicious Filer Group, which consists of 41 participating states; eight of the 41 participating states submitted information on over 5,000 suspicious filers under an exchange of information agreement
- Launched the Law Enforcement Assistance Program nationwide; the program allowed victimized taxpayers to sign a waiver (Form 8821-A) authorizing the release of any tax information to the designated state or local law enforcement official pursuing the investigation; in fiscal year 2013, 270 state/local law enforcement agencies from 31 states participated in the program, resulting in over 3,200 waiver requests for taxpayer consent access to their tax return data
- Implemented new identity theft screening filters, including filters that target multiple refunds deposited into a single bank account or sent to a single address, to improve the ability to identify fraudulent returns before processing and issuing refunds
- Improved customer service using the Two Dimension (2D) Barcode technology which enabled assistors to instantly access the correct taxpayer account information and reduced notice processing errors
- Initiated 1,492 identity theft investigations and recommended 1,257 cases for prosecution in fiscal year 2013
- Suspended the use of BOLO lists in the application process for tax exempt status

*Actions Planned or Underway*

- Expand partnerships and participation in data exchange and information sharing programs to combat identity theft and tax fraud
- Receive installment payment information through the 2D Barcode technology to expedite payment processing and reduce payment errors
- Develop guidance for specialists on how to process requests for tax-exempt status involving potentially significant political campaign intervention; this guidance should also be posted to the Internet to provide transparency to organizations on the application process

| TIGTA CHALLENGE NO. 10 | SUMMARY OF MAJOR ISSUES |
|---|---|
| **Achieving Program Efficiencies and Cost Savings** | Use resources to focus on producing the best value for stakeholders |

*Fiscal Year 2013 Accomplishments*

- Completed space reductions that resulted in the release of 557,000 square feet for an annualized rent savings of $15.7 million
- Operated under an exception-only hiring freeze since December 2010 and reduced the total number of full-time, permanent IRS employees by almost 9,000

- Secured buyout authority that resulted in the elimination of 1,224 positions
- Limited employee travel and training to mission-critical projects, reducing training costs by 83 percent and training-related travel costs by 87 percent since 2010
- Reduced spending on professional and technical service contracts by $200 million
- Generated $60 million in printing and postage savings
- Reduced retention allowances paid to senior staff
- Updated and expanded the use of cost accounting information for exam and collections operations to improve program efficiency
  - Expanded study on source of assessment for notices and added FTE's to the notice cost model to compare Balance Due notice process against other collection processes
  - Developed the average hourly rate for use in determining the costs of different types of exams based on the hours expended on them
  - Enhanced the cost/benefit study on notices to include costs and revenues for first through fourth balance due notices
  - Developed the cost/benefit of the Federal Agency Delinquency program which established the threshold amount for write-off of aged delinquent accounts
  - Developed the cost of examinations of Tax-Exempt organizations
- Submitted requirements for the RRP to design a web-based portal to exchange data between the IRS and correctional agencies that are required to submit inmate data to the IRS to speed up the process of receiving, reviewing and loading data files into the system.
- Established a policy to periodically evaluate the job series profiled for aircards and smartphones as well as monitor and document smartphones with no usage
- Released 45,395 square feet of available data center space by consolidating information technology operations in Atlanta, GA; Brookhaven, NY; Ogden, UT; Philadelphia, PA; and the New Carrollton Federal Building to be used for other IRS space requirements
- Issued additional guidance related to conference spending, attendance and tracking of expenditure

*Actions Planned or Underway*

- Complete the development of the cost of collection processes by activity
- Enhance the hourly rate for small business exams by incorporating more detail such as grade and activity type
- Support the development of a marginal revenue/cost model for exam by completing the costs of enforcement labor costs by job series and grade
- Create a database to import prisoner/prison data files, which will eliminate any missing corrected files that are returned from the states
- Use available data systems to systemically research missing prisoner Social Security Numbers that were not provided by the prisons
- Relocate Detroit Computing Center infrastructure and equipment to appropriate IRS facilities
- Update IRM 6.410.1, *Leadership and Education, Selection of Off-Site Locations and Facilities for Training*, to include:
  - Procedures that require all documentation supporting the selection of non-Government facilities for future conferences be maintained for management review
  - Guidance on the use, selection and compensation if event planners must be used

# SECTION D: SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

## SUMMARY OF FINANCIAL STATEMENT AUDIT

| Audit Opinion | Unmodified | | | | |
|---|---|---|---|---|---|
| Restatement | No | | | | |
| Material Weakness | Beginning Balance | New | Resolved | Consolidated | Ending Balance |
| Material Weakness in Internal Control Over Financial Reporting at the IRS | 1 | 0 | 0 | 0 | 1 |

## SUMMARY OF MANAGEMENT ASSURANCES

| Effectiveness of Internal Control over Financial Reporting (FMFIA § 2) | | | | | | |
|---|---|---|---|---|---|---|
| Statement of Assurance | Qualified | | | | | |
| Material Weakness | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
| IRS – Unpaid Tax Assessments | 1 | 0 | 0 | 0 | 0 | 1 |

| Effectiveness of Internal Control over Operations (FMFIA § 2) | | | | | | |
|---|---|---|---|---|---|---|
| Statement of Assurance | Qualified | | | | | |
| Material Weaknesses | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
| IRS – Computer Security | 1 | 0 | 1 | 0 | 0 | 0 |
| Fiscal Service – Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements | 1 | 0 | 0 | 0 | 0 | 1 |
| Total Material Weaknesses (FMFIA § 2) | 3 | 0 | 1 | 0 | 0 | 2 |

| Conformance with Financial Management System Requirements (FMFIA § 4) | | | | | | |
|---|---|---|---|---|---|---|
| Statement of Assurance | Systems conform to financial management system requirements | | | | | |
| Material Weaknesses | Beginning Balance | New | Resolved | Consolidated | Reassessed | Ending Balance |
| Total Non-conformances | 0 | 0 | 0 | 0 | 0 | 0 |

| Compliance with Federal Financial Management Improvement Act (FFMIA) | | |
|---|---|---|
| | Agency | Auditor |
| Noncompliance noted | Noncompliance noted | Noncompliance noted |
| 1. System Requirements | Noncompliance noted | |
| 2. Accounting Standards | Noncompliance noted | |
| 3. USSGL at the Transaction Level | No noncompliance noted | |

# SECTION E: IPIA (AS AMENDED BY IPERA)

On July 22, 2010, President Obama signed into law the *Improper Payments Elimination and Recovery Act* (IPERA, Pub. L. 111-204). IPERA amends the *Improper Payments Information Act* (IPIA), generally repeals the *Recovery Auditing Act*, and significantly increases agency payment recapture efforts by expanding the types of payments to be reviewed and lowering the dollar threshold of annual payments that requires agencies to conduct payment recapture audit programs. Agencies continue to be required to review their programs and activities periodically to identify those susceptible to significant improper payments. OMB Circular No. A-123, *Management's Responsibility for Internal Control,* Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments* (A-123, Appendix C), amended April 14, 2011, defines "significant improper payments" as gross annual improper payments in a program exceeding both the threshold of 2.5 percent and $10 million of total program outlays or $100 million regardless of the improper payment percentage. A-123, Appendix C, also requires agencies with programs susceptible to significant improper payments to implement corrective action plans that include improper payment root cause identification, reduction targets, and accountable officials.

Section 2(B) of IPERA allows the development of an alternative approach for meeting the requirements for obtaining a statistically valid estimate of the annual amount of improper payments for federal programs that are so complex that developing an annual error rate is not feasible. Agencies may establish an annual estimate for a high-risk component of a complex program (e.g., a specific program population) with OMB approval. Agencies must also perform trend analyses to update the program's baseline error rate in the interim years between detailed program studies. When development of a statistically valid error rate is possible, the reduction targets are revised and become the basis for future trend analyses.

