Part 1
Management's Discussion & Analysis

Introduction

Fiscal year 2009 began with the passage of historic legislation to support a tenuous financial system. Following the placement of Fannie Mae and Freddie Mac into conservatorship, failures of Lehman Brothers and Washington Mutual, and significant troubles at American International Group (AIG) and other firms, Congress enacted the *Emergency Economic Stabilization Act of 2008* (EESA), providing $700 billion in spending authority to support financial markets. In the months that followed, Treasury played a key role in stabilizing the financial system and limiting damage in the broader economy.

In February 2009, with the economy contracting at the fastest speed in the last quarter century, Congress passed the *American Recovery and Reinvestment Act of 2009* (Recovery Act) to provide economic stimulus. Implementation of tax and other provisions by Treasury under the Recovery Act limited the fallout from the financial crisis and encouraged investment in renewable energy projects and low-income communities. Programs implemented by Treasury under the Recovery Act, *Housing and Economic Recovery Act of 2008* (HERA), and EESA provided support for homeowners and helped avoid unnecessary foreclosures.

In February 2009, Treasury issued the Financial Stability Plan, helping boost confidence in the stability of financial institutions and unlock frozen securitization markets. Since then, Treasury has put in place a series of financial initiatives to help lay the foundation for economic recovery: 1) a broad program to stabilize the housing market by encouraging lower mortgage rates and making it easier for millions to refinance and avoid foreclosure; 2) a new capital program to provide banks with a safeguard against a deeper recession; 3) a major new lending program with the Federal Reserve targeted at the securitization markets critical for consumer and small business lending; and 4) a program to set up funds to provide a market for legacy loans and securities that currently burden the financial system.

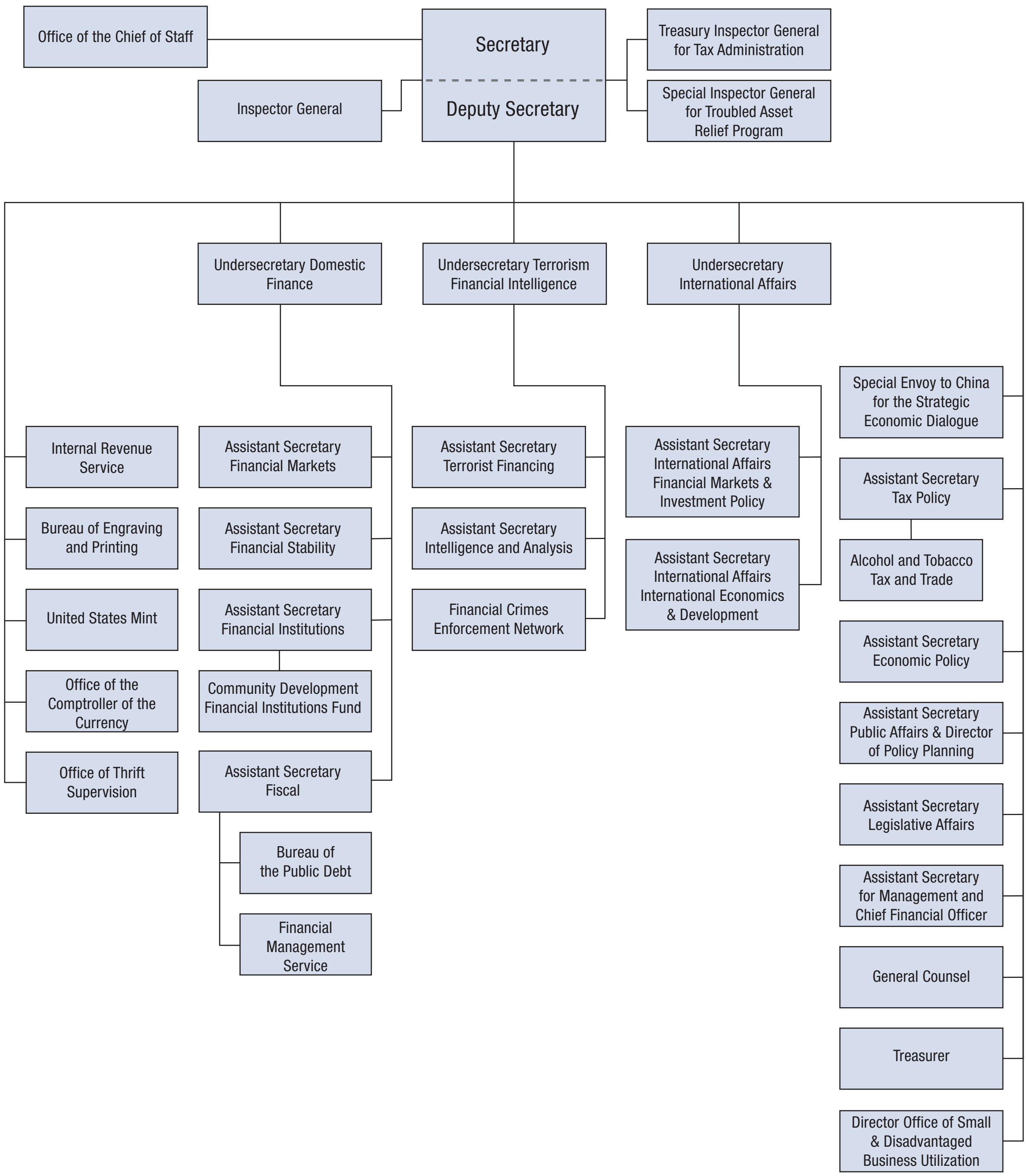
In June 2009, the President announced a comprehensive plan to reform the United States' outdated and ineffective financial regulatory system. The goals of the plan are simple: to protect responsible consumers and investors; to lay the foundation for a safer, more stable financial system that is less prone to panic and crisis; and to safeguard American taxpayers from bearing risks that ought to be borne by shareholders and creditors. Treasury submitted proposed legislative text to implement the plan in August 2009 and is actively working with Congress to pass this critical legislation.

Treasury has initiated the next phase of the strategy to stabilize and rehabilitate financial markets. As the need for the emergency programs that were put in place during the most acute phase of the crisis declines, those programs will wind down. At the same time, the use of those programs, by design, continues to decline as the financial system recovers. But the financial system is still fragile, and some of the improvements that have been realized in many financial markets are still largely dependent on the support of extraordinary policies. Going forward, the U.S. Government must work to promote the public trust, use taxpayer money prudently to repair the financial system, and reassure market participants so that they have the confidence to get credit flowing again to families and businesses.

Treasury will continue to implement the programs set in place to restore essential balance in the U.S. and global economies. In implementing these programs, the Department of the Treasury will exercise diligent stewardship and provide exceptional accountability and transparency in performing its work on behalf of the American people.

Organization

THE DEPARTMENT OF THE TREASURY ORGANIZATIONAL CHART



The Department of the Treasury is the executive agency responsible for promoting economic prosperity and ensuring the financial security of the United States. The Department is organized into two major components, the departmental offices and the bureaus. The departmental offices are primarily responsible for policy formulation, while the bureaus are primarily the operating units of the organization.

Departmental Offices

Domestic Finance advises and assists in areas of domestic finance, banking, and other related economic matters. In addition, this office develops policies and guidance for Treasury Department responsibilities in the areas of financial institutions, federal debt finance, financial regulation, capital markets, financial management, fiscal policy, and cash management decisions.

International Affairs advises and assists in the formulation and execution of U.S. international economic, financial, monetary, trade, investment, bilateral aid, environment, debt, development, and energy policy, including U.S. participation in international financial institutions.

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, 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.

Treasurer of the United States advises the Secretary on matters relating to coinage, currency, and the production of other financial instruments. The Treasurer also serves as one of the Department's principal advisors and a spokesperson in the area of financial literacy and education.

The Community Development Financial Institutions Fund (CDFI) expands the capacity of community development financial institutions and community development entities to provide credit, capital, tax credit allocations, and financial services to underserved domestic populations and communities.

The Office of Small and Disadvantaged Business Utilization assists, counsels, and advises small businesses of all types: disadvantaged, women-owned, veteran-owned, service-disabled veteran-owned, and small businesses located in historically underutilized business zones on procedures for contracting with Treasury.

Internally, the Treasury's Departmental Offices are responsible for the overall management of the Department. The *Office of the Assistant Secretary of Management and Chief Financial Officer* is responsible for internal management and controls, and also serves as the Department's Chief Performance Officer. Support organizations include *General Counsel, Legislative Affairs, and Public Affairs*. Also, three inspectors general, the *Treasury Inspector General for Tax Administration, the Office of the Inspector General, and the Special Inspector General for the Troubled Asset Relief Program* provide independent audits, investigations, and oversight of the Department of Treasury and its programs.

Bureaus

Bureaus employ 98 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 excise taxes on alcohol, tobacco, and firearms that are lawfully due the government, protects consumers of alcoholic beverages through voluntary compliance programs that are based on education and enforcement to ensure a fair marketplace, and assists industry members in understanding and complying voluntarily with federal tax, product, and marketing requirements.

The Bureau of Engraving and Printing (BEP) designs and manufactures high quality notes and other financial documents that deter counterfeiting and meet customer requirements for quality, quantity, and performance.

The Bureau of the Public Debt (BPD) borrows the money needed to operate the Federal Government through the sale of marketable, savings, and special purpose U.S. Treasury securities. In addition, it accounts for and services the public debt and provides reimbursable support services to federal agencies.

The Financial Crimes Enforcement Network (FinCEN) safeguards the financial system from the abuses of financial crime, including terrorist financing, money laundering, and other illicit activity.

The Financial Management Service (FMS) provides central payment services to federal program agencies, operates the Federal 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.

The Internal Revenue Service (IRS) is the largest of the Department's bureaus and determines, assesses, and collects tax revenue for the Federal Government.

The United States Mint designs, produces, and issues circulating and bullion coins, numismatic coins and other items, Congressional gold medals, and other medals of national significance. The United States Mint maintains physical custody and protection of the nation's gold assets.

The Office of the Comptroller of the Currency (OCC) charters, regulates, and supervises national banks to ensure a safe, sound, and competitive banking system that supports citizens, communities, and the economy.

The Office of Thrift Supervision (OTS) charters, examines, supervises, and regulates federal and many state-chartered thrift associations in order to maintain their safety and soundness and compliance with consumer laws.

The Treasury Department's 2007-2012 Strategic Framework

The Treasury Department's *Strategic Framework* is a summary of our goals, objectives, and outcomes. This framework provides the basis for performance planning and continuous improvement.

	Strategic Goals	Strategic Objectives	Value Chains**	Value Chain Outcomes
FINANCIAL	Effectively Managed U.S. Government Finances	Available cash resources to operate the government	Collect Disburse Borrow Account Invest	• Revenue collected when due through a fair and uniform application of the law at the lowest possible cost • Timely and accurate payments at the lowest possible cost • Government financing at the lowest possible cost over time • Effective cash management • Accurate, timely, useful, transparent, and accessible financial information
ECONOMIC	U.S. and World Economies Perform at Full Economic Potential	Improved economic opportunity, mobility and security with robust, real, sustainable economic growth at home and abroad	Strengthen Regulate	• Strong U.S. economic competitiveness • Free trade and investment • Decreased gap in global standard of living • Competitive capital markets • Prevented or mitigated financial and economic crises
		Trust and confidence in U.S. currency worldwide	Manufacture	• Commerce enabled through safe, secure U.S. notes and coins
SECURITY	Prevented Terrorism and Promoted the Nation's Security Through Strengthened International Financial Systems	Pre-empted and neutralized threats to the international financial system and enhanced U.S. national security	Secure	• Removed or reduced threats to national security from terrorism, proliferation of weapons of mass destruction, narcotics trafficking ,and other criminal activity on the part of rogue regimes, individuals, and their support networks • Safer and more transparent U.S. and international financial systems
MANAGEMENT	Management and Organizational Excellence	Enabled and effective Treasury Department	Manage	• A citizen-centered, results-oriented, and strategically aligned organization • Exceptional accountability and transparency

** Value Chains – Programs grouped by a common purpose.

Fiscal Year 2009 Summary of Performance by Strategic Goal

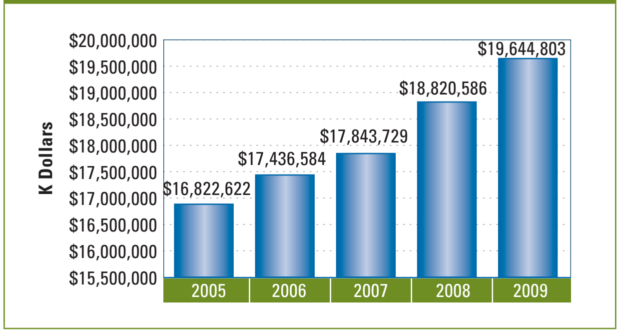
STRATEGIC GOAL	KEY ACCOMPLISHMENTS	KEY CHALLENGES	TREND
U.S. and World Economies Perform at Full Economic Potential Cost: 2008: $3.7 Billion 2009: $4.4 Billion	• Supported stabilization of the financial system through implementation of the *Emergency Economic Stabilization Act of 2008* and the Financial Stability Plan • Improved mortgage availability and stability of the housing market through implementation of the *Housing and Economic Recovery Act of 2008* • Implemented economic stimulus measures under the *American Recovery and Reinvestment Act of 2009* • Issued "Financial Regulatory Reform: A New Foundation" and drafted legislation for fundamental financial regulatory reform • Contributed to stabilization of the money market through implementation of a Temporary Guarantee Program for Money Market Funds • Implemented measures to bolster regulation of national banks and thrifts • Expanded international economic partnerships to better manage the financial crisis • Hosted G-20 meetings and supported elevation of the G-20 to premier international economic forum • Supported trebling resources for the International Monetary Fund and restructuring of the Financial Stability Forum into the Financial Stability Board • Coordinated the Economic Track of the U.S.-China Strategic and Economic Dialogue • Provided grants, investments, financial services and technical support for underserved and low-income communities through the CDFI Fund	• Repair and reform the regulatory system to improve supervision of financial markets and institutions • Continue to mitigate risks at national banks and thrifts • Reduce mortgage delinquency and foreclosure rates • Reduce direct government support for securitization and other financial markets • Maintain open economies despite rising protectionist interests • Reform Medicare and Social Security to ensure long-term solvency • Continue international movement towards a global agreement on climate change • Increase financial knowledge and access, especially in low-income and underserved communities • Improve productivity management related to coin and currency production • Improve supply management for bullion coin production • Manage cost issues related to the penny and nickel • Encourage robust circulation of the $1 coin cost-effectively • Increase financial literacy and access to financial services in low-income and underserved communities	Performance ▼ Budget ▲ Cost ▲
Effectively Managed U.S. Government Finances Cost*: 2008:$14.0 Billion 2009: $14.4 Billion	• Collected $2.3 trillion in tax revenue and $20.6 billion in federal excise taxes on tobacco, alcohol, firearms, and ammunition • Processed over 144.4 million individual returns and issued over 111.4 million refunds • Increased individual electronic tax returns processed by 8 percentage points, from 58 to 66 percent • Issued over 54.8 million payments valued at more than $13.7 billion under the *American Recovery and Reinvestment Act of 2009* • Converted over one million federal benefit check recipients to direct deposit • Conducted more than 290 auctions resulting in the issuance of more than $8 trillion in marketable Treasury securities • Began the monthly issuance of the three and seven year notes • Collected $5.07 billion in delinquent debt	• Continue to work toward the Congressional goal of having 80 percent of tax returns filed electronically • Continue to convert from paper to electronic savings bonds • Process 90 percent of Treasury payments and associated information electronically • Reduce the use of illegal international tax shelters • Reduce the erroneous payments rate within the Earned Income Tax Credit (EITC) program • Continue on path to complete CADE implementation by 2011 • Improve audit coverage of high net-worth/high-income taxpayers • Reduce average taxpayer telephone wait time • Accurately forecast government receipts	Performance ▲ Budget ▲ Cost ▲

STRATEGIC GOAL	KEY ACCOMPLISHMENTS	KEY CHALLENGES	TREND
Prevented Terrorism and Promoted the Nation's Security Through Strengthened International Financial Systems Cost: **2008:** $555 Million **2009:** $570 Million	• Strengthened measures against Iran to protect U.S. national security • Enhanced mechanisms to combat mortgage and loan modification fraud • Lifted sanctions on 125 individuals or entities from the list of Specially Designated Nationals (SDNs) • Retired magnetic media filing • Strengthened the review process for foreign investment in the United States	• *Modernize Bank Secrecy Act* (BSA) information and analysis • Encourage Pakistan to make its anti-money laundering law permanent • Continue to provide additional guidance to the charitable sector • Establish external performance measure evaluation	Performance ▲ Budget ▲ Cost ▲
Management and Organizational Excellence Cost: **2008:** $508 Million **2009:** $296 Million	• Treasury OIG completed 10 Material Loss Reviews (MLRs) • Treasury OIG issued 68 audit products related to Treasury operations • Treasury Inspector General for Tax Administration issued 142 audit reports of the IRS that could produce $14.7 billion in financial benefits • Employed dynamic new approach to the 2011 Treasury budget process • Expanded human capital initiatives	• Continue to complete an increased number of MLR • Continue to improve management of information technology	Performance ▲ Budget ▼ Cost ▼

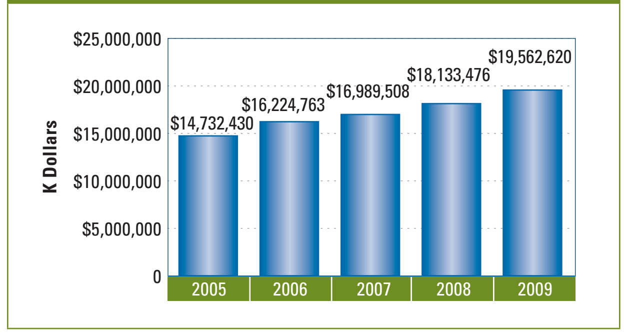
*Cost is stated as "Performance Cost," and in addition to budgetary resources, includes imputed costs, depreciation, losses, and other expenses not requiring budgetary resources.