On January 10, 2013, the President signed into law, the Improper Payments Elimination and Recovery Improvement Act of 2012 (IPERIA; Pub. L. 112-248), which also amends IPIA. It is important to note that Section 5 of IPERIA, regarding the *Do Not Pay Initiative*, is treated separately from Circular No. A-136 reporting requirements.

## I. RISK ASSESSMENT

Each year, the Department develops a comprehensive inventory of the funding sources for all programs and activities and distributes it to the Treasury bureaus and offices. The bureaus and offices must perform risk assessments at the payment type level (e.g., payroll, contracts, vendors, travel, etc.). The Department's risk assessment process follows the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control Integrated Framework. The framework includes:

1. Internal Control Environment
2. Risk Assessment
3. Internal Control Activities
4. Information and Communication
5. Monitoring

The factors considered in the determination of risk levels include:

**Operating Environment** – Existence of factors which necessitate or allow for loosening of financial controls; any known instances of fraud

**Payment Processing Controls** – Management's implementation of internal controls over payment processes including existence of current documentation, the assessment of design and operating effectiveness of internal controls over payments, the identification of deficiencies related to payment processes, and whether or not effective compensating controls are present

**Internal Monitoring Activities** – Periodic internal program reviews to determine if payments are made properly; strength of documentation requirements and standards to support testing of design and operating effectiveness for key payment controls

**Human Capital** – Experience, training, and size of payment staff; ability of staff to handle peak payment requirements; level of management oversight, and monitoring against fraudulent activity

Prior to the enactment of the IPERA changes to IPIA, Treasury maintained and performed a robust improper payment risk assessment process in which the new IPERA payment types were included. During fiscal year 2013, Treasury continued the use of its robust assessment process.

For those payment types resulting in high-risk assessments that comprise at least 2.5 percent and $10 million in total program outlays or $100 million at any rate, (1) statistical sampling must be performed to determine the actual improper payment rate, and (2) a corrective action plan must be developed and submitted to the Department and OMB for approval. Responses to the risk assessments produce a score that falls into pre-determined categories of risk. The following table describes the actions required at each risk level:

| Risk Level | Required Action(s) |
|---|---|
| High Risk > 2.5% Error Rate & > $10 Million or $100,000,000 at any error rate | Corrective Action Plan |
| Medium Risk | Review Payment Controls for Improvement |
| Low Risk | No Further Action Required |

The risk assessments performed across the Department in fiscal year 2013 resulted in all programs and activities being of low or medium risk susceptibility for improper payments, except for the IRS's Earned Income Tax Credit (EITC) program. The EITC's high-risk status is well-documented, having been identified previously in the former Section 57 of OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, and has been deemed by OMB a complex program for the purposes of the IPIA. OMB's guidance requires additional reporting on programs deemed high-risk; that information, for the EITC program only, follows.

## II. Statistical Sampling

### EITC Program

This section describes how the IRS currently develops its erroneous payment projections for the EITC.

The EITC is a refundable federal tax credit that offsets income taxes owed by low-income workers and, if the credit exceeds the amount of taxes owed, provides a lump-sum refund to those who qualify. The most recent projection is based on a tax year 2009 reporting compliance study that estimated the level of improper overclaims for fiscal year 2013 to range between $13.3 to $15.6 billion and 22.1 percent (lower bound) to 25.9 percent (upper bound) of approximately $60.3 billion in total program payments.

The complexity of the EITC program, the nature of tax processing, and the expense of compliance studies preclude statistical sampling on an annual basis to develop error rates for comparison to reduction targets. The estimates are based primarily on information from the IRS's National Research Program (NRP) reporting compliance study of individual income tax returns for tax year 2009—the most recent year for which compliance information from a statistically valid, random sample of individual tax returns is available.

Under the tax year 2009 NRP reporting compliance study, which reviewed individual income tax returns filed during calendar year 2010 for tax year 2009, approximately 2,400 of the returns in the regular NRP sample were EITC claimants randomly selected for examination.

The IRS National Research Program (NRP) conducts annual studies on the reporting compliance of Form 1040 taxpayers. Imbedded in these annual studies is a sample of EITC claimants large enough to estimate the improper payment percentage with plus or minus 2.5 percent precision and 90 percent confidence. This is the data source used to estimate the absolute amount of EITC overclaims and underpayments. EITC overclaims are defined as the difference between the EITC amount claimed by the taxpayer on his or her return and the amount the taxpayer should have claimed, as determined by the NRP examination. EITC underpayments are defined as the amount of EITC disallowed by the IRS in processing that should have been allowed, as determined by the NRP examination. For tax year 2009 (the most recent data available), the absolute overclaim and underpayment amount is estimated to be $16.3 billion. This year is the first year in which the estimate includes underpayments in the improper payment calculation. The underpayments increase the overall improper payment rate by less than 0.05 percent.

The IRS also uses the NRP sample to estimate the total amount of EITC claims. The amount of the taxpayers' original claims is captured during data processing. Rather than try to edit the entire population of claimants, the IRS chose to use the NRP sample, edit those returns and use them to estimate the total amount of claims. For tax year 2009, approximately $58.8 billion was claimed for EITC.

The improper payments estimates for fiscal year 2013 through fiscal year 2016 were developed by multiplying the improper payment rate estimated from the fiscal year 2009 NRP data by total estimated EITC claims for the corresponding fiscal year. It is assumed that the NRP-based tax year 2009 improper payments rate is applicable for each of these years

To obtain projections of total EITC claims, upward adjustments were made to estimates of EITC tax expenditures and outlays in the fiscal year 2014 federal budget; this was done for two types of adjustments. The first adjustment reflects that these amounts likely understate the amount of EITC initially claimed on filed tax returns. This is because some of the original claims are never actually disbursed to taxpayers, being disallowed through math-error processing or revenue protected by pre-refund examinations, although these are offset to some extent by new EITC claims made

on amended returns. The relationship between estimates of EITC claims and estimates of expenditures and outlays in prior years was used to determine the appropriate adjustment factor.

The second adjustment reflects that projected EITC claims published in the fiscal year 2014 budget assumed the third child EITC provisions would expire after tax year 2012. With the passage of the American Taxpayer Relief Act of 2012, the third child EITC provisions were extended through tax year 2017. The adjustments made to the fiscal year 2014 budget are based on prior year increases in total EITC claims resulting from the third child EITC provisions.

The final step of estimating EITC improper payments for fiscal year 2013 involves multiplying the improper payment rate by the estimate of total claims for that year. This yields the estimate for EITC improper payments for fiscal year 2013 shown in the table. In order to provide projections through fiscal year 2016, the same improper payment rate is applied to future year projections of total claims.

## III. Corrective Actions

This section describes the ongoing and planned corrective actions to reduce the improper payment rate for Treasury's only high-risk susceptible program, the EITC.

### Root Causes

The root causes of EITC improper payments are from the following sources:

**Authentication** – It is estimated that 70 percent or $10.15 billion in improper payments are from authentication errors. They include errors associated with the inability to authenticate qualifying child eligibility requirements, mainly relationship and residency requirements, filing status, when married couples file as single or head of household, and eligibility in nontraditional and complex living situations. Authentication is completed on a portion of this error category during pre-refund examinations.

**Verification** – It is estimated that 30 percent or $4.35 billion in improper payments are from verification errors. These errors relate to improper income reporting which allows claimants to fall within the EITC income limitations and qualify for EITC. The errors include both underreporting and overreporting of income by both wage earners and taxpayers who report that they are self-employed.

Income reported through information returns such as Forms W-2, Forms 1099, etc, which can be used for verification of some income, becomes available only after tax returns are processed. Under law, the IRS must process income tax returns within 45 days of receipt or pay interest to taxpayers.