How Well is Treasury Performing?

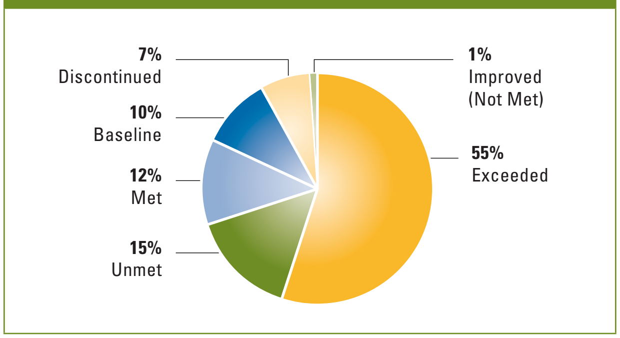
Treasury Performance Cost Trend



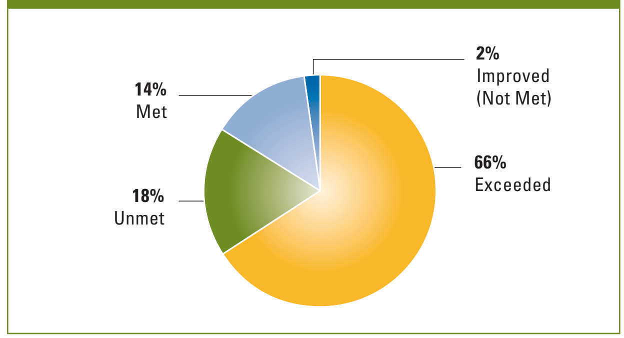
Treasury Total (Direct and Non-Appropriated) Budget Trend



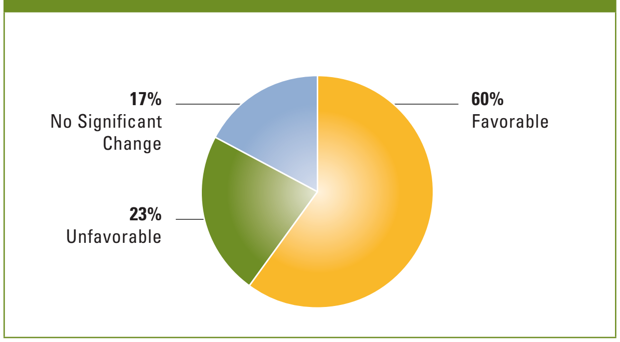
Fiscal Year 2009 Treasury-wide Performance Results Including Discontinued and Baseline Measures



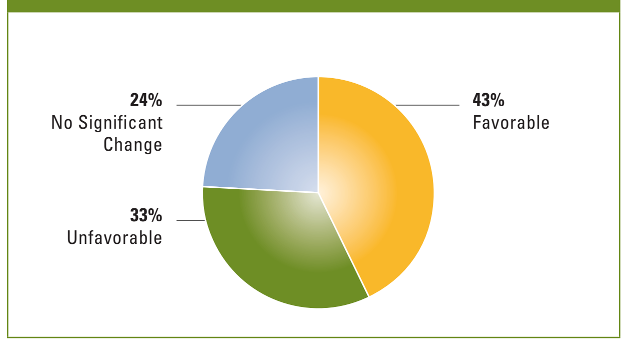
Fiscal Year 2009 Treasury-wide Performance Results Excluding Discontinued and Baseline Measures



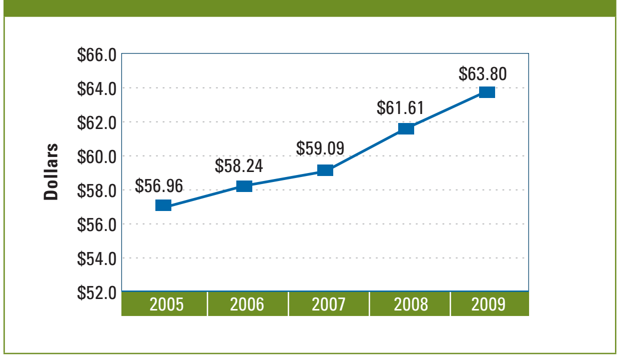
Treasury Actual Performance Trends 2006–2009



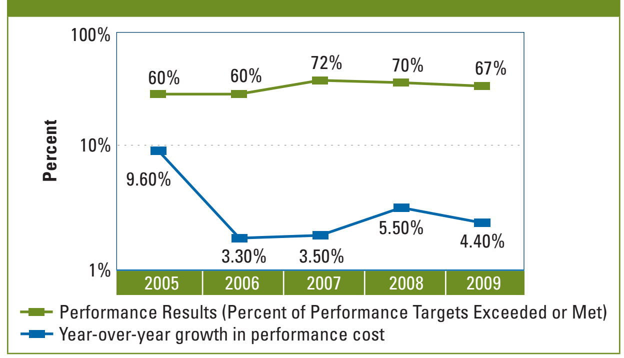
Treasury Target Performance Trends 2006–2009



Treasury Department Cost per Person in the United States



Treasury Performance vs. Performance Cost Trends



Please see next page for explanation of charts.

HOW WELL IS TREASURY PERFORMING DISCUSSION

PERFORMANCE COST AND BUDGET TRENDS

Performance cost represents the best indication of the total actual cost to operate the Treasury Department. It includes normal operating expenses from the Department's Statement of Net Cost, but also includes adjustments for costs which do not require budgetary resources such as imputed costs, depreciation, amortization, losses, and other non-budgetary expenses. Performance cost in fiscal year 2009 was $19.6 billion, a 4.4 percent increase from fiscal year 2008, and has risen 4 percent per year since fiscal year 2005. The Department's total enacted budget, however, which includes direct appropriations, non-appropriated, and reimbursable amounts, rose by an average of 7.4 percent per year since fiscal year 2005.

PERFORMANCE TO TARGET

In fiscal year 2009, the Treasury Department continued reporting using the revised performance rating system rolled out in 2008. Performance to target is rated as: Exceeded, Met, Improved from the prior year (but not met), Unmet, Baseline, or Discontinued. Prior to 2008, performance measures were rated only as met or unmet. Results are shown in two pie charts, one including all performance measures, and one not including baseline and discontinued measures. While 68 percent of targets were exceeded, met, or improved based on all measures, 82 percent of targets were exceeded, met, or improved based on measures that were not baselined or discontinued.

ACTUAL AND TARGET PERFORMANCE TRENDS

Trends in actual performance and targets have been analyzed since 2005 where data were available. Trends can move upward, downward, or remain flat. Depending on the type of measure, a trend can be favorable, unfavorable, or remain unchanged. Results indicate that 60 percent of actual performance trends were favorable, 23 percent were unfavorable, and 17 percent were unchanged. Target trends were 43 percent favorable, 33 percent unfavorable, and 24 percent unchanged.

TREASURY COST PER PERSON

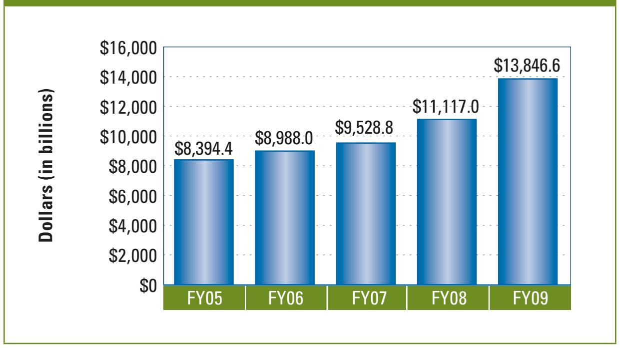
The chart reflecting the approximate cost of the Treasury Department per person in the United States is based on calculations determined by dividing Treasury Performance Cost by an estimate of the U.S. population at the end of fiscal year 2009. This ratio attempts to describe the estimated cost of operating the Treasury Department borne by everyone in the United States on a per person basis. The estimated cost per person for fiscal year 2009 is $63.80, up from $61.61 in fiscal year 2008.

TREASURY PERFORMANCE AND REAL COST

This chart provides information on Treasury's performance to target trends compared with the year-to-year increase in the Department's performance cost. The percent of targets met or exceeded dropped by two percentage points compared to the prior fiscal year, while performance cost increased by 4.4 percent.

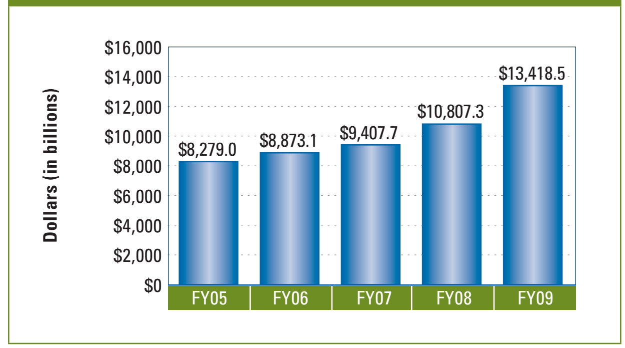
Financial Highlights

Total Assets (in billions)



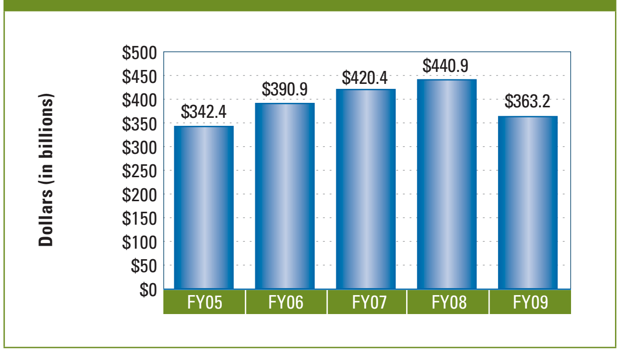
The increase of $2.7 trillion in total assets in fiscal year 2009 is largely due to the increase in future funds required from the General Fund of the U.S. Government to pay for the federal debt owed to the public and other federal agencies.

Total Liabilities (in billions)



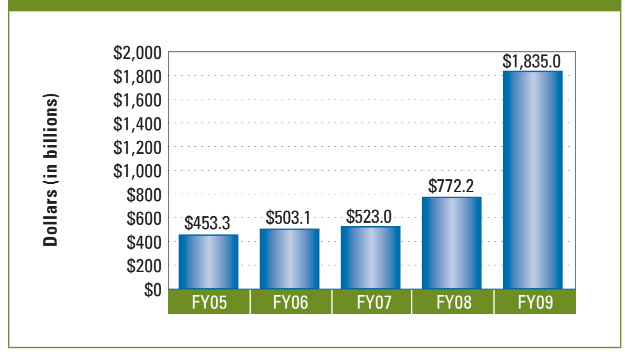
Total liabilities increased by $2.6 trillion from fiscal year 2008 to fiscal year 2009. The majority of the increase is due to borrowings from other federal agencies and debt issued to the public.

Net Federal Debt Interest Costs (in billions)



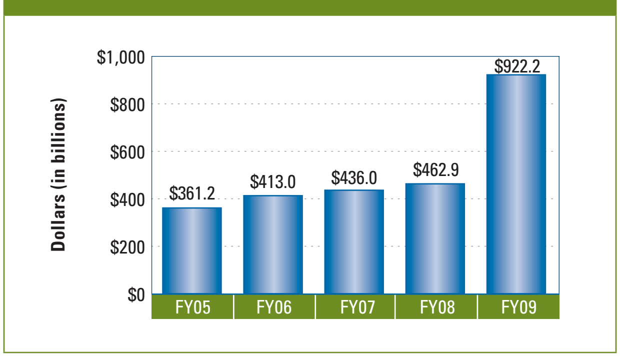
The decrease of $77.7 billion in net interest paid on the federal debt is due to the decrease in the average interest rate for debt held by federal entities and federal debt held by the public.

Total Budgetary Resources (in billions)



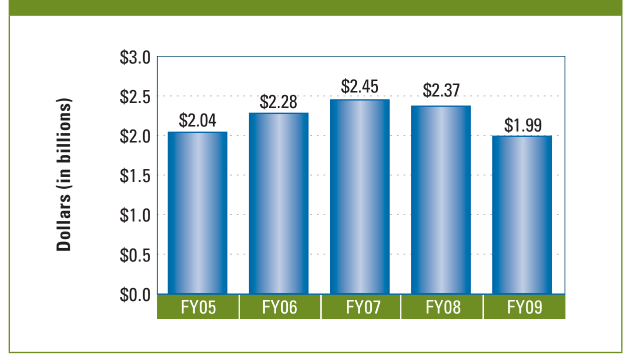
The majority of the increase in total budgetary resources for fiscal year 2009 is due to Troubled Asset Relief Program (TARP) activity and additional investments in the Government-Sponsored Enterprises.

Net Outlays (in billions)



The majority of the $459.3 billion increase in net outlays was due to Troubled Asset Relief Program (TARP) activity and additional investments in the Government-Sponsored Enterprises.

Net Custodial Revenue Received (in trillions)



Net custodial revenue collected on behalf of the U.S. Government decreased by $379.3 billion. This decrease can be contributed to the weakened economic conditions that existed during fiscal year 2009.

Fiscal Year 2009 Performance by Strategic Goal

U.S. AND WORLD ECONOMIES PERFORM AT FULL ECONOMIC POTENTIAL

Treasury remains at the forefront of the U.S. Government's response to the financial crisis and economic recession. Through implementation of the *Housing and Economic Recovery Act of 2008* (HERA), *Emergency Economic Stabilization Act of 2008* (EESA), and *American Recovery and Reinvestment Act of 2009* (Recovery Act); coordination with federal, state, and international partners; regulation of national banks and thrifts; temporary measures to stabilize money markets; and various other initiatives, Treasury worked in fiscal year 2009 to stabilize the financial system and restore economic growth. Ahead is a process of repairing and reforming the financial system to close the gaps and weaknesses in supervision and regulation of financial firms, continuing economic stabilization and stimulus, and defining an appropriate path for unwinding the government programs which have been put in place to support the economy.

TROUBLED ASSET RELIEF PROGRAM/ FINANCIAL STABILITY PLAN

On October 3, 2008, Congress passed EESA to prevent a potentially catastrophic failure of the financial system. Under the legislation, the Office of Financial Stability (OFS) was created within Treasury to purchase and insure up to $700 billion in certain types of assets under the Troubled Asset Relief Program (TARP). Operating in conjunction with Federal Reserve and FDIC programs, TARP has provided resources facilitating stabilization of the financial system and restoration of credit to businesses and consumers. For the period ended September 30, 2009, the face value of the amounts obligated under TARP was $454 billion and funds disbursed totaled $364 billion.

TABLE 1: TARP SUMMARY AS OF SEPTEMBER 30, 2009 $ IN BILLIONS

	Purchase Price or Guarantee Amounts	Total $ Disbursed	Investment Repayments	Outstanding Balance	Cash Received from Investments
Capital Purchase Program	$ 204.6	$ 204.6	$ 70.7	$ 133.9	$ 9.7
Targeted Investment Program	$ 40.0	$ 40.0	$ 0.0	$ 40.0	$ 1.9
Asset Guarantee Program	$ 5.0	$ 0.0	$ 0.0	$ 0.0	$ 0.5
AIG Investments	$ 69.8	$ 43.2	$ 0.0	$ 43.2	$ 0.0
Term Asset-Backed Securities Loan Facility	$ 20.0	$ 0.1	$ 0.0	$ 0.1	$ 0.0
Public Private Investment Program	$ 6.7	$ 0.0	$ 0.0	$ 0.0	$ 0.0
Automotive Industry Financing Program	$ 81.1	$ 75.9	$ 2.1	$ 73.8	$ 0.7
Home Affordable Modification Program	$ 27.1	$ 0.0	NA	NA	$ 0.0
Totals	$ 454.3	$ 363.8	$ 72.8	$ 291.0	$ 12.7

Some figures may not sum to total due to rounding.

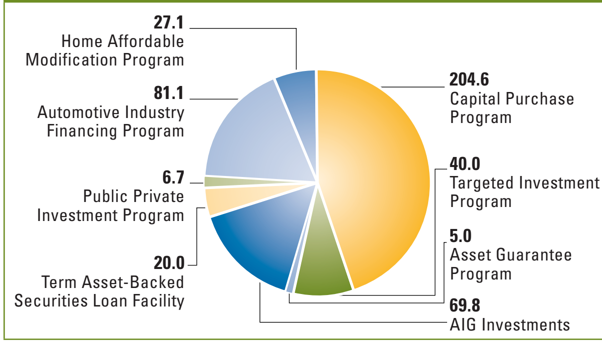
The incoming Obama Administration faced an extremely fragile financial system and deep ongoing economic recession. On February 10, 2009, Secretary Geithner announced a series of new financial programs, most of which relied on TARP, that were designed to help rebuild confidence in the financial system, draw in private capital, and restart critical channels of credit supply. These programs helped bolster confidence in financial markets on the state of the country's financial institutions and ensure the availability of essential capital support for small businesses, consumers and home owners.

TARP operations are managed with four primary goals:

- **Goal 1 –** Ensure the overall stability and liquidity of the financial system
    - a. Make capital available to viable institutions
    - b. Provide targeted assistance as needed
    - c. Increase liquidity and volume in securitization markets
    - Contributing programs:
        - Capital Purchase Program
        - Public-Private Investment Program
        - Consumer and Business Lending Initiative
            - Term Asset-Backed Securities Loan Facility
            - Unlocking Credit for Small Business Initiative
        - Targeted Investment Program
        - American International Group (AIG) Investment Program
        - Asset Guarantee Program
        - Automotive Industry Financing Program
- **Goal 2 –** Prevent avoidable foreclosures and help preserve homeownership
    - Contributing program:
        - Home Affordable Modification Program
- **Goal 3 –** Protect taxpayer interests
- **Goal 4 –** Promote transparency

The purpose of TARP was to restore the liquidity and stability of the financial system. While EESA provided the Secretary of the Treasury with the authority to spend $700 billion to meet the objectives of the Act, it is clear today that TARP will not cost taxpayers $700 billion, based on what has already been disbursed and current program estimates. The current cost estimate of the program is $69 billion, with net costs in the AIG Program, Automotive Industry Financing Program, and Home Affordable Modification Program partially offset by net gains in other programs. (See Table 2, page 19.) On December 9, 2009, Secretary Geithner certified to Congress extension of TARP authority to October 3, 2010 under Section 120(b) of EESA.

FIGURE 1. Total TARP Funds Obligated in Fiscal Year 2009 (in billions)



Capital Purchase Program (CPP)

Treasury created the Capital Purchase Program (CPP) in October 2008 to stabilize the financial system by providing capital to viable financial institutions of all sizes across the country. The program was intended to strengthen banks' capital base to enable them to absorb losses from bad assets while continuing to lend to consumers and businesses. Through the program, Treasury has provided capital to 685 financial institutions across 48 states, the District of Columbia, and Puerto Rico, including more than 300 small and community banks.

Treasury provided capital to qualified financial institutions through the purchase of senior preferred equity or subordinated debentures. Obligations were structured to encourage repayment, with dividends set at five percent for the first five years and nine percent thereafter. In addition, to participate in financial gains, Treasury received from participating institutions warrants to purchase common equity, additional preferred shares, or additional subordinated debentures. All funding recipients were subject to limitations on executive pay to protect taxpayers and encourage early repayment. Treasury initially committed over a third of total TARP funding, $250 billion, to the CPP; which was lowered to $218 billion in March 2009. Treasury is continuing to monitor CPP investments, collect dividends, and ensure compliance with contractual obligations.

As of September 30, 2009, more than 40 banks had repaid TARP investments made by Treasury, including over $70 billion in repayments. The repayments had reduced program commitments to below $135 billion. In addition, dividends and interest from CPP participants was over $6.8 billion and proceeds from the repurchase of warrants and stock was $2.9 billion. Many investments aimed at stabilizing banks are expected to deliver returns for taxpayers.

Capital Purchase Program information on ***FinancialStability.gov***.

Capital Assistance Program (CAP) and the Supervisory Capital Assessment Program (SCAP)

In early 2009, the Federal Reserve, OCC and FDIC conducted a one-time, forward-looking assessment or "stress test" (the SCAP) on the 19 largest U.S. bank holding companies. The goal was to determine whether these banks, which hold two-thirds of U.S. banking system assets, had sufficient capital to withstand losses and sustain lending through a severe economic downturn. Participant banks were encouraged to raise needed capital from private investors, with a backstop financial arrangement available through Treasury's Capital Assessment Program.

For the assessment, supervisors used historically high loss estimates on securities and loans and historically low estimates on potential earnings to determine baseline capital levels. The stress test results published on May 9, 2009 revealed that nine of the 19 banks had sufficient capital buffers while the remaining 10 banks needed to raise their capital buffers by a combined $75 billion. Since the release of the results, U.S. banks have raised over $80 billion in common equity and $40 billion in non-government guaranteed debt. Treasury had not funded any investments through CAP as of the end of fiscal year 2009.

Capital Assistance Program information on ***FinancialStability.gov***.

Public-Private Investment Program (PPIP)

To help clean up the balance sheets of major financial institutions and restore liquidity to financial markets, Treasury proposed creation of a Public-Private Investment Program to purchase legacy loans and securities under the Financial Stability Plan. Under the legacy securities PPIP program, Treasury is investing equity on a dollar-for-dollar basis with private investors in qualified Public-Private Investment Funds and providing access to debt financing for up to 100 percent of the fund's total equity. Funds are required to obtain commitments of at least $500 million in private capital to qualify and are expected to employ a predominately long-term buy-and-hold strategy. Treasury will receive pro rata any profits or losses in the funds alongside private investors. A total of nine asset managers were designated to establish funds for the program in July 2009 (selected out of 100 applicants) and the first fund closing occurred on September 30, 2009. The maximum capital commitment for the first round is $30 billion. As of September 30, 2009, no private fund managers had made any investments and Treasury had not disbursed any funds.

After announcement of the program, non-agency mortgage-backed securities (MBS) rose substantially in price. Prime fixed rate securities issued in 2006 that traded as low as $60 in March had increased in value by over 40 percent by the end of September. That improvement in financial market condition created the positive backdrop to enable introduction of the program at a smaller scale than originally envisioned. The Department will assess the need for additional rounds following the results of the first round.

Public-Private Investment Program information on ***FinancialStability.gov***.

Term Asset-Backed Securities Loan Facility (TALF)

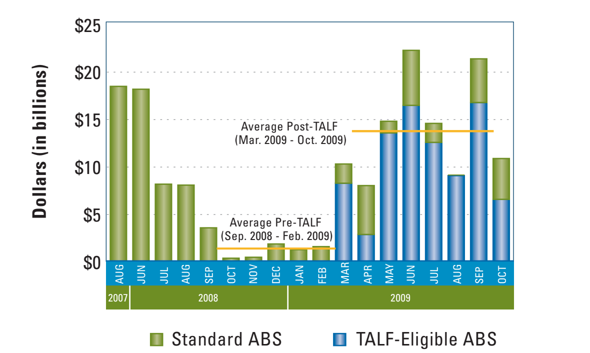
Treasury and the Federal Reserve announced creation of TALF in November 2008 to help unlock credit markets for households and small businesses. Under TALF, the Federal Reserve announced intention to lend up to $200 billion to eligible investors purchasing AAA-rated asset-backed securities (ABS) collateralized by newly and recently originated consumer and small business loans. (Including securities backed by auto loans, student loans, credit card loans, equipment loans, floorplan loans, loans guaranteed by the Small Business Administration, insurance premium finance loans, residential mortgage servicing advances, and commercial mortgage loans.) Borrowers are eligible to borrow up to the market value of the ABS, less a fixed percentage, ensuring they take the first loss if the securities lose value. Under TALF, Treasury provided up to $20 billion to the Federal Reserve in credit protection to be employed in the event of borrower default.

Prior to introduction of the program, the market for newly-issued ABS had largely shut down. Interest rate spreads on the most highly-rated AAA tranches of ABS and CMBS rose to levels outside their historical range, in certain cases well over seven to 15 times their average, respectively. The disruption of these markets contributed to the lack of credit to households and businesses of all sizes, impacting U.S. economic activity. Through October 2009, the TALF program had supported nearly $86 billion of new consumer and small business credit, including over 3.6 million consumer and small business loans and leases, and over 132 million active credit card accounts. TALF has also provided liquidity for $4.1 billion of legacy CMBS securities. This aid to the securitization market has had a clear impact on liquidity, spreads and the availability of consumer and small business credit. Since the peak of the crisis, spreads for the asset classes backed by the program have come down by 60 percent or more, including a reduction in credit card and auto loan ABS rates from six percentage points above the benchmark to only one percentage point above the benchmark.

In August 2009, Treasury and the Federal Reserve announced extension of TALF through March 31, 2010 for newly-issued ABS and legacy commercial mortgage-backed securities (CMBS) and through June 30, 2010 for newly-issued CMBS.

Term Asset-Backed Securities Loan Facility information on the ***Federal Reserve*** website.

FIGURE 2. Issuance of ABS Backed by Consumer and Small Business Loans (US$, billions)



Unlocking Credit for Small Business Initiative

To help restore the confidence needed for financial institutions to increase lending to small businesses, Treasury announced an initiative to expand securitization of small business loans on March 16, 2009. Securitization of small business loans provides community banks and other lenders with an important source of capital for additional loans. However, as a result of the severe dislocations in the credit markets, both lenders that originate loans under SBA programs and the "pool assemblers" that package such loans for securitization experienced significant difficulty selling SBA loans or securities in the secondary market. This, in turn, significantly reduced the ability of such lenders and pool assemblers to obtain funds to make new small business loans. Under the program, Treasury has planned to make up to $15 billion in TARP resources available to purchase securities backed by the SBA guaranteed portions of loans made under the SBA's 7(a) loan program, as well as first-lien mortgage securities made by private sector lenders in connection with

SBA's 504 community development loan program. (The SBA's 7(a) program is the SBA's most basic and widely used loan program.)

Since Treasury's announcement of this program, the credit markets for small businesses have improved somewhat. The secondary market for guaranteed SBA loans, for example, had essentially ceased working last fall and had only $86 million in January re-sales. That market improved notably this spring in the wake of Treasury's announcement, with $399 million settled from lenders to broker-dealers in September 2009. As a result of this improvement, as well as reluctance on the part of market participants to accept TARP funds, Treasury found that demand for its proposed program declined. As of September 30, 2009, no funds had been disbursed under the program, although funding remains available.

Unlocking Credit for Small Business Initiative on ***FinancialStability.gov.***

Targeted Investment Program (TIP)

Treasury provided assistance on a case-by-case basis to stabilize key financial institutions during the height of the financial crisis. Through TIP, Treasury sought to prevent a loss of confidence in critical financial institutions which could have resulted in significant financial market disruption. Assistance was provided through the purchase of preferred shares paying an annual dividend of eight percent. These investments impose greater reporting requirements and harsher restrictions on the companies than under CPP terms, including restrictions on dividend payments to $0.01 per share per quarter, limits on executive compensation and corporate expenses, and other measures. In addition, Treasury received warrants from participant companies to purchase common shares.

Under the TIP, Treasury purchased $20 billion in preferred shares from Citigroup in December 2008 and $20 billion in preferred shares from Bank of America in January 2009. Treasury has exchanged the preferred shares for Citigroup received under the TIP and CPP programs into common shares and trust preferred securities to strengthen Citigroup's capital base. As of September 30, 2009, Treasury had received $1.9 billion in dividends, interest and fees from holdings under the TIP program.

Targeted Investment Program information on ***FinancialStability.gov***.

AIG Investment Program

In November 2008, Treasury purchased $40 billion in cumulative preferred shares from AIG. In April 2009, the $40 billion in cumulative shares were exchanged for $41.6 billion in non-cumulative preferred shares paying a 10 percent dividend. At the same time, an equity capital facility was created providing an additional $29.8 billion as needed, of which $3.2 billion had been drawn as of September 30, 2009. The Federal Reserve provided loans to AIG and a public trust was created to hold convertible preferred shares representing 79.8 percent of the current voting power of AIG common shares. These shares are held in trust for the sole benefit of taxpayers. (The Department of the Treasury does not control the trust and cannot direct the trustees.) As of September 30, 2009, AIG had not made any dividend payments on any of the perpetual preferred stock. Subsequently, AIG failed to make a dividend payment on November 2, 2009. Per the terms of the preferred stock, if AIG misses four dividend payments, Treasury may appoint to the AIG board of directors the greater of two members or 20 percent of the total number of directors of the Company.

AIG Program information on the ***Federal Reserve*** website.

Asset Guarantee Program (AGP)

The Asset Guarantee Program was created in November 2008 to stabilize the financial system by providing guarantees against severe credit losses by large financial institutions. The AGP has been applied with extreme discretion and Treasury does not anticipate wider use of this program. Announced in January 2009, Treasury guaranteed up to $5 billion of potential losses on a $301 billion pool of loans for Citigroup. Under the program, Citigroup will absorb the first $39.5 billion of losses on the pool, with Treasury taking second loss on the next $5 billion. Additionally, Federal Deposit Insurance Corporation (FDIC) will absorb $10 billion in third losses and the Federal Reserve will provide secured loans for 90 percent of the remaining value in the pool, following FDIC and Treasury payments. The guarantee will expire in 2014 for non-residential assets and 2019 for residential assets. In return, Treasury received $4 billion in preferred shares and warrants, which have since been converted into trust preferred securities.

In January 2009, Treasury, the Federal Reserve and FDIC announced agreement to share potential losses on a $118 billion pool of loans at Bank of America. Bank of America terminated the request prior to funding, paying $425 million in fees to Treasury, FDIC and the Federal Reserve.

Asset Guarantee Program information on *FinancialStability.gov*.

Automotive Industry Financing Program (AIFP)

Treasury established the Automotive Industry Financing Program on December 19, 2008, to help prevent a significant disruption to the American automotive industry, which would have posed a systemic risk to financial market stability and had a negative effect on the economy. AIFP loans and equity investments (purchases of preferred and common shares) totaling $76 billion were provided to General Motors (GM), Chrysler and their respective financing entities. GM and Chrysler were provided funds with the requirement that they develop plans to achieve long term viability. Following finalization of the plans, GM and Chrysler conducted orderly bankruptcies (40 days for GM and 42 days for Chrysler). The U.S. Government currently holds 61 percent of common stock in GM and 10 percent of common stock in Chrysler under the program.