### Base Program

In 2013, the IRS prevented approximately $4 billion of EITC from being paid in error. The prevention activity primarily focused on three areas:

- **Examinations** – IRS identifies tax returns for examination and holds the EITC portion of the refund until an audit can be conducted. This is the only ongoing IRS audit program where exams are conducted before a refund is released. The examination closures and enforcement revenue protected in the charts below do not include test initiatives

- **Math Error** – Refers to an automated process in which the IRS identifies math or other irregularities and automatically prepares an adjusted return for a taxpayer. Legislation is required for each specific type of math error

- **Document Matching** – Involves comparing income information provided by the taxpayer with matching information (e.g., W-2s, 1099s) from employers and other third parties to identify discrepancies

The chart below shows significant results from fiscal year 2008 through an estimate of fiscal year 2014. In fiscal year 2013 alone, the IRS conducted an estimated 483,000 EITC-related examinations, issued approximately 240,000 math error notices, and closed nearly 907,000 document matching reviews.

**Compliance Activities**

| | FY08 | FY09 | FY10 | FY11 | FY12* | FY13** | FY14*** | FY08-FY14 Total |
|---|---|---|---|---|---|---|---|---|
| Examination Closures | 503,755 | 508,180 | 473,999 | 483,574 | 487,408 | 483,139 | 483,000 | 3,423,055 |
| Math Error Notices | 432,797 | 355,416 | 341,824 | 293,450 | 270,492 | 240,000 | 210,000 | 2,143,979 |
| Document Matching | 727,916 | 688,087 | 904,920 | 1,178,129 | 985,172 | 906,994 | 907,000 | 6,298,218 |
| Amended Returns[1] | 32,473 | 25,395 | 19,347 | 14,317 | 13,284 | 8,129 | 8,000 | 120,945 |

* Restated actual.

** Preliminary estimates.

*** Estimate based on fiscal year 2013 preliminary data.

[1] Amended returns are a subset of Examination Closures.

These compliance activities had a significant effect. Treasury projects that continued enforcement efforts will protect a total of approximately $27 billion in revenue through fiscal year 2014, as shown below.

**Enforcement Revenue Protected (Dollars in Billions)**

| | FY08 | FY09 | FY10 | FY11 | FY12* | FY13** | FY14*** | FY08-FY14 Total |
|---|---|---|---|---|---|---|---|---|
| Examination Closures | $ 2.00 | $ 2.15 | $ 1.97 | $ 2.04 | $ 2.05 | $ 2.11 | $ 2.00 | $ 14.32 |
| Math Error Notices | $ 0.44 | $ 0.40 | $ 0.41 | $ 0.35 | $ 0.31 | $ 0.28 | $ 0.24 | $ 2.43 |
| Document Matching | $ 1.23 | $ 1.17 | $ 1.43 | $ 1.32 | $ 1.55 | $ 1.42 | $ 1.42 | $ 9.54 |
| Amended Returns | $ 0.07 | $ 0.07 | $ 0.06 | $ 0.04 | $ 0.04 | $ .03 | $ 0.03 | $ 0.34 |
| TOTAL | $ 3.74 | $ 3.79 | $ 3.87 | $ 3.75 | $ 3.95 | $ 3.84 | $ 3.69 | $ 26.63 |

* Restated actual.

** Preliminary estimates.

*** Estimate based on fiscal year 2013 preliminary data.

## Maximizing Current Business Processes

- Completed strategic studies to update the estimates of the two key EITC performance measures, participation rate and error rate, which comply with the Government Performance and Results Act of 1993. Delivered estimates of EITC participation for tax year 2010, using a Census-IRS match. IRS also completed a new error rate estimate based on the EITC component of the tax year 2009 National Research Plan (NRP) study that meets IPIA standards for measuring and reporting on improper payments. This year is the first year in which the estimate includes underpayments in the improper payment calculation, although its effect was not significant.

- As part of the fiscal year 2013 EITC Return Preparer Strategy, the IRS completed activities associated with a traditional suite of EITC paid preparer treatments, selected from a risk-based model, and activities associated with an expanded pilot that used real-time data to assess EITC preparer risk and test progressive sets of treatments.

- As part of the traditional suite of treatments, IRS completed 540 pre-filing season due diligence visits (DDVs) reflecting a continuing high penalty rate of 86 percent and over $14.9 million in proposed penalties. Revenue and criminal investigation agents completed 109 Knock and Talk (KTV) educational visits. IRS proposed penalties of over $200 thousand on 27 DDVs completed as a follow-up for those preparers who received pre-filing season KTVs, but did not improve their due diligence. Almost 3,000 educational notices were mailed before the filing season as well. Additionally, the IRS obtained four civil injunctions protecting revenue of $15.4 million.

- In the second year of the real-time return preparer pilot, the IRS expanded the number of non-compliant preparers treated to almost 7,000 and tested progressive combinations of treatments that included pre-filing season letters and client return audits and filing season letters, phone calls, client return audits, and DDVs. The 300 real-time DDVs closed with a penalty rate of 81 percent and almost $2.9 million in penalties.

- The preliminary analysis of the fiscal year 2013 EITC Preparer Strategy revealed that in addition to the penalties and injunction revenue protected above, the treatments protected over half a billion dollars (EITC and Child Tax Credit). The analysis showed that low cost treatments do have an impact on non-compliant return preparers. The low cost letters have a high return on investment and alone protected an estimated $408.5 million.

- As a result of IRS's collaboration with software developers, most companies did program their tax year 2012 professional software to automatically transmit Form 8867. As a result, IRS received far less than one percent of paid preparer electronic returns without the required form attached.

## IV. Improper Payments Reporting

The following table provides the improper payment reduction outlook for Treasury's only high risk susceptible program, the EITC:

**Improper Payment (IP) Reduction Outlook**
**(Dollars in Billions)**

| Program | 2012 Outlays | 2012 IP% | 2012IP$ | 2013 Outlays | 2013 IP% | 2013 IP$ | 2014 Est. Outlays | 2014 IP% | 2014 IP$ | 2015 Est. Outlays | 2015 IP% | 2015 IP$ | 2016 Est. Outlays | 2016 IP% | 2016 IP$ |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| EITC Upper Bound Estimate | $55.4 | 24.6% | $13.6 | $60.3 | 25.9% | $15.6 | $58.3 | 25.9% | $15.1 | $60.0 | 25.9% | $15.6 | $61.1 | 25.9% | $15.9 |
| EITC Lower Bound Estimate | $55.4 | 21.0% | $11.6 | $60.3 | 22.1% | $13.3 | $58.3 | 22.1% | $12.9 | $60.0 | 22.1% | $13.3 | $61.1 | 22.1% | $13.5 |

The term "Outlays" equals "Estimated Claims."

Estimated Claims: Estimated total claims for the EITC are based on projections of EITC tax expenditures plus outlays as estimated by the Office of Tax Analysis within the Department of the Treasury, adjusted to account for the difference between taxpayer claims and accounts received by taxpayers due to return processing and enforcement.

IP % and IP $: These estimates follow the prior approach which provided a range for the error rate (%) and improper payments amounts ($).

## V. Recapture of Improper Payments Reporting

In accordance with IPERA and OMB Circular No. A-123, Appendix C, Treasury performs and reports annually on its payment recapture program. In fiscal year 2011, Treasury incorporated the IPERA amendments into the existing Treasury payment recapture (recovery audit) program, and continued to address them in fiscal years 2012 and 2013. Prior to the enactment of the IPERA changes to IPIA, Treasury maintained and performed a robust improper payment risk assessment process which already included the new IPERA payment types.

During fiscal year 2013, Treasury issued contracts and other reviewed payments totaling approximately $11 billion. The amended act expanded the payment types reviewed beyond just contracts to include grants, benefits, loans, and miscellaneous payments.

Treasury's annual risk assessment process includes a review of pre-payment controls that minimize the likelihood and occurrence of improper payments. Treasury requires each bureau and office to conduct post-award audits and report on payment recapture activities, contracts issued, improper payments made, and recoveries achieved. Bureaus and offices may use payment recapture audit contingency firms to perform many of the steps in their payment recapture auditing program and identify candidates for payment recapture action. However, no Treasury bureaus used contractors to perform recapture activities for fiscal year 2013. Treasury employees performed this work.