As an extension of AIFP, in March 2009 Treasury created an Auto Supplier Support Program providing qualified automotive supply companies financial protection on their receivables from domestic auto manufacturers. Treasury also established a Warranty Commitment Program designed to give consumers considering new car purchases confidence that their warranties from GM and Chrysler would be honored. As of July 10, 2009, the Warranty Commitment program was terminated after New GM and New Chrysler completed the purchase of substantially all of the assets of GM and Chrysler from their respective bankruptcies.

Automotive Industry Financing Program information on *FinancialStability.gov*.

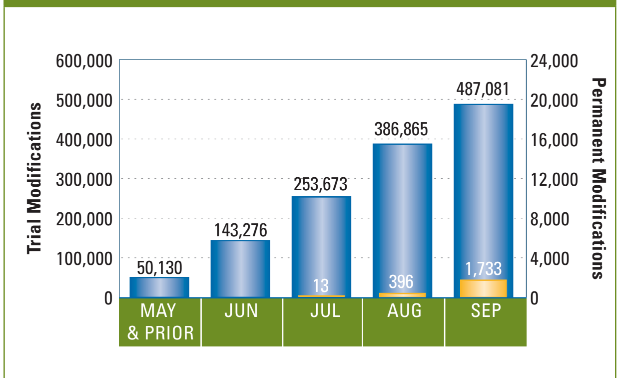
Home Affordable Modification Program (HAMP)

To mitigate foreclosures and help ensure homeownership preservation, Treasury announced the Home Affordable Modification Program in February 2009 to provide incentives for mortgage servicers, borrowers and investors to modify loans that are delinquent or at imminent risk of default. Funded jointly by EESA and HERA, with $50 billion from TARP and $25 billion from HERA, HAMP provides financial support for loan modifications which reduce a borrower's monthly mortgage payment to no more than 31 percent of their monthly gross income. Modifications are intended to provide sustainably affordable mortgage payments for responsible mortgage holders, and mitigate the spillover effects of preventable foreclosures on neighborhoods, communities, the financial system and the economy. With over 85 percent of mortgage loans in the country covered by the program, HAMP is expected to help three to four million eligible homeowners modify their mortgages on more affordable terms before the end of 2012.

At a meeting between Treasury and participating servicers on July 28, 2009, the servicers committed to reaching a cumulative target of 500,000 trial modifications by November 1, 2009. As of September 30, 2009, over 487,000 HAMP trial modifications had been completed, well on the way to achieving the target. Servicers have also agreed to work with Treasury to implement actions designed to improve program effectiveness, including streamlining application procedures. To provide transparency and servicer accountability, servicer-specific results are reported on a monthly basis on ***FinancialStability.gov*** and ***MakingHomeAffordable.gov***. Treasury is also establishing specific performance metrics to measure the performance of each servicer, such as average borrower wait time in response to inquiries and the response time for completed applications, and has implemented a "second look" review of samples of rejected applications to ensure borrower applications are not inadvertently or incorrectly denied.

Home Affordable Modification Program information on ***MakingHomeAffordable.gov***.

FIGURE 3. HAMP Loans Entering Trial and Permanent Modification



TARP accomplishments in fiscal year 2009

Viewed in conjunction with other Federal Government programs, TARP should be evaluated primarily on its impact on stabilizing the financial system. Today, the financial system and the economy are showing signs of stability. The economy grew in the third quarter and private economists generally expect moderate growth in the remainder of this year and next. The cost of borrowing has declined to pre-crisis levels for many banks, non-financial corporations, states and local governments, and the government-sponsored enterprises (GSEs). U.S. equity markets have surged, and prices for bank securities have improved significantly. Credit creation in securities markets has increased, facilitating new credit for consumers and businesses. Housing markets are also stabilizing. Home prices, as measured by the national LoanPerformance index, increased by five percent over the last six months, reversing three straight years of decline. While clear challenges remain, particularly with continuing bank failures, high foreclosure rates, high unemployment and concerns in commercial real estate markets, the worst of the crisis has passed.

The ultimate return on the TARP investments that remain outstanding will depend on how the economy and financial markets evolve. The improvement in economic and financial prospects that has already occurred has had a significant impact on the expected cost. As of September 30, 2009, the estimated cost of TARP programs is $110 billion lower than the initial estimates made at the time the programs were initiated. (See table 2.) About $10 billion of that decline in costs stems from early repayments of TARP funds. The rest of the decline is primarily a function of improvements in the economic and financial environment since TARP programs were initiated.

TABLE 2: ESTIMATED CHANGE IN COST FOR THE TARP PROGRAMS
$ IN BILLIONS

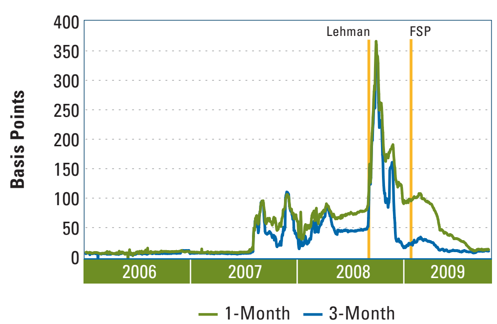
	Original Estimate[1]	Current Estimate	Net Change
Capital Purchase Program	- 57.4	+ 15.0	+ 72.4
Targeted Investment Program	- 19.6	+ 1.9	+ 21.5
Asset Guarantee Program	+ 1.0	+ 2.2	+ 1.2
AIG Investments	- 31.5	- 30.4	+ 1.1
Automotive Industry Financing Program	- 43.7	- 30.4	+ 13.3
Term Asset-Backed Securities Loan Facility	+ 0.1	+ 0.3	+ 0.2
Subtotal	**- 151.1**	**- 41.4**	**+ 109.7**
Home Affordable Modification Program	- 27.1	- 27.1	0.0
Total	**- 178.2**	**- 68.5**	**+ 109.7**

1 Original estimates completed on or near the initiation of each program. Amounts shown based on total program disbursements through fiscal year 2009.

Measuring the impact of TARP in isolation is challenging. Most TARP programs were part of a coordinated government response to restore confidence in the financial system. The health of the overall system and its impact on the U.S. economy are therefore the most important metrics by which the effectiveness of these policies can be assessed. However, a few TARP programs were uniquely targeted to specific markets and institutions, allowing for more direct assessment of performance.

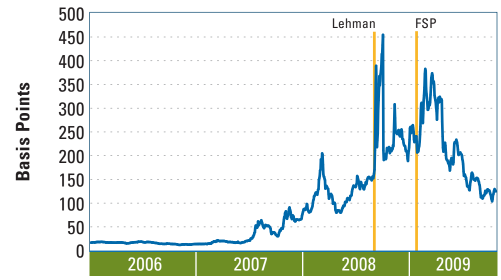
Below are several accepted indicators of financial market stress. The London Inter-Bank Offered Rate – Overnight Index Swap (LIBOR-OIS) spread measures the difference between short-term borrowing rates between banks and expected short-term borrowing rates for banks from the Federal Reserve. The spread reflects the additional risk banks perceive when lending to other banks, versus borrowing costs from the Federal Reserve. Historically, LIBOR-OIS spreads have been 0.1 percent or less. With greater stress in financial markets in October 2008, the three-month LIBOR-OIS spread spiked to 3.64 percent. At the end of the fiscal year, LIBOR-OIS spreads were 0.25 percent, within reach of historical levels.

FIGURE 4. Libor-OIS Spread (basis points)



Credit-default swap spreads for financial institutions, which measure investor confidence in their health, have also fallen significantly. A measure of credit-default swaps for the largest U.S. banks reached 450 basis points last fall, as shown in Figure 5, and is just over 100 basis points today. The TARP was a necessary step, but not the only step, to achieving this recovery.

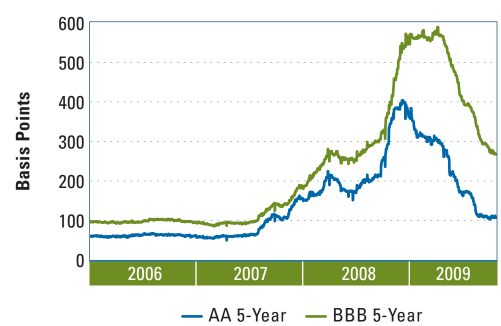
FIGURE 5. Credit Default Spreads for Financial Institutions (basis points)



Notes: Includes Bank of America, Citigroup, Goldman Sachs, JPMorgan, Morgan Stanley, and Wells Fargo.

In conjunction with lower credit default swap rates, borrowing costs have declined for many businesses. Investment-grade corporate bond rates have fallen by over 70 percent since last fall, and high-yield bond rates have fallen by more than half. Businesses have issued about $900 billion in investment-grade debt and over $100 billion in high-yield debt this year. While much of the new issuance earlier in the year was supported by the government, private investors have funded most new corporate debt in recent months.

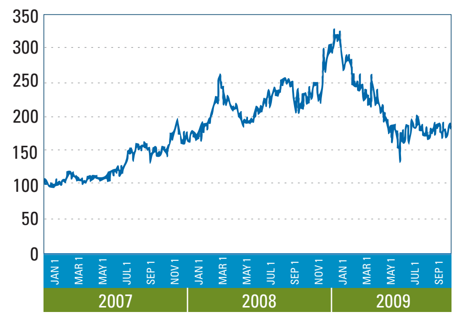
FIGURE 6. Corporate Bond Spreads (basis points)



An indicator of borrowing costs for homeowners is the spread between the 30-year fixed mortgage rate and 10-year Treasuries. Higher spreads indicate that banks perceive greater risks in issuing mortgages and homeowners face higher borrowing costs. In mid-December

2008, the 30-year mortgage to 10-year Treasury spread reached almost 3.3 percent, its highest level since January 2002. On September 30, 2009, the spread was 1.85 percent, well below its height during the crisis.

FIGURE 7. Spread between 30 year Mortgage and 10 year Treasury Rates



Finally, the Chicago Board Options Exchange Volatility Index (VIX) is a gauge of the expected volatility of the S&P 500 equity index. The VIX is often referred to as the "Fear Index", since high levels imply investors "fear" sharp moves in the market in either direction (up or down). Historically, the VIX has ranged between 10 and 30. In November 2008 the VIX reached nearly 81, its highest level on record. On September 30, 2009, the VIX was nearly 26, still relatively high by historic levels, but well below its height during the crisis.

FIGURE 8. Market Volatility Index of S&P 500 (VIX)

Taxpayer protection and promoting transparency

In implementing EESA, Treasury has sought to carefully and assertively manage taxpayer resources. No investments have been made unless they are compliant with statutory requirements, necessary for restoring or maintaining financial stability, and structured to protect the taxpayer. Programs have been designed to achieve these objectives by:

- setting commercial terms and conditions on financial assistance;
- taking warrants to capture gains from assistance;
- requiring private capital or risk sharing;
- restricting executive compensation and other related activities;
- minimizing self-dealing and other conflicts of interest;
- managing the role of the U.S. Government as a shareholder, but only a "reluctant shareholder".

Given its unusual position in managing financial market stress, EESA designated four reviewing bodies to oversee TARP operations: a Financial Stability Oversight Board, a Special Inspector General for TARP (SIGTARP), a Congressional Oversight Panel (COP), and the Government Accountability Office (GAO). The Assistant Secretary for Financial Stability meets weekly with the SIGTARP and makes frequent reports and/or updates to Congress and the COP to ensure transparency and accountability for OFS activities. OFS involves the oversight bodies early in the design process for new programs or investments to benefit from any suggestions.

Treasury has made every effort to communicate program activities in a fully transparent and timely manner, through correspondence with oversight authorities, activity reports, testimony, speeches and publication of program information. To provide transparency and accountability for TARP and other programs designed to repair and reform the financial system, Treasury created ***FinancialStability.gov***. The website includes reports and information on Treasury programs, including transaction reports, program guidelines, speeches, press releases and other information. As of September 30, 2009, Treasury had published 86 Transaction Reports, 10 Section 105(a) monthly Congressional Reports, seven Tranche Reports, three dividend and interest reports, and two MHA Program Reports, all of which are posted on ***FinancialStability.gov***. This information is intended to answer the basic questions many Americans have about how TARP monies are invested. In keeping with principles of good stewardship, Treasury has never missed a deadline for a report. Additionally, Treasury posts program guidelines on the website within two business days of any program launch, all obligations made under TARP, and all contracts with Treasury service providers involved with TARP programs. Additional information on the Making Home Affordable program can be found at ***MakingHomeAffordable.gov***.

Managing TARP assets

Treasury manages TARP investments under several core principles:

First, the U.S. government is a shareholder reluctantly and out of necessity. The government intends to dispose of its interests as soon as practicable, with the dual goals of achieving financial stability and protecting taxpayer interests.

Second, there is no intention to be involved in the day-to-day management of any company. Government involvement in daily management of a company could possibly reduce the value of these investments, impede the ability of companies to return to full private ownership, and frustrate attainment of broader economic policy goals.

Third, consistent with these goals, the Department takes a commercial approach to the exercise of shareholder rights. Voting participation only corresponds to four core matters: board membership; amendments to the charter and by-laws; liquidations, mergers and other substantial transactions; and significant issuances of common shares.

While some new investments are still being made to support financial markets and the economy, the Administration intends to exit TARP investments as soon as prudent judgment allows.

Exiting TARP

TARP was designed as an emergency response to a major financial crisis. Because financial conditions have started to improve, Treasury has begun the process of exiting from some emergency programs. As of September 30, 2009, Treasury had received over $73 billion in principal repayments and warrant repurchases from CPP participants. For banks that have elected not to repurchase their CPP warrants, Treasury began auctioning their warrants in December 2009. In addition, many programs were structured to encourage early repayment of funds, including interest rates on preferred stock and subordinated debentures which increase over time and restrictions on executive compensation. Most TARP programs also have defined lives with clear end dates. For example, new lending under CPP is scheduled to end December 31, 2009 and TALF is scheduled to end in June 30, 2010. For investments in the automobile industry and for other companies that have received exceptional assistance, clear principles have been outlined ensuring support is limited and temporary. Specifically under AIFP, Chrysler Financial has already repaid its assistance, and an initial public offering for GM is expected next year.

The financial and economic recovery is fragile and faces significant headwinds. The unemployment rate reached 10.2 percent in October and may remain elevated for some time. Delinquencies of subprime residential mortgages reached over 26 percent and conforming mortgages nearly seven percent in the third quarter. A contraction in bank lending, particularly for smaller businesses which do not have access to bond markets, has had a significant impact on economic growth. The number of bank failures and "problem institutions" as classified by FDIC has increased significantly, and will likely remain elevated through 2010. Financial stability is a necessary precondition for the resumption of economic growth. Treasury and other institutions of government have accomplished a great deal in a short amount of time. Still, there is more work ahead. While a number of TARP initiatives have begun to wind down, Treasury continues to focus on stabilizing housing markets as well as improving access to credit for small businesses. For these reasons, Treasury determined in December 2009 to extend TARP spending authority beyond the initial expiration date of December 31, 2009. The authority to make new TARP investments will now expire on October 3, 2010, two years from the enactment of EESA, under provisions of the Act's Section 120(b).

FINANCIAL REGULATORY REFORM

On June 17, 2009, the President announced a comprehensive plan to reform an outdated and ineffective financial regulatory system. Treasury submitted proposed legislative text to implement the plan in July and August 2009, and is currently working with Congress to promulgate legislation by the end of the calendar year. The plan has five key objectives: promote robust supervision and regulation of financial firms; establish comprehensive regulation of financial markets; protect consumers and investors; provide the government with the ability to manage financial crises; and improve international cooperation.

Promote robust supervision and regulation of financial firms

Financial institutions that are critical to market functioning should be subject to strong oversight. No financial firm that poses a significant risk to the financial system should be unregulated or weakly regulated.