Treasury considers both pre- and post-reviews to identify payment errors a sound management practice that should be included among basic payment controls. All Treasury bureaus have a process in place to identify improper payments during pre- and post-reviews. At times, bureaus may use the results of IG and GAO reviews to help identify payment anomalies and

target areas for improvement. However, Treasury applies extensive payment controls at the time each payment is processed, making recapture activity minimal.

**Payment Recapture Audit Reporting**

| Type of Payment | Amount Subject to Review for 2013 Reporting | Actual Amount Reviewed and Reported (2013) | Amount Identified for Recovery (2013) | Amount Recovered (2013) | % of Amount Recovered out of Amount Identified (2013) | Amount Outstanding (2013) | % of Amount Outstanding out of Amount Identified (2013) |
|---|---|---|---|---|---|---|---|
| Contracts | $7,289,700,639 | $ 7,114,265,877 | $ 1,285,978 | $ 1,205,728 | 93.8 | $ 80,250 | 6.2 |
| Grants | $ 87,160,667 | $ 87,160,667 | $ 17,814,845 | $ 16,361,039 | 91.8 | $ 1,453,806 | 8.2 |
| Benefits | $ 651,558,439 | $ 4,654,814 | $ 1,081,184 | $ 1,075,563 | 99.4 | $ 5,621 | 0.5 |
| Loans | $ 0 | $ 0 | $ 0 | $ 0 | 0 | $ 0 | 0 |
| Other | $3,978,608,796 | $ 3,961,793,673 | $ 143,048 | $ 110,692 | 77.3 | $ 31,438 | 22.0 |

| Type of Payment | Amount Determined Not to be Collectable (2013) | % of Amount Determined Not to be Collectable out of Amount Identified (2013) | Amounts Identified for Recovery (2004-2012) | Amounts Recovered (2004-2012) | Cumulative Amounts Identified for Recovery (2004-2013) | Cumulative Amounts Recovered (2004-2013) | Cumulative Amounts Outstanding (2004-2013) | Cumulative Amounts Determined Not to be Collectable (2004-2013) |
|---|---|---|---|---|---|---|---|---|
| Contracts | $ 0 | 0 | $ 7,967,748 | $ 6,653,882 | $ 9,253,726 | $ 7,859,610 | $ 81,550 | $ 75,130 |
| Grants | $ 0 | 0 | $ 917,316 | $ 917,316 | $ 18,732,161 | $ 17,278,355 | $ 1,453,806 | $ 0 |
| Benefits | $ 0 | 0 | $ 14,968 | $ 1,438 | $ 1,669,073 | $ 1,132,587 | $ 286,409 | $ 248,706* |
| Loans | $ 0 | 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Other | $ 918 | 0.7 | $ 2,999,477 | $ 2,885,738 | $ 3,142,525 | $ 2,999,430 | $ 38,490 | $ 1,603 |

*This amount includes a prior year amount of $248,706. This amount represents annuitant benefit balances determined to be uncollectible by the Department of Justice.

During fiscal year 2013, Treasury determined that conducting a Payment Recapture Audit on the following five programs would not be cost-effective:

- Fiscal Service Debt Activity Programs
- Treasury Management Accounts
- Treasury Executive Office for Asset Forfeiture
- Departmental Offices International Financial Institutions – International Assistance Programs
- Federal Financing Bank

The Fiscal Service Debt Activity Programs continued to reflect a low level of risk in every group and payment type in fiscal year 2013.

Disbursements from the Fiscal Service - Treasury Managed Accounts are based on public law, adjudications, or payment certifications from federal agencies. Payments are made via the Fiscal Service Secure Payment System.

The Treasury Executive Office for Asset Forfeiture's program payments to state and local law enforcement agencies are intergovernmental payments that represent a low risk of improper payment. In addition, the Treasury Executive Office of Asset Forfeiture staff reviews payments monthly for accuracy.

The Departmental Offices International Financial Institutions non-federal payments to the Multilateral Development Banks are submitted by either a voucher on a letter of credit administered by the Federal Reserve Bank of New York or through direct cash payments via the Fiscal Service Secure Payment System. These payments present a low level of improper payment risk based on the number of payments annually and the quality of third party controls.

The FFB has an interagency agreement with the General Services Agency (GSA) to provide acquisition support. Invoices are paid through GSA's ITSS platform and are reviewed prior to payment by the task order COR. Contractor payments are paid through the GSA via the Intra-Governmental Payment and Collection Systems. The FFB's lone contractor bills the FFB once a month. The effort required in performing this review would be significantly disproportionate to the low volume of invoices associated with a single vendor.

Based on the justifications submitted by the five Treasury entities, payment recapture audits for these programs were not deemed cost effective.

## Payment Recapture Audit Targets

The payment recapture audit targets listed below are preliminary estimates developed by Treasury bureaus and offices based on historical performance and current payment recapture audit programs.

| Type of Payment | 2013 Amount Identified | 2013 Amount Recovered | 2013 Recovery Rate (%) (Amount Recovered / Amount Identified) | 2014 Recovery Rate (%) Target | 2015 Recovery Rate (%) Target | 2016 Recovery Rate (%) Target |
|---|---|---|---|---|---|---|
| Contracts | $ 1,285,978 | $ 1,205,728 | 93.8 | 85 | 85 | 85 |
| Grants | $ 17,814,845 | $ 16,361,039 | 91.8 | 85 | 85 | 85 |
| Benefits | $ 1,081,184 | $ 1,075,563 | 99.4 | 85 | 85 | 85 |
| Loans | $ 0 | $ 0 | 0 | 85 | 85 | 85 |
| Other | $ 143,048 | $ 110,692 | 77.3 | 85 | 85 | 85 |

**Aging of Outstanding Overpayments**

| Type of Payment | CY* Amount Outstanding (0-6 months) | CY Amount Outstanding (6 months – 1 year) | CY Amount Outstanding (Over 1 year) |
|---|---|---|---|
| Contracts | $ 80,250 | $ 0 | $ 1,300 |
| Grants | $ 1,453,806 | $ 0 | $ 0 |
| Benefits | $ 5,621 | $ 0 | $ 280,788 |
| Loans | $ 0 | $ 0 | $ 0 |
| Other | $ 31,437 | $ 0 | $ 7,052 |

*CY = Current Year

**Disposition of Recaptured Funds**

| Type of Payment | Agency Expenses to Administer the Program | Payment Recapture Auditor Fees | Financial Management Improvement Activities | Original Purpose | Office of the Inspector General | Returned to Treasury |
|---|---|---|---|---|---|---|
| Contracts | $ 62,761 | $ 0 | $ 0 | $ 1,137,168 | $ 0 | $ 6,152 |
| Grants | $ 0 | $ 0 | $ 0 | $ 17,492,189 | $ 0 | $ 0 |
| Benefits | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Loans | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Other | $ 9,395 | $ 0 | $ 0 | $ 106,179 | $ 0 | $ 0 |

**Overpayments Recaptured Outside of Payment Recapture Audit**

| Source of Recovery | Amount Identified CY | Amount Recovered CY | Amount Identified PY* | Amount Recovered PY | Cumulative Amount Identified (CY + PY) | Cumulative Amount Recovered (CY+PY) |
|---|---|---|---|---|---|---|
| Statistical Samples | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Post Payment Reviews or Audits | $ 84,305 | $ 84,305 | $ 112 | $ 112 | $ 84,417 | $ 84,417 |
| OIG Reviews | $ 1,089 | $ 0 | $ 8 | $ 8 | $ 7,331 | $ 3,121 |
| Single Audit Reports | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 | $ 0 |
| Self-Reported | $ 0 | $ 0 | $ 2,896,776 | $ 2,896,776 | $ 2,896,776 | $ 2,896,776 |
| Reports from Public | $ 40,045,280 | $ 40,044,803 | $ 155,484 | $ 149,402 | $ 40,200,764 | $ 40,194,205 |

*PY = Prior Year

## VI. Accountability

The Secretary of the Treasury has delegated responsibility for addressing improper payments to the Assistant Secretary for Management (ASM). Improper payments fall under the Department's management and internal control program. A major component of the internal control program is risk assessments, which are an extension of each bureau's annual improper payment elimination and recovery review process, as required under A-123, Appendix C. Under Treasury Directive 40-04, *Treasury Internal (Management) Control Program*, executives and other managers are required to have management control responsibilities as part of their annual performance plans. With oversight mechanisms such as the Treasury CFO Council and the IRS's Financial and Management Controls Executive Steering Committee, managerial responsibility and accountability in all management and internal control areas are visible and well-documented. Treasury has identified executives who are responsible and accountable for reducing the level of EITC overclaims, while other senior and mid-level officials have responsibility for monitoring progress in this area as bureau and program internal control officers.