- *Create a Financial Services Oversight Council.* The Administration's regulatory reform plan will create a Financial Services Oversight Council to facilitate the coordination of financial regulatory policy, provide a forum for the resolution of jurisdictional disputes, and identify emerging risks in financial markets. This Council would include the heads of the principal federal financial regulators and be chaired by Treasury. The Council will replace the President's Working Group on Financial Markets and have a permanent, full-time staff at Treasury.
- *Supervise and regulate all of the largest, most interconnected financial firms.* Under the reform plan, the largest, most interconnected financial firms will be subjected to strong, comprehensive and consolidated oversight by the Federal Reserve, regardless of whether the firm owns an insured depository institution. Larger and more interconnected firms will be subjected to higher prudential standards and prompt corrective action will be required should their capital levels decline. Shareholders and creditors should bear the risks and the ultimate costs of failure, ending the implicit guarantee of public support for the largest, most interconnected financial firms.
- *Raise standards for all financial firms.* Tougher standards should be imposed on all financial firms so that the system is not compromised by the failure of one firm. Capital and liquidity requirements must be raised and exposures between financial firms should carry added capital charges. These tougher standards should incentivize firms to shrink, increase their capacity to absorb losses, and reduce their leverage, complexity and interconnectedness.
- *Establish a National Bank Supervisor and eliminate loopholes in banking regulation.* Merging the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) into a National Bank Supervisor (NBS) and eliminating the federal thrift charter would streamline the regulatory system and reduce potential for regulatory arbitrage. The proposed legislation also requires the Federal Reserve, the FDIC, and NBS adopt joint rules on bank regulatory fees to eliminate arbitrage between regulators based on bank examination fees.
- *Establish an Office of National Insurance.* The regulatory reform legislation includes a proposal to establish an Office of National Insurance (ONI) to serve as an advisor to the Secretary and coordinate

and develop federal policy in the insurance sector. As part of Treasury, ONI will monitor all aspects of the insurance industry, including identifying issues and gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or within the broader financial system. ONI would also assist the Secretary in negotiating international insurance agreements on prudential measures.

- *Register hedge funds.* Hedge funds and other private pools of capital, including private equity and venture capital funds, will be required to register with the Securities and Exchange Commission (SEC). Due to insufficient oversight and regulation prior to the financial crisis, the government lacked the data necessary to monitor these funds' activities and assess potential risks in the market. The legislation would help to protect investors from fraud and abuse, provide increased transparency, and supply the information necessary to assess whether risks in the aggregate or risks in any particular fund pose a threat to our overall financial stability.
- *Realign executive compensation.* Treasury delivered draft "say-on-pay" legislation to Congress that would require all publicly traded companies establish non-binding shareholder votes on executive compensation packages, encouraging greater accountability and disclosure of compensation practices. In addition, the draft legislation would help ensure the independence of board compensation committees. Overall, federal standards and guidelines should better align executive compensation practices of financial firms with long-term shareholder value and prevent these practices from providing incentives that could threaten the safety and soundness of supervised institutions.

Regulatory reform information at ***FinancialStability.gov***.

Establish comprehensive supervision of financial markets

New requirements for transparency and improved risk management capacity should be built into the financial market infrastructure to improve understanding of the risks associated with new financial instruments. In addition, regulation of financial markets should be enhanced to better manage system-wide stress and the failure of one or more large institutions.

- ***Strengthen supervision and regulation of securitization markets***. Securitization, by breaking down the traditional relationship between borrowers and lenders, created conflicts of interest that market discipline failed to correct. To better align investor and issuer interests, regulation should require that originators or sponsors retain an economic stake in a material portion of the credit risk of these securitized credit exposures. The SEC should continue its efforts to increase the transparency and standardization of securitization markets and be given clear authority to require robust reporting by issuers of asset-backed securities.
- ***Strengthen credit rating agency regulation***. The Administration's financial regulatory reform effort includes legislation to increase transparency, improve oversight, and reduce reliance on credit rating agencies. Credit rating agencies often failed to accurately describe the risks associated with certain products, preventing investors from understanding the underlying risks which contributed to the severity of the crisis. The legislation includes provisions expanding transparency and disclosure requirements for credit rating agencies, establishing mandatory registration with the SEC, instituting tougher examination of internal controls and processes, and ending the practice of firms providing consulting services to companies they rate.
- ***Regulate over-the-counter derivatives markets, including credit default swaps***. One of the most significant developments in the financial sector in recent decades has been the growth and rapid innovation in credit default swaps and other

over-the-counter (OTC) derivatives. The proposed legislation will regulate OTC derivative markets for the first time. This legislation will provide regulation and transparency for all OTC derivative transactions, stronger prudential and business conduct regulation of all major participants in OTC derivative markets, and improved regulatory and enforcement tools to prevent manipulation, fraud and other abuses.

- ***Strengthen oversight of systemically important payment, clearing and settlement systems***. To mitigate systemic risk and promote financial stability, the plan proposes giving the Federal Reserve stronger statutory authority to oversee systemically important payment, clearing and settlement systems. The Federal Reserve is the only agency with sufficiently broad and deep knowledge of financial institutions and capital markets to effectively assume this responsibility. Under the Administration's plan, the Federal Reserve will be required to consult with the Financial Services Oversight Council to identify systemically important systems and set appropriate standards. In the case of clearing and settlement systems for regulated markets, the Federal Reserve will be required to coordinate its risk management oversight with the CFTC or the SEC, which will remain the primary regulators for these markets.
- ***Harmonize futures and securities regulation***. The legislation proposes to harmonize statutory and regulatory regimes for futures and securities markets to better address gaps in regulation between the CFTC and SEC.

Protect consumers and investors from financial abuse

To rebuild trust in U.S. markets, it is critical to ensure strong, consistent regulation and supervision of consumer financial services and investment markets.

- ***Create a Consumer Financial Protection Agency***. Failure of the consumer protection regime significantly contributed to the financial crisis. On June 30, 2009, the President proposed creation of the Consumer Financial Protection Agency (CFPA) to protect consumers against deceptive and unscrupulous financial practices and improve innovation, efficiency and access in the marketplace. This agency will consolidate the current fragmented regulatory regime into a single, independent federal consumer protection agency with the authority to write rules, oversee compliance, and address violations by non-bank and banking institutions.
- ***Strengthen investor protection***. The Administration's financial regulatory reform legislation includes a provision to strengthen the SEC's authority to protect investors. The legislation outlines steps to establish consistent standards of conduct and accountability for broker-dealers and investment advisors, and improve the timing and the quality of disclosures. The proposed legislation also establishes a permanent Investor Advisory Committee to ensure investor representation at the SEC.

Provide the government with the tools it needs to manage financial crises

The government should have the tools necessary to address the potential failure of a bank holding company or other non-bank financial firm when the stability of the financial system is at risk.

- ***Enhance resolution authority***. Plans should be in place to resolve the failure of any large interconnected financial firm which could threaten the stability of the financial system. Bankruptcy will remain the primary option, but the recent financial crisis demonstrates the need for enhanced resolution capacity. Major financial firms will be required to develop rapid resolution plans to better prepare for the potential of failure. This authority will also give Treasury the ability to appoint FDIC or SEC as conservator for a failing firm that poses a threat to the system. Under the legislation, the Federal Reserve would be required to receive prior written approval from the Secretary of the Treasury before providing emergency lending under its "unusual and exigent circumstances" authority.

Raise international regulatory standards and improve international cooperation

As witnessed during the financial crisis, problems in any single country can easily and quickly spread across borders. As financial regulatory reform progresses within the United States, stronger standards need to be established across global markets to ensure international financial stability.

- ***Enhance international cooperation and reform of global financial markets***. To ensure that U.S. safeguards are not undermined abroad, the U.S. Government has taken the lead in calling for strong, modern regulation and supervision around the world through the G-20, the Financial Stability Board, the Basel Committee on Banking Supervision, and other organizations. Led by the United States, the leaders of the Group of Twenty (G-20) pledged to take action to build a stronger, more globally consistent supervisory and regulatory framework to oversee today's international markets. The United States is seeking consensus on four core issues: regulatory capital standards, oversight of global financial markets, supervision of internationally active financial firms, and crisis prevention and management.

TREASURY HOUSING GOVERNMENT-SPONSORED ENTERPRISE PROGRAMS

To provide stability to the financial markets, increase the availability of mortgage finance and protect taxpayer interests, Treasury implemented three emergency programs in September 2008 with respect to Fannie Mae, Freddie Mac and the Federal Home Loan Banks (FHLBs). Authority for the action was provided by Section 1117 of the Housing and Economic Recovery Act of 2008, which authorized Treasury to purchase obligations and other securities issued by Fannie Mae, Freddie Mac and any FHLB. The programs include:

- Preferred Stock Purchase Agreements (PSPAs) with Fannie Mae and Freddie Mac providing backstop funding for program operations
- A Mortgage-Backed Securities (MBS) Purchase Program limited to securities issued by Fannie Mae and Freddie Mac
- An emergency credit facility for Fannie Mae, Freddie Mac and the FHLBs

Preferred Stock Purchase Agreements

The PSPAs were created to instill confidence in investors that Fannie Mae and Freddie Mac would remain viable entities critical to the functioning of the housing and mortgage markets. Investors purchased securities issued or guaranteed by Fannie Mae and Freddie Mac in part because ambiguities in their Congressional charters created a perception of government backing. These ambiguities fostered enormous growth in the obligations issued or guaranteed by Fannie Mae and Freddie Mac, which by the scale and breadth of public holdings eventually posed a systemic risk to global financial markets in the event of their failure. The focus of the PSPAs is to enhance market stability by providing additional security to holders of Fannie Mae and Freddie Mac securities to avoid a mandatory triggering of receivership. Because the U.S. government created these ambiguities, it had a responsibility to both avert and ultimately address this systemic risk. In February 2009, the PSPAs were increased from $100 billion per GSE to $200 billion per GSE to provide additional security for financial markets. As of September 30, 2009, Fannie Mae and Freddie Mac had utilized $95.6 billion dollars of the $400 billion set aside under the PSPAs.

GSE MBS Purchase Program

The GSE MBS Purchase Program was created to help support the availability of mortgage credit by temporarily providing additional capital to the mortgage market. By purchasing these securities, Treasury has sought to broaden access to mortgage funding for current and prospective homeowners as well as to promote market stability.

Program priorities:

- Support mortgage availability for both current and prospective homeowners
- Promote secondary market stability
- Ensure zero principal loss on outlays

As of September 30, 2009, Treasury had purchased $192.2 billion in agency MBS and received back $22.2 billion in principal and $5.0 billion in interest.

GSE Credit Facility

The GSE Credit Facility was created to ensure credit availability to Fannie Mae, Freddie Mac, and the FHLBs by providing secured funding on an as-needed basis under terms and conditions established by the Treasury Secretary. Funding is provided directly by Treasury from its general fund held at the Federal Reserve Bank of New York in exchange for eligible collateral limited to guaranteed MBS issued by Fannie Mae and Freddie Mac and advances made by the FHLBs. Loans will be for short-term durations, but would in general be expected to be for between one week and one month. To date, this facility has not been used. The facility is scheduled to be terminated on December 31, 2009.

TEMPORARY GUARANTEE PROGRAM FOR MONEY MARKET MUTUAL FUNDS

At the height of the crisis in September 2008, Treasury established a Temporary Guarantee Program for Money Market Mutual Funds to provide stability in the wake of the failure of Lehman Brothers and well-publicized troubles at several large funds. Program participants were charged a fee of four to six basis points on an annualized basis, with coverage provided to guarantee maintenance of each fund's typical stable share price of $1. Eligibility was open to all money market mutual funds regulated under Rule 2a-7 of the *Investment Company Act of 1940* and registered with the SEC, upon payment of an up-front participation fee and satisfaction of certain criteria related to their net asset value on September 19, 2008. Shortly after its inception, the program provided guarantees to 93 percent of the money market mutual fund market, covering $3.62 trillion in assets. At its expiration, utilization had fallen to 68 percent of the market. Treasury had no losses under the program and in fact earned the U.S. Government $1.2 billion in fees.

The program expired on its scheduled end date of September 18, 2009 under improved general market conditions and restored confidence in the money market industry.

EXPANDED INTERNATIONAL ECONOMIC PARTNERSHIPS

Managing financial crises, trade flows, financial security, climate change, and aid for developing economies in a global economy requires coordination with international partners. In all of these areas, Treasury worked with international partners to improve joint stewardship of the global economy. Throughout the financial crisis, Treasury officials have been in constant communication with international colleagues, showing clear and compelling results. Treasury helped facilitate international cooperation in responding to the global financial crisis, averting a more serious economic downturn, and anchoring the largest, most coordinated fiscal and monetary stimulus ever undertaken.

Demonstrated U.S. leadership at G-20 meetings

The G-20 is a multilateral forum bringing together the leaders from the 20 largest economies in the world, accounting for 85 percent of world output. At the G-20 Summits in Washington (November 2008), London (April 2009), and Pittsburgh (September 2009), Treasury took a lead role in developing a dynamic global recovery formula and securing G-20 leaders' commitments on measures to combat the economic and financial crisis. Through these summits, G-20 members agreed to pursue a globally-coordinated policy response to stabilize the financial system and provide monetary policy support, fiscal stimulus, and emergency capital for emerging and developing economies. In addition to coordinating national fiscal and monetary policies, major accomplishments included decisions to:

- Treble resources for the IMF from $250 billion to $750 billion, enabling it to provide emergency loans to countries adversely affected by the financial crisis
- Restructure the Financial Stability Forum into the Financial Stability Board, by adding G-20 members not previously part of the Financial Stability Forum, broadening its capacity to manage global banking regulation and supervision
- Establish a *Framework for Strong, Sustainable, and Balanced Growth*, formulated around peer reviews of national economic policies and regulatory standards to collaboratively identify and prevent imbalances in the global economy
- Establish processes to ensure that all systemically important financial institutions, markets and instruments are subject to appropriate regulation
- Improve coordination in international crisis management
- Determine common rules for compensation practices at large financial institutions
- Improve international accounting standards
- Jointly manage concerns related to tax havens and non-cooperative jurisdictions
- Jointly manage oversight of credit rating agencies

At the G-20 summit in Pittsburgh, the leaders announced that the G-20 would replace the G-7 as the main economic council of wealthy nations. Through the G-20 process, Treasury has participated in developing a strong multilateral system to coordinate a global policy response to reverse the economic slide and do what is necessary to restore public confidence, economic growth, and job creation.

Deepened U.S. engagement with key emerging market and priority countries

Given that the global economy is increasingly impacted by emerging market countries, more inclusive representation in international bodies is essential for long-term global recovery and growth. Treasury strongly supported the transition from reliance on the G-7 negotiation process to the G-20 process, the trebling of the IMF's resources, and creation of the Financial Stability Board. Treasury also supported quota reforms at the World Bank and IMF to allow greater participation by developing nations and increased financial support for multilateral development banks (MDBs) that will boost lending by $100 billion over the next three years. To manage key partnerships, the Treasury Department has established bilateral strategic dialogues with China, India, Russia, Afghanistan, Pakistan and Iraq. (The U.S.-China Strategic and Economic Dialogue is discussed in a following section.)

Promoted free international trade and investment

Treasury promoted open investment policies at home and for U.S. investors abroad through bilateral and multilateral outreach. Announcement of the intention to complete the Doha Round of World Trade Organization negotiations by the end of 2010 increased activity in fiscal year 2009 surrounding trade negotiations. Treasury staff participated in the launching, negotiation or implementation of 15 trade and investment agreements, including free trade agreements with Oman, Costa Rica and Peru; the Trans-Pacific Agreement; the Asia-Pacific Economic Cooperation cross-border services initiative; and the Mauritius Bilateral Investment Treaty. Treasury has supported efforts by G-20 leaders to refrain from new protectionist measures and keep markets open. Finally, Treasury played a key role in establishing the U.S.-EU Investment Dialogue and the U.S.-China Investment Forum to discuss high-priority investment issues, and efforts to codify investment criteria for sovereign wealth funds.