## VII. Information Systems and other Infrastructure

Overall, Treasury has the internal controls, human capital, and information systems and other infrastructure it needs to reduce improper payments to the targeted levels.

## VIII. Limiting Statutory and Regulatory Barriers

A number of factors continue to serve as barriers to reducing overclaims in the EITC program. These include:

- Complexity of the tax law (including the need for Congressional authorization of math error authority)
- Structure of the EITC
- Confusion among eligible claimants
- High turnover of eligible claimants
- Unscrupulous return preparers
- Fraud

No one of these factors can be considered the primary driver of program error. Furthermore, the interaction among the factors makes addressing the credit's erroneous claims rate, while balancing the need to ensure the credit makes its way to taxpayers who are eligible, extremely difficult.

Also, statutory requirements limit the IRS's ability to ensure that EITC claims are valid before they are paid. Since the EITC is administered through the Internal Revenue Code, it is claimed by taxpayers during the filing and processing of their tax returns. The Internal Revenue Code requires the IRS to process tax returns and pay any related tax refunds within 45 days of receipt of the tax return or the tax return due date, whichever is later. Because of this requirement, the IRS cannot conduct extensive eligibility checks similar to those that occur with other federal programs that typically certify eligibility prior to the issuance of payments or benefits.

## IX. Additional Comments

In fiscal year 2013, the OIG issued Report Number OIG-13-034, *Treasury was Not in Compliance with IPERA for Fiscal Year 2012*, which covered the IPERA program as presented in Treasury's fiscal year 2012 Agency Financial Report. During fiscal year 2013, the Department continued to implement corrective actions to address the findings and recommendations in the OIG report.

# SECTION F: MATERIAL WEAKNESSES AND AUDIT FOLLOW-UP

This section provides detailed descriptions of Treasury's material weakness inventory, including summaries of actions taken and planned to resolve the weaknesses; tracking and follow-up activities related to Treasury's GAO, OIG, TIGTA, and SIGTARP audit inventory; an analysis of potential monetary benefits arising from audits performed by Treasury's three IGs; and an update on Treasury's financial management systems framework.

## I. Treasury's Material Weaknesses

Management may declare audit findings or internal situations as a material weakness whenever a condition exists that may jeopardize the Treasury mission or continued operations. The FMFIA requires agency reporting on material weaknesses.

### FMFIA and FFMIA

The FMFIA requires agencies to establish and maintain internal controls. The Secretary must evaluate and report annually on the operational and financial reporting controls (FMFIA Section 2) and financial systems (FMFIA Section 4 and FFMIA) that protect the integrity of federal programs. The requirements of the FMFIA serve as an umbrella under which other reviews, evaluations, and audits should be coordinated and considered to support management's assertion about the effectiveness of internal control over operations, financial reporting, and compliance with laws and regulations.

As of September 30, 2013, Treasury had two material weaknesses under Section 2 of the FMFIA, summarized as follows:

| Summary of FMFIA Material Weaknesses | Section 2 | Section 4 | Total |
|---|---|---|---|
| Balance at the Beginning of Fiscal Year 2013 | 3 | 0 | 3 |
| Closures/Downgrades during Fiscal Year 2013 | 1 | 0 | 1 |
| Reassessed during Fiscal Year 2013 | 0 | 0 | 0 |
| New Material Weakness Declared during Fiscal Year 2013 | 0 | 0 | 0 |
| Balance at the End of Fiscal Year 2013 | 2 | 0 | 2 |

Below are detailed descriptions of Treasury's two material weaknesses:

| Material Weakness Description | |
|---|---|
| Internal Revenue Service – Unpaid Tax Assessments<br><br>The IRS needs to improve its internal control over Unpaid Assessments. Original key elements:<br>• Subsidiary ledger does not track and report one Trust Fund Recovery Penalty (TFRP) balance<br>• Untimely posting of TFRP assessments and untimely review of TFRP accounts<br>• General ledger cannot accurately report the Taxes Receivable balance without a statistical estimation process | |
| **Actions Completed in FY 2013** | **What Remains to be Done** |
| ✓ Evaluated contractor recommendations and determined that changes to the estimation process are not needed<br>✓ Completed the fiscal year 2012 "After the Audit" report and issued the results to the Business Owners for follow-up and corrective action<br>✓ Performed a "look back" analysis on fiscal year 2010 and determined that sampled items were accurate. The analysis was completed to ensure business rules and methodology were current and accurate.<br>✓ Partnered with the Business Owners to verify that IRS management is performing continuous monitoring to ensure data input to Integrated Data Retrieval System (IDRS) is accurate<br>✓ Determined process improvement for entering data into IDRS to decrease errors posting to Master File and CADE 2, including the feasibility of changes to the IDRS system. Based on the analysis, process improvements will be incorporated into CADE2 requirements which will decrease errors posting in CADE2.<br>✓ Programmed Custodial Detail Database (CDDB) to accurately report on single Business Master File (BMF) modules with a partial collection statute-expired assessment.<br>✓ Verified that the CDDB program changes achieved the expected results. Implemented program changes for the fiscal year 2013 audit, as appropriate. CFO verified that the CDDB programming changes accurately report on single BMF modules with a partial collection statute-expired assessment met the desired results. These changes will enable CDDB to classify the cases when the BMF modules have no additional freezes and complex transactions are not in the module. The programming changes were successfully tested and implemented. | ☐ Automated Trust Fund Recovery (ATFR) JAVA Conversion – move processing of transcripts for performing payment cross-referencing from PowerBuilder to JAVA to improve accuracy of assessments and timeliness in crediting payments<br>☐ Complete the fiscal year 2013 "After the Audit" report and issue the results to the Business Owners for follow-up and corrective actions<br>☐ Follow-up with the business owners as to the results of the "After the Audit" report findings and issue responses for corrective actions<br>☐ Develop milestones for leveraging funded CADE 2 TS2 functionality and determine a date the plan will be completed and add to the Remediation Plan to address the Unpaid Assessment Material Weakness.<br>☐ Targeted Downgrade/Closure: Fiscal year 2015 |

| Material Weakness Description | |
|---|---|
| Bureau of the Fiscal Service – Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements<br><br>The government does not have adequate systems, controls, and procedures to properly prepare the Consolidated Government-wide Financial Statements. Original key elements:<br>• The government lacks a process to obtain information to effectively reconcile the reported excess of net costs over revenue with the budget deficit, and when applicable, a reported excess of revenue over net costs with the budget surplus<br>• Weaknesses in financial reporting procedures in internal control over the process for preparing the Consolidated Financial Statements | |
| **Actions Completed in FY 2013** | **What Remains to be Done** |
| ✓ Partially reconciled fiscal year 2012 operating revenues with budget receipts<br>✓ Refined analysis model for unreconciled transactions that affect the change in net position<br>✓ Accounted for intra-governmental differences through formal consolidating and elimination accounting entries using all reciprocal fund categories including the General Fund<br>✓ Completed closing package submitted to GAO by federal agencies<br>✓ Established traceability from agency footnotes to the Consolidated Financial Statements (CFS) for completeness | ☐ Complete reconciliation of operating net cost to the budget deficit<br>☐ Complete reciprocal category for the Treasury General Fund<br>☐ Implement changes to capture material balances and activity from the Reporting Entity as defined per the Financial Accounting Standards Advisory Board criteria<br>☐ Include all disclosures as appropriate<br>☐ Include all loss contingencies as appropriate<br>☐ Targeted Downgrade/Closure: Fiscal year 2015 |

## II. Audit Follow-up Activities

During fiscal year 2013, Treasury continued to place emphasis on both the general administration of internal control issues throughout the Department and the timely resolution of findings and recommendations identified by GAO, OIG, TIGTA, SIGTARP, external auditors, and management. During the year, Treasury continued to implement enhancements to the tracking system called the "Joint Audit Management Enterprise System" (JAMES). JAMES is a Department-wide, interactive, web-based system accessible to management, OIG, TIGTA, SIGTARP, and others. The system tracks information on audit reports from issuance through completion of all corrective actions required to address findings and recommendations contained in an audit report. JAMES is the official system of record for Treasury's audit follow-up program.