U.S.–China Strategic and Economic Dialogue

In April 2009, President Barack Obama and Chinese President Hu Jintao announced the establishment of the U.S.-China Strategic and Economic Dialogue (S&ED). The Dialogue provides an overarching framework bringing together the two countries' highest-level officials to address a range of critical bilateral and global economic, environmental and diplomatic issues. In fiscal year 2009, the Dialogue contributed to coordinated monetary and fiscal policy actions to restore growth and the successful restructuring of multilateral economic institutions. The S&ED builds on its predecessor, the Strategic Economic Dialogue (SED), which was created in 2006, and includes two tracks, one economic track led by Secretary Geithner, and a strategic track led by Secretary Clinton. The last meeting of the S&ED was held in Washington in July 2009. The next meeting will be held in Beijing in 2010.

Supported a Global Agreement on Climate Change

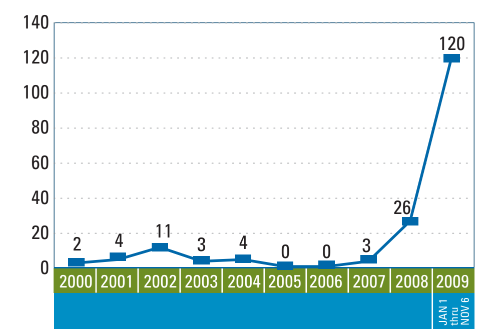
With the parties to the United Nations Framework Convention on Climate Change scheduled to meet in Copenhagen in December 2009, Treasury is working closely with other federal agencies and international partners to secure an effective global agreement. Treasury's efforts were critical to establishing and launching the Climate Investment Funds, two new multilateral trust funds hosted by the World Bank that promote clean energy in developing countries, and establishment of an Experts Group on Climate Finance at the G-20. The Clean Technology Fund (CTF), the first of the two new funds, aims to reduce global emissions growth by helping to close the price gap in developing countries between dirtier conventional technologies and commercially available cleaner alternatives. The CTF is currently co-chaired by the Treasury's Deputy Assistant Secretary for Environment and Energy.

CONTINUED EFFORTS TO BOLSTER REGULATION OF NATIONAL BANKS AND THRIFTS

OCC and OTS are the primary regulators of national banks and thrifts, respectively. Given continuing concerns about the soft economy and bank solvency following the financial crisis, both made extensive efforts to monitor evolving conditions at financial institutions they regulate and implement measures intended to restore financial health. In fiscal year 2009, the Inspector General again indicated regulation of national banks and thrifts as a Management Challenge.

Despite efforts to identify and correct potential issues at an early stage, a number of national banks and thrifts were closed by federal regulators in fiscal year 2009 due to difficult market conditions. In total, 107 financial institutions regulated by FDIC with $111.3 billion in deposits failed over the year. Of these, 13 were national banks with $14.8 billion in deposits, 14 were federal thrifts with $35.8 billion in deposits, and 80 were state banks with $60.8 billion in deposits. Work-out solutions, whereby some or all deposits and assets were assumed by another existing bank, were arranged by FDIC and regulators for almost all failed institutions.

FIGURE 9. Failed Banks in USA from 2000-2009



OCC and OTS supervisory activities in fiscal year 2009 focused on monitoring and responding to adverse conditions in credit and financial markets. OCC's on-site supervisory assessments focused on the quality of national banks' credit risk management practices (including effective credit risk rating systems and problem loan identification), adequacy of loan-loss reserves, and effective loan work-out strategies. Primary emphasis was placed on ensuring the strength of capital buffers to weather earnings pressures and asset quality deterioration. Other critical areas included sound liquidity risk management through diversified funding sources and realistic contingency funding plans, and maintenance of consistent underwriting standards regardless of intent to hold or sell a loan. OTS examinations emphasized assessment of risk management structures, liquidity plans, capital management, concentration risk and maintenance of strong underwriting standards. Given the natural exposure of thrifts to the real estate market, OTS utilized the Net Portfolio Value model (enhanced in 2008) extensively to value financial instruments and evaluate interest risk related to real estate and other investments. (Thrifts are required to hold 65 percent of their holdings in mortgages.) For troubled institutions, OCC and OTS employed a number of remedial measures, including Prompt Corrective Action determinations when institution capital deteriorated below specified thresholds, requirements to increase available capital and liquidity, required changes in bank management, and required approval for changes in business plans. To combat mismanagement, formal enforcement actions such as cease-and-desist orders, removal or prohibition orders, civil money penalties and formal agreements were utilized. In severe cases, financial institutions were required to enter into sales, mergers, liquidation or enter FDIC receivership.

To minimize real estate losses and avoid unnecessary foreclosures, both agencies encouraged financial institutions and at-risk mortgage holders to work constructively to find effective work-out solutions. Both OCC and OTS urged adoption of loan modification programs and other foreclosure mitigation practices and provided information for consumers on ways to identify and avoid foreclosure fraud. In November 2008, the federal banking agencies issued the *Interagency Statement on Meeting the Needs of Creditworthy Borrowers*, providing guidance to financial institutions on managing mortgage delinquency. OCC and OTS worked closely with HUD and other Treasury officials to develop the Making Home Affordable Program, including establishing transparent capital standards for treatment of mortgage loans modified under the program to encourage bank participation. OCC was also actively involved in identifying potential bank responses to the foreclosure crisis, including working with community development organizations to rehabilitate foreclosed properties and working with HUD to stabilize neighborhoods.

In fiscal year 2009, OCC's Annual Survey of Credit Underwriting Practices indicated a continuation of tighter underwriting standards begun in mid-2007. In contrast with the period of "originate and sell", where banks originated loans and then sold them to other investors, survey results showed that the majority of banks applied the same tight underwriting standards regardless of intent to hold or sell. With increased weakness in commercial real estate markets, both agencies warned of the accumulating risks in many small and medium-sized institutions' portfolios. At an inter-agency level, both OCC and OTS have worked directly with the Federal Reserve and FDIC to review large syndicated loans held by multiple banks through the Shared National Credit Program. This year's review covered 8,955 credit facilities with commitments totaling $2.9 trillion. OCC and OTS will continue to coordinate their licensing and supervisory procedures with other federal agencies to keep regulations current, transparent and supportive of financial industry stability and growth.

OCC and OTS have issued direct warnings to financial institutions of the risks posed by excessive asset or liability concentrations in their portfolios. During the last four years, OCC has conducted asset quality reviews of all the OCC community and mid-sized banks with significant commercial real estate concentrations, to ensure they have adequate credit underwriting, problem loan identification, and loan-loss reserves. More recently, the federal banking agencies issued guidance on managing concentration risks that may emerge from correspondent banking relationships, to reduce any carryover effect from one bank's failure.

Given the global nature of the financial crisis, OCC and OTS worked closely with both domestic and international banking supervisors to identify problems and coordinate actions to restore functioning markets and strengthen risk management. The Federal Reserve, OCC and SEC worked with key global regulators and market participants to strengthen operational infrastructure and processes used to oversee OTC derivatives. OCC was actively involved in developing and implementing a package of measures announced by the Basel Committee of Banking Supervisors in July 2009 to capture the credit risk of complex trading activities and institute higher capital requirements for certain activities. OCC and OTS also joined other global supervisors in endorsing the Basel Committee's *Principles for Sound Liquidity Risk Management and Supervision*, underscoring the importance of liquidity management. Through the Financial Stability Board's Working Group of Provisioning, chaired by the Comptroller of the Currency, OCC has actively promoted use of credit valuation processes to reduce the pro-cyclicality of loan-loss requirements. During the year, OCC and OTS provided significant support for TARP, including reviewing financial institutions' Capital Purchase Program (CPP) applications; participating on the TARP CPP Council (which provides advisory support to OFS); conducting "stress tests" for regulated entities; providing legal analysis on financial institution participation in TARP; and establishing credit rules promoting use of the Making Home Affordable Program. OCC and OTS also continued to jointly issue the Mortgage Metrics Report, providing detailed information on 34.7 million mortgages serviced by their regulated institutions, including new sections in 2009 on loan modifications.

To strengthen its unfair or deceptive acts and practices rules, OTS, Federal Reserve and National Credit Union Association issued final rules in December 2008 governing practices for credit cards and overdraft protection programs. For credit cards, these addressed unfair practices in the areas of providing reasonable time periods for making payments, payment allocations, interest rate increases on outstanding balances, security deposits and fees charged to an account prior to the issuance of credit.

PROVIDED ASSISTANCE TO LOW-INCOME AND UNDERSERVED COMMUNITIES

The Community Development Financial Institutions (CDFI) Fund expands the capacity of financial institutions to provide credit, capital, and financial services to underserved populations and low-income communities. With the economic downturn, demand for the Fund's services increased as mainstream lenders reduced lending activities. At the same time, constrained debt and equity markets limited CDFIs' access to private capital. To address the shortfall, Treasury increased funding through the CDFI program in fiscal year 2009 to help meet demand. This year, the CDFI Program competitively made 194 awards totaling $160.8 million (including $98 million in Recovery Act awards) to CDFIs and Native American CDFIs for loans, investments, financial services, and technical assistance (a 158 percent increase over fiscal year 2008). Under the New Markets Tax Credit Program (NMTC), which provides tax credit allocation authority to designated financial institutions for investments in low-income communities, Treasury awarded $6.5 billion in fiscal year 2009 (including $3 billion in Recovery Act awards), compared with $3.5 billion in fiscal year 2008, a nearly 86 percent increase. Treasury will continue to provide funding through the CDFI program to mitigate tight capital conditions in underserved markets.

MANAGEMENT OF CURRENCY AND COIN MANUFACTURING IN TODAY'S ECONOMY

Record low demand for currency and coins

The economic and financial crises significantly affected note and coin demand in fiscal year 2009. Manufacturing of currency notes experienced a 1.5 billion unit (19.5 percent) reduction in quantity ordered by the Federal Reserve, a drop from 7.7 billion notes in fiscal year 2008 to 6.2 billion notes in fiscal year 2009. This reduction in the Federal Reserve order was large enough to increase BEP's average cost per note produced by 7 percent over the prior fiscal year. The U.S. Mint shipped an estimated 5.2 billion coins, down from 10.0 billion in fiscal year 2008, representing a 45-year low for coin demand. As a result, the U.S. Mint transferred $475 million to the Treasury General Fund in fiscal year 2009, significantly lower than the $750 million transferred in fiscal year 2008. To compensate for weak demand, both the U.S. Mint and BEP are optimizing manufacturing and administrative efficiencies, focusing on maintenance, capital improvements, and employee cross-training.

Responding to record high demand for bullion products

As the economy and financial markets weakened, investors sought the perceived safety of precious metals. U.S. Mint revenue from the sale of gold, platinum, and silver bullion products increased by 79 percent in fiscal year 2009, from $949 million in fiscal year 2008 to $1,695 million in fiscal year 2009. However, these record-breaking demand levels and successful sales efforts in the bullion product line posed a new set of challenges. The number of bullion coins produced by the U.S. Mint was constrained in fiscal year 2009 by limited availability of precious metal blanks from suppliers. These constraints compelled the U.S. Mint to suspend the sale of certain bullion coins during the fiscal year. In order to satisfy its legislative mandate to fulfill public demand for bullion products, the U.S. Mint shifted available blank supply to production of bullion coins from proof coins and worked with suppliers to augment blank volumes and sources. Subsequent increases in allocation and ordering limits towards the end of the year allowed the U.S. Mint to satisfy all investor demand for 22-karat one-ounce gold and silver bullion coins by the third quarter of fiscal year 2009. However, at the end of the fiscal year, one-ounce gold and silver eagle proof coins remained unavailable.

Completion of the most ambitious currency redesign in U.S. history

The redesign of the $100 note will mark the completion of a multi-year initiative to implement the most ambitious currency redesign in United States history. Finalized and presented for approval in fiscal year 2009, BEP expects to produce and deliver 2.4 billion redesigned $100 notes in fiscal year 2010. In cooperation with the Federal Reserve, BEP administers a public education program to support the introduction of new currency designs. To maintain trust and confidence in U.S. currency, BEP is continuously engaged in improving note design to keep the nation's currency a step ahead of counterfeiters. While no specific timetable has been set, the next currency redesigns will include improvements to the nation's currency to better serve the blind and visually impaired.

Implementing the Presidential and Native American $1 Coin Acts

The *Presidential $1 Coin Act* (Public Law 109-145) and the *Native American $1 Coin Act* (Public Law 110-82) mandate that the U.S. Mint take cost-effective measures to identify, analyze and overcome barriers to circulation of $1 coins. The increased circulation of $1 coins could save the Federal Government money because $1 coins last longer than $1 notes. A four-city pilot focusing on new messaging and retail activation showed American acceptance of $1 coins is growing. However, despite U.S. Mint advertising campaigns, consumer acceptance of $1 coins has remained low and inventories at the Federal Reserve Bank have continued to rise.

AMERICAN RECOVERY AND REINVESTMENT ACT

The *American Recovery and Reinvestment Act of 2009* (Recovery Act) was signed into law on February 17th, 2009. The Recovery Act is an unprecedented effort to jumpstart the economy, create or save millions of jobs, and address long-neglected challenges. It includes extraordinary measures to modernize the nation's infrastructure, enhance energy independence, expand educational opportunities, preserve and improve affordable health care, and provide tax relief. Of the $787 billion provided through the Recovery Act, Treasury is managing programs that will contribute over $300 billion in benefits to the American people through the year 2019.

Making Work Pay credit. Taxpayers can receive this benefit through a reduction in the amount of federal income tax that is withheld from their paychecks, or through claiming the credit on their tax returns. It is estimated that over 120 million households will benefit from this provision through 2010.

Expanded tax break for 2009 first-time home-buyers. Taxpayers who qualify for the First-Time Homebuyer Credit and purchase a home this year before December 1 may claim a maximum $8,000 credit on their 2009 tax return. The estimated benefit claimed by 479,622 taxpayers through fiscal year 2009 was over $3.5 billion. The credit has been extended through April 30, 2010, with closing required by June 30, 2010.

American Opportunity Credit. Under the Recovery Act, more parents and students will qualify over the next two years for a tax credit, the American Opportunity Credit, to pay for college expenses. The new credit modifies the existing Hope Credit for tax years 2009 and 2010, making the Hope Credit available to a broader range of taxpayers, including many with higher incomes and those who owe no tax. It also adds required course materials to the list of qualifying expenses and allows the credit to be claimed for four post-secondary education years instead of two. The full credit is available to individuals whose modified adjusted gross income is $80,000 or less, or $160,000 or less for married couples filing a joint return. The credit is phased out for taxpayers with incomes above these levels. Many of those eligible will qualify for the maximum annual credit of $2,500 per student. The estimated benefit in 2009 is $328 million.

COBRA health insurance continuation premium subsidy. To help people maintain health care coverage, the Recovery Act provides a 65 percent subsidy for COBRA continuation premiums for themselves and their families, up to nine months, for workers who have been involuntarily terminated. Eligible workers are required to pay 35 percent of the premium to their former employers. Employers are required to pay the full premium, but are entitled to a credit of 65 percent on their payroll tax return. To qualify, a worker must have been involuntarily terminated between September 1, 2008 and December 31, 2009. Over $313 million in COBRA credits have been claimed by employers through fiscal year 2009.

Build America Bonds. State and local governments issuing taxable bonds are eligible to receive direct federal subsidies of 35 percent of bond interest. Through September 30, 2009, over $35.6 billion in Build America Bonds had been issued to help finance projects across the nation, including schools, utilities, public safety and transportation.

Sales tax deduction for vehicle purchases. Taxpayers can deduct state and local sales and excise taxes paid on the purchase of new cars, light trucks, motor homes and motorcycles through 2009.

Economic recovery payments. The Recovery Act provided $250 one-time economic recovery payments to eligible retirees, veterans and other high-need recipients. FMS, in coordination with the Social Security Administration, the Railroad Retirement Board, and the Department of Veterans Affairs, issued over 54.9 million economic recovery payments to beneficiaries, totaling more than $13.7 billion.

Community Development Financial Institutions (CDFI) awards. The CDFI Fund makes monetary awards (grants, loans and other investments) on a competitive basis to certified CDFIs. The Recovery Act appropriated $98 million to expand funding for the CDFI and Native American CDFI Assistance (NACA) programs. All $98 million was awarded to CDFI recipients by July 1, 2009.