### Potential Monetary Benefits

The *Inspector General Act of* 1978, as amended, Public Law 95-452, requires the IGs and secretaries of executive agencies and departments to submit semiannual reports to the Congress on actions taken on audit reports issued that identify potential monetary benefits. The Department consolidates and analyzes all relevant information for inclusion in this report. The information contained in this section represents a consolidation of information provided separately by OIG, TIGTA, SIGTARP, and Treasury management.

In the course of their audits, the IGs periodically identify "questioned costs", recommend that funds be put to better use, enhancements to revenues of the federal government, and identify measures that demonstrate the value of audit recommendations to tax administration and business operations.

"Questioned costs" include a:

- Cost that is questioned because of an alleged violation of a provision of a law, regulation, contract, or other requirement governing the expenditure of funds
- Finding, at the time of the audit, that such costs are not supported by adequate documentation (i.e., an unsupported cost)
- Finding that expenditure of funds for the intended purpose is unnecessary or unreasonable

The phrase "disallowed cost" means a questioned cost that management, in a management decision, has sustained or agreed should not be charged to the U.S. Government.

"Funds Put to Better Use" include:

- Reductions in outlays
- Deobligation of funds from programs or operations
- Costs not incurred by implementing recommended improvements related to operations
- Avoidance of unnecessary expenditures noted in pre-award reviews of contract agreements
- Prevention of erroneous payment of refundable credits (e.g., the Earned Income Tax Credit)
- Any other savings that are specifically identified

"Revenue Enhancements" include opportunities to increase revenue to the federal government.

The Department regularly reviews progress made by the bureaus to realize potential monetary benefits identified in audit reports, and coordinates with the auditors as necessary to ensure the consistency and integrity of information on monetary benefit recommendations tracked in JAMES.

The statistical data in the following summary tables represent audit report activity for the period from October 1, 2012 through September 30, 2013. The data reflect information on OIG, TIGTA, and SIGTARP reports that identified potential monetary benefits.

**Audit Report Activity With Potential Monetary Benefits for Which Management Has Identified Corrective Actions (OIG, TIGTA, and SIGTARP) October 1, 2012 through September 30, 2013**
**(Dollars in Millions)**

| | Disallowed Costs | | Funds Put to Better Use | | Revenue Enhancements | | Totals | |
|---|---|---|---|---|---|---|---|---|
| | Reports | Dollars | Reports | Dollars | Reports | Dollars | Report Total | Total Dollars |
| Beginning Balance | **14** | **$80.1** | **11** | **$9,299.7** | **8** | **$2,047.6** | **33** | **$11,427.4** |
| New Reports | 8 | 32.0 | 11 | 5,899.0 | 10 | 9,234.4 | 29 | 15,165.4 |
| Total | 22 | 112.1 | 22 | 15,198.7 | 18 | 11,282.0 | 62 | 26,592.8 |
| Reports Closed | 11 | 64.2 | 16 | 9,310.3 | 8 | 2,048.3 | 35 | 11,422.8 |
| a. Realized or Actual[1] | 10 | 31.7 | 7 | 18.1 | 2 | 55.6 | 19 | 105.4 |
| b. Unrealized or Written off[1] | 3 | 32.5[2] | 10 | 9,292.2[3] | 7 | 1,992.7[4] | 20 | 11,317.4 |
| **Ending Balance** | **11** | **$47.9** | **6** | **$5,888.4** | **10** | **$9,233.7** | **27** | **$15,170.0** |

[1] *Report numbers in categories a and b may not equal the Reports Closed. One report can be included in one or both categories.*

[2] *This figure includes one TIGTA report, with $32.4 million written off, for which TIGTA does not agree with the IRS that the benefit has not been realized.*

[3] *This figure includes six TIGTA reports, with $7.1 billion written off, for which IRS management did not concur with TIGTA's projected benefits; and six TIGTA reports with $869.3 million written off, for which TIGTA does not agree with the IRS that the benefits have not been realized. There are two reports that have monetary benefits that fall into both categories which is why the total of the reports exceed the total reports written off.*

[4] *This figure includes three TIGTA reports, with $1.8 billion written off, for which IRS management did not concur with TIGTA's projected benefits or recommendation; and one TIGTA report, with $44.9 million written off, for which TIGTA does not agree with the IRS that the benefit has not been realized.*

The following table presents a summary of OIG, TIGTA, and SIGTARP audit reports with potential monetary benefits that were open for more than one year as of the end of fiscal years 2011, 2012, and 2013.

**Number of Reports with Potential Monetary Benefits Open for More than One Year**
**(Dollars In Millions)**

| | AFR Report Year | 9/30/2011 | 9/30/2012 | 9/30/2013 |
|---|---|---|---|---|
| OIG | No. of Reports | 0 | 0 | 0 |
| | $ Projected Benefits | $ 0 | $0 | $0 |
| TIGTA | No. of Reports | 11 | 9 | 7 |
| | $ Projected Benefits | $ 4,384.6 | $10,018.5 | $39.2 |
| SIGTARP | No. of Reports | 0 | 2 | 2 |
| | $ Projected Benefits | $ 0 | $8.7 | $8.8 |

The following table presents a summary of the audit reports containing potential monetary benefits, broken out by year of report issuance, on which management decisions were made on or before September 30, 2012, but the final actions had not been taken as of September 30, 2013.

**Details of the Audit Reports with Potential Monetary Benefits**
**on Which Management Decisions Were Made On or Before September 30, 2012,**
**But Final Actions Have Not Been Taken as of September 30, 2013**
**(Dollars In Millions)**

| Bureau | Report No. | Report Issue Date | Brief Description | Dis-allowed Costs | Funds Put to Better Use | Revenue Enhance-ment | Total | Due Date |
|---|---|---|---|---|---|---|---|---|
| IRS | 2011-1c-080 | 8/23/2011 | The IRS should use the Defense Contract Audit Agency (DCAA) report in the administration of the contract and determine whether the questioned costs should be recovered. | 0.09 | - | - | 0.09 | 8/31/2016 |
| IRS | 2011-1c-122 | 9/28/2011 | The IRS should use the DCAA report in the administration of the contract and determine whether the questioned costs should be recovered. | 28.57 | - | - | 28.57 | 9/30/2016 |
| OFS | SIG-AR-11-003 | 4/14/2011 | OFS should review previously paid legal fee bills to identify unreasonable or unallowable charges, and seek reimbursement for | 0.68 | - | - | 0.68 | Delay due to Contracting 4/30/2014 |