New Markets Tax Credit (NMTC). The NMTC Program, administered by the CDFI Fund, facilitates investment in low-income communities by permitting credits against federal income taxes for equity investments in designated Treasury-certified Community Development Entities (CDEs).

CDEs are required to use substantially all NMTC proceeds to make loans and investments in businesses and real estate developments in low-income and distressed urban and rural communities. The Recovery Act provided a total of $3 billion for the credits. The first NMTC award of $1.5 billion was allocated in May 2009 to 32 organizations. The second allocation of $1.5 billion was awarded in October 2009 to 24 organizations.

Health Coverage Tax Credit (HCTC). HCTC was created to help displaced workers and retirees who have lost their jobs due to promulgation of free trade agreements. The Trade Adjustment Assistance Reform Act of 2002 created HCTC to assist eligible beneficiaries between the ages of 55 and 64 receive affordable health care. The program originally provided a refundable tax credit for 65 percent of the cost of qualified insurance. In May 2009, the tax credit was increased from 65 percent to 80 percent of qualified health insurance premiums, allowing participants to only pay 20 percent for health insurance each month. The increased credit expires on December 31, 2010. The number of new enrollees has increased more than four times since April 2009, to over 6,000 recipients.

Payments for Specified Energy Property in Lieu of Tax Credits. Because of the impact of current economic conditions on taxable income, the value of energy property tax credits to investors who finance renewable energy projects has decreased. Designed with the Department of Energy, this program's objective is to provide an alternative means to attract financing for renewable energy projects by providing direct payments in lieu of tax credits. The program began accepting applications on July 31, 2009 and by September 30, 2009 had made awards for 37 projects totaling more than $1 billion. The high demand for this program is expected to continue in fiscal year 2010.

Payments for Low-Income Housing Projects in Lieu of Tax Credits. Current economic conditions have severely undermined the effectiveness of tax credits intended to attract private capital investment for the construction, acquisition or rehabilitation of qualified low-income housing projects. The Recovery Act gives state housing credit agencies the choice to receive cash assistance for all or a part of their 2009 low-income tax credit allocation. Through September 30, 2009, the Department has received 57 applications and approved payments to 40 state housing agencies for over $2.5 billion. However, only $29 million has been drawn down so far. Initial feedback suggests that states are evaluating their financial capacity and determining how to provide funding needed to complete qualifying projects.

EFFECTIVELY MANAGED U.S. GOVERNMENT FINANCES

The Treasury Department manages the nation's finances by collecting money due to the United States, making its payments, managing its borrowing, investing when appropriate, and performing central accounting functions. With the financial crisis and recession, fiscal year 2009 provided unique challenges in implementing Recovery Act provisions, forecasting government receipts, and conducting a record number of auctions of government securities. Treasury continues to focus on its ongoing efforts to increase the total volume of electronic payments and receipts and improve taxpayer service and enforcement.

TAX RETURNS FILED ELECTRONICALLY

In fiscal year 2009, Treasury processed 144.4 million individual returns and issued 114.4 million refunds totaling $339.6 billion. Sixty-six percent of individual returns were filed electronically, up from 58 percent in fiscal year 2008. Although this is a clear improvement, Treasury has not yet reached the Congressional goal of 80 percent of tax returns filed electronically. Treasury continues to promote the use of the IRS Free File program and engage in national and local outreach efforts to increase electronic filing by businesses and tax return preparers.

IMPROVED SERVICE TO MAKE VOLUNTARY TAX COMPLIANCE EASIER

Treasury makes every effort to ensure that taxpayers have access to the necessary information and support to meet their tax obligations. In fiscal year 2009, the IRS fielded over 107 million taxpayer calls. The second "Super Saturday" tax information event was held on March 21, 2009, providing on-site support at more than 250 local IRS offices and 1,700 Volunteer Income Tax Assistance (VITA) sites. Over the year, 82,000 volunteers at the VITA and Tax Counseling for the Elderly sites helped file over 3 million returns and provided face-to-face assistance to 3.4 million taxpayers. To track their refunds, more than 54 million taxpayers used the online service "Where's My Refund?", an increase of 39 percent over 2008. Outreach efforts and service locations for U.S. overseas taxpayers were increased to facilitate information availability and support. IRS is making every effort to restore its level of service, which dropped from 82 percent in 2007 to 53 percent in 2008, due largely to increased volume of inquiries related to economic stimulus payments. The level of service for fiscal year 2009 was 70 percent.

EXPANDED ENFORCEMENT OF TAX LAWS TO ENSURE TAX COMPLIANCE

Treasury has expanded its international enforcement presence, continued to pursue high net-worth/high income non-compliant taxpayers, and initiated efforts to improve coordination with the tax return preparer community. In fiscal year 2009, Treasury focused on detecting and bringing to justice individuals and businesses who hide assets overseas to avoid paying taxes. The largest bank in Switzerland agreed to pay a $780 million fine and provide the names of 4,450 U.S. account holders in response to a summons. Another bank entered into a deferred prosecution agreement and forfeited $340 million in connection with violations of the International Emergency Economic Powers Act. An Offshore Merchant Account Initiative increased focus on U.S. businesses that deposit unreported business receipts from debit and credit card sales in bank accounts domiciled in secrecy jurisdictions. For high-net-worth individuals, 11.2 percent of taxpayers with incomes over $200,000 were audited and 29 percent of taxpayers with incomes over $1 million were audited. Audits were also increased on self-employed taxpayers by over 21 percent. In fiscal year 2009, the IRS developed a comprehensive set of recommendations to ensure consistent standards for tax preparer qualifications, ethics and service, with the intention of establishing a foundation for improving enforcement coordination with the tax preparer community.

The *Children's Health Insurance Program Reauthorization Act* (CHIPRA) was enacted in February 2009. CHIPRA imposes significantly increased tax rates on tobacco products and introduced requirements for permits and taxes on products which had not previously been taxed or regulated (cigarettes went from a tax rate of $.39 to $1.01). Implementing the provisions was a major undertaking for TTB, including mailing of almost 500,000 information packets and fielding 50,000 inquiries about the tax increase and permit requirements, resulting in an additional $6 billion in Federal tax revenues. CHIPRA also levies a floor stocks tax (FST), a one-time excise tax placed on a commodity undergoing a tax increase, on all tobacco products held for sale as of April 1, 2009. In fiscal year 2009, TTB processed more than 133,000 receipts and collected a record $1.2 billion dollars of FST.

TTB is using automated data analysis techniques to target non-filers for audit, and is reviewing sales data to find unusual patterns that may indicate a business was stock piling product prior to the effective date of the new tax rates. TTB will use this information to identify tobacco dealers to target for audit in fiscal year 2010.

IMPROVED ELECTRONIC RETURN PROCESSING THROUGH BUSINESS SYSTEMS MODERNIZATION

Treasury continues to make efforts to improve business systems for tax processing. Upgrades to the Customer Account Data Engine (CADE) in 2009 enabled the system to process 40 million returns, 34.9 million refunds and over seven million payments. Treasury is committed to completing CADE implementation by 2011. Modernized e-File (MeF) release 5.5 enabled system processing of 33 percent more Form 1120s and 307 percent more Form 990s. (Returns submitted through the MeF system have an average processing error rate of seven percent, versus 19 percent for transcription-based paper processing.) MeF return receipts increased to about 4.5 million, an increase of 21 percent over 2008.

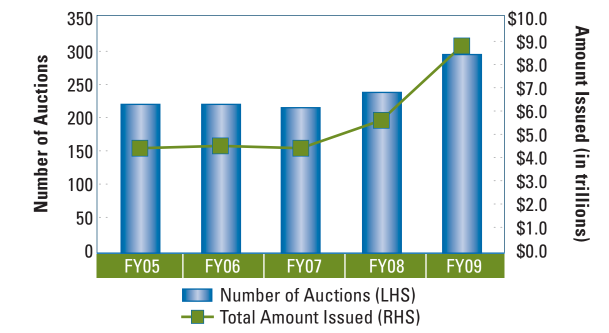
CHALLENGES ASSOCIATED WITH IMPLEMENTING RECOVERY ACT TAX PROVISIONS

Upon enactment of the Recovery Act, Treasury worked to ensure timely implementation of tax provisions, including creating and issuing forms and publications, developing and disseminating information through the internet, print media and television, and implementing safeguards against tax fraud. Despite the successes implementing these provisions, increased customer inquiries and payments added strains to existing management systems. The increased volume of taxpayer calls resulted in increased waiting times and busy signals, with the average caller waiting nearly 9 minutes. Average wait time in 2007 was 4.5 minutes. The additional payments also increased the incidence of improper payments, particularly for the First-Time Homebuyer Credit. The IRS will continue to make efforts to reduce service wait time and improper payments.

MANAGED INCREASED ISSUANCE OF DEBT FINANCING

In fiscal year 2009, the Department conducted over 290 government securities auctions, resulting in the issuance of over $8 trillion dollars in marketable securities. The results of each auction were released within the target time of two minutes plus or minus 30 seconds after the auction close. The prompt release of auction results reduced the amount of time bidders were exposed to adverse market movements, encouraging more competitive bidding and allowing the Department to secure lower borrowing rates for the U.S. Government. Treasury also successfully began the monthly issuance of three and seven year notes in order to meet the demand for borrowing and allow for greater flexibility in borrowing options.

FIGURE 10. Number of Auctions and Amount Issued by Fiscal Year



IMPROVED RETAIL SECURITIES SERVICES

BPD's Retail Securities Services program serves more than 50 million retail investors in marketable securities and savings bonds. In fiscal year 2009, BPD achieved its long-term goal of completing 90 percent of time-sensitive retail customer service transactions within 10 business days, one year ahead of schedule. BPD will transition to a new performance measure in fiscal year 2010 targeting completion of these transactions within 5 business days. TreasuryDirect, which provides investors electronic savings bonds, continues to grow. In fiscal year 2009, the system was enhanced to enable entities such as trusts, corporations, fiduciaries, and estates to open accounts and conduct transactions.

EXPANDED USE OF ELECTRONIC FUND TRANSFERS

During fiscal year 2009, FMS continued to expand the use of electronic fund transfers to deliver federal payments, improve service to payment recipients, and reduce government program costs. The Go Direct campaign, which encourages current federal benefit check recipients to switch to direct deposit, concluded a successful fourth year with over one million conversions. The total number of conversions since inception of the campaign is over 3 million. Overall, 81 percent of Treasury payments and associated information were made electronically, an increase of two percent from fiscal year 2008. This helped decrease the number of paper checks issued, minimizing costs associated with postage and the re-issuance of lost, stolen and misplaced checks.

CHALLENGES FORECASTING GOVERNMENT RECEIPTS DURING THE RECESSION

The financial and economic crisis made fiscal year 2009 an extremely challenging year to forecast government tax receipts. Expanded tax credit programs under the Recovery Act and rising unemployment levels reduced tax receipts and increased the difficulty of forecasting accurately. Given the severity of the recession and uncertainty surrounding future private consumption and investment, predicting the timing and rate of recovery in fiscal year 2010 could be equally challenging. Treasury missed its performance target of five percent maximum variance between estimated and actual fiscal receipts in fiscal year 2009, with an actual variance of 5.5 percent.

PREVENTED TERRORISM AND PROMOTED THE NATION'S SECURITY THROUGH STRENGTHENED INTERNATIONAL FINANCIAL SYSTEMS

While promoting financial and economic growth at home and abroad, the Treasury Department performs a unique role in preserving national security. In fiscal year 2009, Treasury continued to safeguard the nation's financial security while carrying out critical law enforcement responsibilities pertaining to predatory lending practices. These expectations require that Treasury continue to modernize its technological infrastructure to ensure a safer and more transparent financial system while protecting U.S. national security.

STRENGTHENED MEASURES AGAINST IRAN TO PROTECT U.S. NATIONAL SECURITY

Since the designation of a large Iranian bank, Bank Saderat, in September 2006, Treasury has led an ongoing effort to warn the world about the threat Iran poses to U.S. security and the integrity of the international financial system. This effort has developed a global consensus. In fiscal year 2009, the Financial Action Task Force (FATF), the global standard-setting body to combat money laundering and terrorist financing, issued its fourth warning alerting countries to strengthen measures to protect their financing sectors. Treasury has continued to strengthen its efforts to ensure that Iran is restricted from the U.S. financial system, while encouraging other countries to do the same.

The Department of the Treasury responded to the FATF warning one month after it was issued. Treasury hindered Iran's ability to financially support illicit activities by revoking an existing "U-turn" license for Iran, further restricting Iran's access to the U.S. financial system. This license had allowed funds transfers to pass though the U.S. financial system for the benefit of Iranian entities. Following this action, U.S. financial institutions are no longer allowed to process such transactions.

Treasury maintained its designations of Iranian financial institutions and individuals due to proliferation concerns and implemented several new designations. The Department, through the FATF, will continue to strengthen its measures and encourage other countries to enhance vigilance over all business with Iran.

ENHANCED MECHANISMS TO COMBAT MORTGAGE AND LOAN MODIFICATION FRAUD

A series of initiatives have been announced to help American homeowners and address the housing crisis. The United States government continues to intensify its efforts to ensure predatory scams do not rob Americans of their savings and potentially their homes. On April 6, 2009, Secretary Geithner announced a coordinated proactive effort to be led by Treasury, to combat fraudulent loan modification schemes and coordinate ongoing efforts across a range of federal and state agencies that investigate fraud and assist with enforcement and prosecutions. Treasury simultaneously issued an advisory to alert financial institutions to the risks of emerging schemes related to loan modification. These efforts are designed to facilitate the detection, deterrence, investigation and prosecution of those who would exploit consumers facing possible home foreclosures, in particular to target fraudulent scams against consumers seeking loan modification assistance.

This advisory was intended to identify "red flags" that may indicate a loan modification or foreclosure rescue scam and warrant the filing of a Suspicious Activity Report (SAR). These red flags alert financial institutions to scams victimizing their customers and provide an opportunity to stop predatory loan modification. The advisory reminded financial institutions of the requirement to implement appropriate risk-based policies, procedures and processes. Financial institutions must conduct customer due diligence on a risk-assessed basis to prevent fraudulent actors from accessing the financial system and to aid in the identification of potentially suspicious transactions.

The advisory required the term "foreclosure rescue scam" to be included in the narrative sections of all relevant SARs. This inclusion allowed law enforcement to more easily search for and identify fraudulent activity when reviewing SAR information, improving the focus of investigative resources. Utilizing the initiative's advanced targeting methods, 30 case referrals were made to law enforcement investigators involving over 140 suspects. Treasury, at the request of civil and criminal law enforcement, also contributed to 35 investigations involving multiple suspects and hundreds of BSA reports. These results have illustrated the benefits of proactive threat identification and preemption of fraudulent activity. However, the management of capital investments is still considered to be a management challenge.

LIFTED SANCTIONS ON 125 INDIVIDUALS OR ENTITIES FROM THE LIST OF SPECIALLY DESIGNATED NATIONALS (SDNs)

Treasury's Office of Foreign Assets Control (OFAC) administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals against targeted foreign countries and regimes, terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy or economy of the United States. Key to OFAC's success is the reaction of the private sector when financial measures are utilized, such as designations, to disrupt or dismantle the forces at work in illicit finance or other criminal behavior. When private sector organizations, particularly those in the international banking community, voluntarily go beyond their legal requirement and demonstrate good corporate citizenship by refusing to handle illicit business, they strengthen the effectiveness of government-imposed measures.

In fiscal year 2009, OFAC had success with financial institutions in South Africa, Latin-America, Mexico, Europe, China, and the Middle East in closing accounts and denying access to the financial system for criminals involved in activities that could jeopardize U.S. national security. Additionally, OFAC took several actions to lift sanctions on 125 individuals or entities, where an individual or entity had to divest themselves of any ownership interest in any OFAC designated companies. As a result, dozens of front companies within the target networks have been liquidated and no longer facilitate illicit business activities.

STRENGTHENED THE REVIEW PROCESS FOR FOREIGN INVESTMENT IN THE UNITED STATES

Treasury chairs the sixteen-member Committee on Foreign Investment in the United States (CFIUS) which reviews certain foreign investments into the United States to identify and resolve national security concerns.