| Bureau | Report No. | Report Issue Date | Brief Description | Dis-allowed Costs | Funds Put to Better Use | Revenue Enhance-ment | Total | Due Date |
|---|---|---|---|---|---|---|---|---|
| | | | those charges, as appropriate. | | | | | |
| OFS | SIG-AR-11-004 | 9/28/2011 | OFS should determine whether the questioned, unsupported legal fees and expenses paid to specified law firms are allowable | 8.07 | - | - | 8.07 | Delay due to Further Research/ Analysis of Data<br>11/10/2014 |
| **FY 2011** | **4** | | | **$37.41** | **$0** | **$0** | **$37.41** | |
| IRS | 2012-1c-003 | 12/02/2011 | The IRS should use the DCAA report in the administration of the contract and determine whether the questioned costs should be recovered | 0.02 | | | 0.02 | 12/02/2016 |
| IRS | 2012-1c-032 | 3/19/2012 | The IRS should use the DCAA report in the administration of the contract to determine whether the questioned costs should be recovered. | 7.42 | - | - | 7.42 | 3/31/2017 |
| IRS | 2012-1c-079 | 8/17/2012 | The IRS should use the DCAA report in administering and closing out contracts. | 1.48 | - | - | 1.48 | 8/07/2017 |
| IRS | 2012-11-101 | 9/19/2012 | The IRS should ensure the validity of all labor charges associated with the procurement TIGTA identified as having a total of $394,430 paid for labor charges that were not supported | 0.93 | - | - | 0.93 | 7/15/2014 |
| IRS | 2012-30-097 | 9/07/2012 | The IRS should develop and implement additional procedures to ensure that all audits entering the Campus Case Processing operation with short statute expiration dates and large dollar assessment amounts are timely and accurately assigned | - | - | 0.72 | 0.72 | Delay due to Further Research/ Analysis of Data<br>1/15/2014 |

| Bureau | Report No. | Report Issue Date | Brief Description | Dis-allowed Costs | Funds Put to Better Use | Revenue Enhance-ment | Total | Due Date |
|---|---|---|---|---|---|---|---|---|
| | | | and processed in accordance with applicable procedures. | | | | | |
| **FY 2012** | **5** | | | **$9.85** | **$0** | **$0.72** | **$10.57** | |
| **Total** | **9** | | | **$47.26** | **$0** | **$0.72** | **$47.98** | |

The following table provides a snapshot of OIG and TIGTA audit reports with significant recommendations reported in previous semiannual reports for which corrective actions had not been completed as of September 30, 2012 and September 30, 2013, respectively. OIG and TIGTA define "significant" as any recommendation open for more than one year. There were no "Undecided Audit Recommendations" during the same periods.

| Audit Reports with Significant Unimplemented Recommendations | | | | |
|---|---|---|---|---|
| | 9/30/2012 | | 9/30/2013 | |
| | OIG | TIGTA | OIG | TIGTA |
| No. of Reports | 5 | 17 | 6 | 25 |

The following table provides a snapshot of the number of recommendations made in SIGTARP audit reports and quarterly reports for which corrective actions had not been completed as of September 30, 2012 and September 30, 2013, respectively. SIGTARP defines a recommendation as "unimplemented" if it is listed as "partially implemented," "in process," or "not implemented" in SIGTARP's quarterly report.

| Unimplemented SIGTARP Recommendations | | |
|---|---|---|
| | 9/30/2012 | 9/30/2013 |
| No. of Unimplemented Recommendations | 25 | 15 |

# APPENDIX:
## GLOSSARY OF ACRONYMS

| Glossary of Acronyms | |
|---|---|
| **2D** | Two Dimension |
| **ABS** | Asset-Backed Securities |
| **ACA** | Affordable Care Act |
| **ACTC** | Additional Child Tax Credit |
| **ACH** | Automated Clearinghouse |
| **AFR** | Agency Financial Report |
| **AFTR** | Automated Trust Fund Recovery |
| **AGP** | Asset Guarantee Program |
| **AIFP** | Automotive Industry Financing Program |
| **AIG** | American International Group, Inc. |
| **AML** | Anti-Money Laundering |
| **AOTC** | American Opportunity Tax Credit |
| **AQC** | Automated Acquisition Credit |
| **ARC** | Administrative Resource Center |
| **ASM/CFO** | Assistant Secretary for Management & Chief Financial Officer |
| **ATFR** | Automated Trust Fund Recovery |
| **BEP** | Bureau of Engraving and Printing |
| **BMF** | Business Master File |
| **BOLO** | Be on the Lookout |
| **BPD** | Bureau of the Public Debt |
| **BSA** | Bank Secrecy Act |
| **CADE2** | Customer Account Data Engine |
| **CCU** | Campus Compliance Unit |
| **CDCI** | Community Development Capital Initiative |
| **CDDB** | Custodial Detail Database |
| **CDE** | Community Development Entity |
| **CDFI** | Community Development Financial Institutions |
| **CDLF** | Community Development Loan Fund |
| **CFIUS** | Committee on Foreign Investment in the United States |
| **CFO** | Chief Financial Officer |
| **CFOV** | CFO Vision Software |
| **CFS** | Consolidated Financial Statements |
| **CFT** | Counter-Terrorist Financing |
| **CGAC** | Common Government-wide Accounting Classification |
| **CHIPRA** | Children's Health Insurance Program Reauthorization Act of 2009 |
| **CIG** | Cyber Intelligence Group |
| **CIGFO** | Council of Inspectors General on Financial Oversight |
| **CIP** | Critical Infrastructure Protection |
| **CMBS** | Commercial Mortgage Backed Securities |
| **COLA** | Certificate of Label Approval |
| **COR** | Contracting Officers Representative |

| Glossary of Acronyms | |
|---|---|
| **COSO** | Committee of Sponsoring Organizations of the Treadway Commission |
| **COTS** | Commercial off-the-shelf |
| **CSRS** | Civil Service Retirement System |
| **CPI** | Consumer Price Index |
| **CPP** | Capital Purchase Program |
| **CRS** | Centralized Receivables Service |
| **CSI** | Customer Satisfaction Index |
| **CY** | Calendar Year |
| **DCAA** | Defense Contract Audit Agency |
| **DCFO** | Deputy Chief Financial Officer |
| **DCP** | Office of D.C. Pensions |
| **DDV** | Due Diligence Visit |
| **DISP** | Debt Issuance Suspension Period |
| **DO** | Departmental Offices |
| **Dodd-Frank Act** | Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 |
| **DOL** | Department of Labor |
| **EAGER** | Early-concept Grants for Exploratory Research |
| **EESA** | Emergency Economic Stabilization Act of 2008 |
| **EFTPS** | Electronic Federal Tax Payment System |
| **EITC** | Earned Income Tax Credit |
| **EO** | Exempt Organization |
| **ESA** | Exchange Stabilization Agreement |
| **ESF** | Exchange Stabilization Fund |
| **Fannie Mae** | Federal National Mortgage Association |
| **FAR** | Federal Acquisition Regulation |
| **FARS** | Financial Analysis and Reporting System |
| **FASAB** | Federal Accounting Standards Advisory Board |
| **FATCA** | Foreign Account Tax Compliance Act |
| **FATF** | Financial Action Task Force |
| **FCDA** | Foreign Currency Denominated Assets |
| **FCRA** | Federal Credit Reform Act |
| **FDC** | Funds from Dedicated Collections |
| **FDIC** | Federal Deposit Insurance Corporation |
| **FECA** | Federal Employees' Compensation Act |
| **FEHBP** | Federal Employees Health Benefits Program |
| **FEGLI** | Federal Employees Group Life Insurance |
| **FERS** | Federal Employees' Retirement System |
| **FFB** | Federal Financing Bank |
| **FFMIA** | Federal Financial Management Improvement Act of 1996 |
| **FHA** | Federal Housing Administration |
| **FHFA** | Federal Housing Finance Agency |
| **FICA** | Federal Insurance Contributions Act |
| **FinCEN** | Financial Crimes Enforcement Network |
| **FIO** | Federal Insurance Office |

| Glossary of Acronyms | |
|---|---|
| **FMFIA** | Federal Managers' Financial Integrity Act |
| **FMS** | Financial Management Service |
| **FMU** | Financial Market Utilities |
| **FOMC** | Federal Open Market Committee |
| **FRAC** | Financial Research Advisory Committee |
| **FRB** | Federal Reserve Bank |
| **FRBNY** | Federal Reserve Bank of New York |
| **FR System** | Federal Reserve System |
| **Freddie Mac** | Federal Home Loan Mortgage Corporation |
| **FS-ISAC** | Financial Services Information Sharing and Analysis Center |
| **FSOC** | Financial Stability Oversight Council |
| **FSSCC** | Financial Services Sector Coordinating Council for Critical Infrastructure Protection |
| **FTE** | Full Time Employee |
| **FTO** | Fine Troy Ounce |
| **FY** | Fiscal Year |
| **GAAP** | Generally Accepted Accounting Principles |
| **GAB** | General Arrangement to Borrow |
| **GAIS** | Government Agency Investment Services |
| **GAO** | U.S. Government Accountability Office |
| **GLC** | Geographic Leadership Community |
| **GSA** | General Services Administration |
| **GSE** | Government Sponsored Enterprise |
| **GTAS** | Government Treasury Account Symbol Adjusted Trial Balance System |
| **HERA** | Housing and Economic Recovery Act |
| **HFA** | Housing Finance Agency |
| **HHS** | Department of Health and Human Services |
| **HUD** | Department of Housing and Urban Development |
| **IA** | International Affairs |
| **IAIS** | International Association of Insurance Supervisors |
| **IAP** | International Assistance Program |
| **IC** | Intelligence Community |
| **IDRS** | Integrated Data Retrieval System |
| **IFR** | Independent Foreclosure Review |
| **IMF** | International Monetary Fund |
| **IP** | Improper Payment |
| **IPERA** | Improper Payments Elimination and Recovery Act |
| **IPERIA** | Improper Payments Elimination and Recovery Act Improvement Act of 2012 |
| **IPIA** | Improper Payments Information Act |
| **IPP** | Invoice Processing Platform |
| **IRM** | Internal Revenue Manual |
| **IRS** | Internal Revenue Service |
| **IT** | Information Technology |
| **ITIN** | Individual Taxpayer Identification Number |
| **ITSS** | Information Technology Solutions Shop |

| Glossary of Acronyms | |
|---|---|
| **JAMES** | Joint Audit Management Enterprise System |
| **KTV** | Knock and Talk Educational Visits |
| **LIBOR** | London Interbank Offered Rate |
| **LIC** | Low-Income Community |
| **LLC** | Limited Liability Corporation |
| **MBS** | Mortgage-Backed Security |
| **MDB** | Multilateral Development Bank |
| **MHA** | Making Home Affordable Program |
| **MOU** | Memoranda of Understanding |
| **MRADR** | Market Risk Adjusted Discount Rate |
| **MSB** | Money Service Businesses |
| **MTM** | Mark- to- Market |
| **NAB** | New Arrangement to Borrow |
| **NACA** | Native American CDFI Assistance |
| **NAFA** | North American Framework Agreement |
| **NARA** | National Archives and Records Administration |
| **NIBP** | New Issue Bond Program |
| **NMTC** | New Markets Tax Credit |
| **NOAA** | National Oceanic and Atmospheric Administration |
| **NOGA** | Notice of Guarantee Availability |
| **NRP** | National Research Program |
| **NYSE** | New York Stock Exchange |
| **OAS** | Office of International Affairs |
| **OCC** | Office of the Comptroller of the Currency |
| **ODCP** | Office of D.C. Pensions |
| **OFAC** | Office of Foreign Assets Control |
| **OFR** | Office of Financial Research |
| **OFS** | Office of Financial Stability |
| **OIA** | Office of Intelligence and Analysis |
| **OIG** | Office of Inspector General |
| **OMB** | Office of Management and Budget |
| **OPEB** | Other Post-Employment Benefits |
| **OPM** | Office of Personnel Management |
| **ORB** | Other Retirement Benefits |
| **OTP** | Office Tax Policy |
| **OTS** | Office of Thrift Supervision |
| **PB** | President's Budget |
| **PCIE** | President's Council on Integrity and Efficiency |
| **PDBP** | Pentegra Defined Benefit Plan |
| **P.L.** | Public Law |
| **PP&E** | Property, Plant, and Equipment |
| **PPD** | Presidential Policy Directive |
| **PPIF** | Public-Private Investment Fund |
| **PPIP** | Public-Private Investment Program |

| Glossary of Acronyms | |
|---|---|
| **PSEP** | Physical Security and Emergency Preparedness |
| **PTIN** | Preparer Taxpayer Identification Number |
| **PY** | Processing Year |
| **QALICB** | Qualified Active Low-Income Community Business |
| **QFI** | Qualified Financial Institution |
| **QLICI** | Qualified Low Income Community Investments |
| **RESTORE Act** | Resources and Ecosystems Sustainability, Tourist Opportunities and Revived Economies of the Gulf Coast States Act |
| **RMBS** | Residential Mortgage Backed Securities |
| **RRA – 98** | IRS Restructuring and Reform Act of 1998 |
| **RRP** | Return Review Program |
| **RTC** | Resolution Trust Corporation |
| **RYO** | Roll-Your-Own |
| **S&ED** | Strategic and Economic Dialogue |
| **SAR** | Suspicious Activity Report |
| **SBA** | Small Business Administration |
| **SBLF** | Small Business Lending Fund |
| **SBR** | Statement of Budgetary Resources |
| **SDN** | Specially Designated Nationals |
| **SDR** | Special Drawing Rights |
| **SEC** | Securities and Exchange Commission |
| **SFFAC** | Statement of Federal Financial Accounting Concepts |
| **SFFAS** | Statement of Federal Financial Accounting Standards |
| **SIGTARP** | Special Office of Inspector General for the Troubled Asset Relief Program |
| **SOMA** | System Open Market Account |
| **SOP** | Standard Operating Procedure |
| **SOS** | Schedule of Spending |
| **SPSPA** | Senior Preferred Stock Purchase Agreements |
| **SPV** | Special Purpose Vehicle |
| **SSBCI** | State Small Business Credit Initiative |
| **SSN** | Social Security Number |
| **STIF** | Short – term Investment Fund |
| **TALF** | Term Asset-Backed Securities Loan Facility |
| **TARP** | Troubled Asset Relief Program |
| **TCLP** | Temporary Credit and Liquidity Program |
| **TFF** | Treasury Forfeiture Fund |
| **TFFC** | Terrorist Financing and Financial Crimes |
| **TFI** | Terrorism and Financial Intelligence |
| **TFRP** | Trust Fund Recovery Penalty |
| **TFS** | TIER Financial Statements |
| **TFTP** | Terrorist Finance Tracking Program |
| **TGA** | Treasury General Account |
| **TIER** | Treasury Information Executive Repository |
| **TIGTA** | Treasury Inspector General for Tax Administration |
| **TIPS** | Treasury Inflation-Protected Securities |

| Glossary of Acronyms | |
|---|---|
| **TP** | Tax Policy |
| **TRIA** | Terrorism Risk Insurance Act |
| **TTB** | Alcohol and Tobacco Tax and Trade Bureau |
| **TY** | Tax Year |
| **UIC** | Unemployment Insurance Compensation |
| **USC** | United States Code |
| **USSGL** | United States Standard General Ledger |
| **VSBTW** | Virtual Small Business Tax Workshop |
| **VSD** | Virtual Service Delivery |
| **WMD** | Weapons of Mass Destruction |

# Website Information

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| Treasury | www.treasury.gov |
| Alcohol and Tobacco Tax and Trade Bureau | www.ttb.gov |
| Bureau of Engraving & Printing | www.bep.gov |
| Fiscal Service | www.fiscal.treasury.gov |
| Community Development Financial Institutions Fund | www.cdfifund.gov |
| Financial Crimes Enforcement Network | www.fincen.gov |
| Internal Revenue Service | www.irs.gov |
| Office of the Comptroller of the Currency | www.occ.gov |
| U.S. Mint | www.usmint.gov |
| The Financial Stability Plan | www.financialstability.gov |
| Making Home Affordable Program | www.makinghomeaffordable.gov |
| The Recovery Act | www.recovery.gov |
| Office of Inspector General | www.treasury.gov/oig |
| Treasury Inspector General for Tax Administration | www.tigta.gov |
| Office of the Special Inspector General for the Troubled Asset Relief Program | www.sigtarp.gov |

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