The *Foreign Investment and National Security Act of 2007* (FINSA) required Treasury to issue new regulations governing the CFIUS process. CFIUS agencies took into account over 30 public comments received from domestic and foreign parties in response to proposed regulations that Treasury published on April 21, 2008. Treasury issued final regulations on November 21, 2008, which went into effect on December 22, 2008. On December 8, Treasury also published guidance on the types of transactions that CFIUS has reviewed which have raised national security concerns. Though the guidance does not have the force of law, it provides helpful insight about how the CFIUS process works.

MODERNIZE BANK SECRECY ACT (BSA) INFORMATION AND ANALYSIS

The current BSA data infrastructure is ill-equipped to meet 21st century realities and unable to quickly adapt to changing financial indicators and patterns of illicit activity. The number of financial institutions falling under the purview of the BSA has grown exponentially in the last six years and will continue to experience robust growth in the future. Treasury developed a strategy in fiscal year 2007 to modernize the BSA data architecture to better serve its internal and more than 10,000 external users that rely on accurate, timely, and reliable BSA data to identify money laundering, terrorist financing, tax evasion, and vulnerabilities in the financial industry.

The modernization will reengineer the BSA data architecture, update antiquated infrastructure required to support data capture and dissemination, implement innovative web-services, enhance electronic-filing, and provide analytical tools. This investment will begin to enrich and standardize BSA data to maximize value, evaluate and deploy advanced analytical technologies, and establish more effective security technologies to enhance data confidentiality and integrity. After two years of analysis, the Department anticipates beginning implementation of this modernization in fiscal year 2010.

ENCOURAGE PAKISTAN TO MAKE ITS ANTI-MONEY LAUNDERING LAW PERMANENT

A key aspect of strengthening anti-money laundering/counter-terrorist financing (AML/CFT) regimes is conducting country assessments to determine the level of compliance with international AML/CFT standards that country has. These evaluation reports also identify deficiencies and ways to strengthen each country's regime. Adopting one of these mutual evaluations triggers a follow-up review, which establishes an avenue for Treasury to encourage additional measures to strengthen a country's AML/CFT regime. Despite the work Treasury has done in fiscal year 2009 and before, there is still room for improvement to implement AML/CFT laws in key countries. In particular, Pakistan needs to build on the progress it made as a result of its mutual evaluation. Its anti-money laundering law must be made permanent and investigations and prosecutions for money laundering and terrorist financing offenses must occur.

CONTINUE TO PROVIDE ADDITIONAL GUIDANCE TO THE CHARITABLE SECTOR

The Department strives to create a robust and aggressive strategy to conduct outreach to the charitable sector to combat terrorist exploitation and abuse of charities. The Department works with various community organizations in order to raise awareness of the risk of terrorist financing and measures to minimize such risks. Outreach events include participation in several interagency outreach efforts, hosted by the Department of Justice as well as the Department of Homeland Security. One key component is that Treasury issues guidance to the charitable sector as part of this comprehensive strategy to raise awareness and minimize the risk of terrorist exploitation through charities. During fiscal year 2009, the Treasury Guidelines Working Group (TGWG) met, which represents major U.S.-based charities, foundations and philanthropic groups, and began revising its *Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S-Based Charities (Guidelines).* It is expected that the TGWG will submit a proposal concerning the revision of the Guidelines by the close of the 2009 calendar year. This is just one component to ensuring risks are minimized by the charitable sector, Treasury will need to continue to develop and implement its strategy to combat further exploitation.

ESTABLISH EXTERNAL PERFORMANCE MEASURE EVALUATION

Treasury introduced and began to apply a composite performance measure to assess the Department's impact in preventing terrorism and safeguarding U.S. and international financial systems. The measure incorporates four focus areas: the impact of policymaking, outreach and diplomacy; economic sanctions; information and analysis; and regulatory activity on transparency of financial systems. Moving forward, refinement of the specific methodologies for data collection and validation related to these focus areas will need to be further refined and reviewed externally.

MANAGEMENT AND ORGANIZATIONAL EXCELLENCE

The Department of the Treasury strives to maintain public trust and confidence in U.S. and international economic and financial systems through exemplary leadership, best-in-class processes, and a culture of excellence, integrity and teamwork. Achieving and maintaining exemplary accountability and transparency is critical for the Treasury Department as the primary financial agency for the U.S. Government. Management of Treasury programs provided significant challenges in fiscal year 2009 associated with implementation and oversight of new programs to manage the economy.

COMPLETED AN INCREASED NUMBER OF MATERIAL LOSS REVIEWS (MLRS)

OIG is mandated to conduct MLRs of any Treasury-regulated bank failure resulting in material losses greater than $25 million, or two percent of the institution's assets. An MLR examines the cause(s) of the failure, with specific attention paid to effectiveness of bank supervision and potential preventative measures to improve regulation. The review also looks for examples of fraud that may lead to criminal or civil prosecution.

In fiscal year 2009, 107 banks failed, of which 27 were regulated by OCC or OTS. Of these Treasury-regulated bank failures, 23 required an MLR by OIG. In fiscal year 2009, OIG completed 10 MLRs, including five MLRs for failures that occurred in fiscal year 2008. The estimated loss to the Federal Deposit Insurance Fund of the 10 reviewed bank failures totaled $14.7 billion, including a $10.7 billion loss resulting from the failure of IndyMac Bank, the largest institution to date to be the subject of an MLR. As of September 30, 2009, 18 MLRs were still in progress.

OIG has reported on several trends from the MLRs. Three primary causes of the failures were identified:

asset quality issues (e.g. risky non-traditional loan products, poor underwriting, commercial real estate); liquidity issues (e.g. reliance on volatile brokered deposits to fund aggressive growth); and management issues (e.g. management systems not commensurate with level of risk, non-responsive to regulator concerns). With respect to supervision, OIG reported that OCC or OTS usually identified the problems early on but did not forcefully act to address them. Both regulators have been responsive to OIG's recommendations for improving supervision processes.

TIGTA AUDITS

TIGTA conducts audits and investigations to ensure fair administration of the nation's tax system and accountability for the more than $2 trillion in tax revenue collected each year. The audits identify high-risk issues and deficiencies related to the administration of programs and operations, ensuring taxpayers are appropriately served and their rights adequately protected. In fiscal year 2009, TIGTA issued 142 audit reports focusing on the areas of improved tax compliance (including the international arena), security maintenance, systems modernization and operations. The audit reports isolated $14.7 billion in potential financial benefits, the majority stemming from a possible $8.9 billion savings over five years from the disallowance of the Additional Child Tax Credit to filers without a valid social security number.

TIGTA conducted a special audit on a major Recovery Act activity for IRS associated with the First-Time Homebuyer Tax Credit. TIGTA found that although the IRS developed controls to identify many questionable claims for the First-Time Homebuyer Tax Credit, some key documentation requirements to substantiate the purchase of a house were inadequate. As a result, 19,351 Tax Year 2008 income tax returns included erroneous or fraudulent claims for the credit, totaling over $139 million for homes that had not yet been purchased. In addition, taxpayers who appeared not to be first-time homebuyers claimed the credit on their returns. The IRS has implemented filters to identify these taxpayers and ensure the credits are properly applied. In addition, IRS identified 48,580 taxpayers who may not have been aware of the changes to the credit and did not claim the full amount. IRS is planning an outreach campaign to inform those taxpayers of the additional credit, if they do not otherwise amend their returns.

EFFECTIVE MANAGEMENT OF TREASURY'S INFORMATION TECHNOLOGY

The Department relies on information technology (IT) infrastructure to manage more than $8 trillion dollars in debt, collect more than $2 trillion in revenue, and conduct more than $58 billion in daily cash transactions. In fiscal year 2009, the Department defined strategic IT management priorities to strengthen cyber security, reduce infrastructure operations costs, increase bureau collaboration and productivity, and improve Treasury IT workforce proficiency. As part of operations management, the Department uses OMB's IT Dashboard to gauge the effectiveness of its IT systems. Each month, Treasury's Chief Information Officer evaluates the Department's 59 major investments on cost and schedule performance metrics. As of October 1, 2009, Treasury had 58 out of 59 investments (98.3 percent) reported as Green or Yellow for Cost Variance and 1 investment (1.7 percent Red) reported as Red. As of October 1, 2008, 37 out of 62 investments (59.7 percent) reported Green for Cost Variance and the remainder (40.3 percent) reported red. As of October 1, 2009, Treasury had 59 out of 59 investments (100.0 percent) reported as Green or Yellow for Schedule Variance and no investments reported as Red. As of October 1, 2008, 50 out of 62 investments (80.6 percent) reported Green for Schedule Variance and the remainder (19.4 percent) reported red. Additionally, the information security management challenge was closed in fiscal year 2009.

EXPANDED HUMAN CAPITAL INITIATIVES

The Office of the Deputy Assistant Secretary for Human Resources/Chief Human Capital Officer (DASHR/CHCO) endeavors to broaden and diversify Treasury's talent pool; develop and retain an effective workforce; effectively manage and utilize human capital; and develop human capital practitioners as strategic business partners. In fiscal year 2009, DASHR/CHCO was directly involved in ramping up emergency programs to support economic stabilization efforts, improving applicant outreach and supporting new hires through the Hamilton Fellows Program and other initiatives, and expanding the diversity of Treasury's workforce. A major challenge in future years will be managing the retirement of a significant percentage of Treasury's employees as baby boomers leave the workforce. Improving retention of new hires and providing executive leadership development for current employees is essential to ensuring Treasury has a strong and professional talent pool.

Department of the Treasury
Key Performance Measures for 2009

The following table contains ten key performance metrics providing a representative overview of the Department's performance for 2009. Discussion of the factors contributing to each measure's performance results, and plans to improve the measure's results in future years, follows the table.

ANNUAL FINANCIAL REPORT FOR FISCAL YEAR 2009

Treasury Department Key Performance Measure Table

Performance Measure Official Title	Bureau	2005 Target	2005 Actual	2006 Target	2006 Actual	2007 Target	2007 Actual	2008 Target	2008 Actual	2009 Target	2009 Actual	Percent Target Achieved 2009	2009 Actual vs. Target	Target Trend	Actual Trend
Percentage collected electronically of total dollar amount of Federal government receipts (%)	FMS	82	79	83	79	80	79	79	80	80	83	104%	Exceeded	▶	▲
Customer Service Representative (CSR) Level of Service (%)	IRS	82.0	82.6	82.0	82.0	82.0	82.1	82.0	52.8	70.0	70.0	100%	Met	▼	▼
Percent of Business Returns Processed Electronically (%)	IRS	17	17.8	18.6	16.6	19.5	19.1	20.8	19.4	21.6	22.8	106%	Exceeded	▲	▲
Percent of Individual Returns Processed Electronically (%)	IRS	51	51.1	55	54.1	57	57.1	61.8	57.6	64	65.9	103%	Exceeded	▲	▲
Number of full-time equivalent jobs created or maintained in underserved communities by businesses financed by CDFI program awardees	CDFI	26,995	23,656	29,158	22,329	34,009	35,022	28,676	29,539	30,000	70,260	234%	Exceeded	▶	▲
Rehabilitated national banks as a percentage of problem national banks one year ago (CAMELS 3, 4 or 5) (%)	OCC	40	44	40	46	40	52	40	47	40	29	73%	Unmet	▶	▼
Clean audit opinion on TARP financial statements	DO									Baseline	Met	100%	Met	B	B
Percentage of SIGTARP and GAO oversight recommendations responded to on time	DO									Baseline	100	100%	Met	B	B
Average days to close a FOIA case	DO									Baseline	67	100%	Met	B	B
Impact of TFI programs and activities	DO									Baseline	7.81	100%	Met	B	B

Legend	Symbol
Favorable upward trend	▲
Favorable downward trend	▼
Unfavorable upward trend	▲
Unfavorable downward trend	▼
No change in trend, no effect	▶
No change in trend, favorable effect	▶
No change in trend, unfavorable effect	▶
Baseline	B

In fiscal year 2009, FMS' total dollar collections decreased from $3.2 trillion to $2.9 trillion as a result of both businesses and individuals being impacted by the economic downturn. However, paper tax receipts collected through a lockbox network and paper federal tax deposits decreased by more than 28 percent compared with 2008, while electronic tax collections only decreased by 11 percent. This caused FMS' metric "Percentage collected electronically of total dollar amount of Federal government receipts" to exceed its performance target by four percent, and show a four percent improvement over 2008.FMS regularly reaches out to the banking community to promote electronic collection, and is implementing marketing programs to encourage migration of paper-based collections to electronic collection systems and Pay.gov. Two initiatives to promote this migration would eliminate paper coupons for employment taxes, transferring them completely to electronic collection systems by 2011, and require certain classes of non-tax collections be paid electronically. Both proposals would help to significantly increase the percentage of electronic collections going forward.

The IRS metric "Customer Service Representative (CSR) Level of Service" met its performance target in fiscal year 2009 and improved on the prior fiscal year's result by 33 percent. Demand for IRS customer service was unusually high in 2009, due largely to inquiries related to the Recovery Act, Rebate Recovery Credit and interest in electronic filing. Given the sunset for Recovery Act provisions and the Recovery Rebate Credit, the IRS does not anticipate a significant increase in the CSR Level of Service for fiscal year 2010.

IRS electronic filing metrics "Percent of Business Returns Processed Electronically" and "Percent of Individual Returns Processed Electronically" exceeded their performance targets by six percent and three percent, respectively, and each improved significantly over their fiscal year 2008 results by 18 percent and 14 percent, respectively. Their favorable results can be attributed to changes in filing patterns, economic and demographic trends, legislative requirements, and IRS administrative processes. IRS expects the percentage of both business and individual returns filed electronically to increase in fiscal year 2010 based on recent experience, historical growth trends, increased marketing, and expanded programs aimed at boosting electronic filing. IRS will continue to pursue additional legislative mandates to increase electronic filing for businesses taxpayers, such as a provision for 2011 requiring taxpayers filing more than ten individual returns during a calendar year file electronically.

CDFI's metric "Number of full-time equivalent jobs created or maintained in underserved communities by businesses financed by CDFI program awardees" in fiscal year 2009 exceeded its performance target by 134 percent and improved over the prior fiscal year's actual result by 138 percent. The primary reason for this increase was the additional $90 million in Recovery Act funds added to the $57 million received under the regular budget. Targeted performance without the additional Recovery Act funding was 30,000 full-time jobs created or maintained; with Recovery Act funding, 70,000 full-time jobs were created. In addition, the amount of money CDFIs were able to attract from private investment reached nearly $1.3 billion, more than double the 2008 target of $635 million, due to commitments made before the full onset of the financial crisis. Based on the increased funding and private sector matching, in 2009 CDFIs were able to invest in projects that created or maintained 70,260 jobs, more than double the target of 30,000 jobs. With an anticipated drop in Recovery Act funding and private sector matching in 2009, it is unlikely that these results will be repeated in 2010.

During fiscal year 2009, OCC's metric "Rehabilitated national banks as a percentage of problem national banks one year ago (CAMELS 3, 4 or 5)" only achieved 73 percent of its performance target, dropping by 38 percent compared with fiscal year 2008. During fiscal year 2009, national banks continued to operate in a highly challenging and volatile environment. Deterioration in the housing and commercial real estate markets and the decline in general economic conditions directly impacted national banks' financial condition and performance. OCC is identifying banks most vulnerable to current economic conditions, and is allocating bank supervision resources to areas and institutions of highest risk. For problem banks, OCC is working to develop specific plans to correct deficiencies in a timely manner and return the bank to a safe and sound condition. For all national banks, OCC is continuing to focus on quick response to deteriorating bank credit quality and on ensuring banks maintain adequate liquidity, loan loss reserves, and capital buffers.

In fiscal year 2009, DO's Office of Financial Stability, responsible for managing TARP, established new performance measures. These measures included the following:

- Clean audit opinion on TARP financial statements: For 2009, OFS received a clean audit opinion on TARP financial statements, a significant accomplishment given OFS's very challenging first year of operations after standing up the organization.
- Percentage of SIGTARP and GAO oversight recommendations responded to on time: In fiscal year 2009, OFS responded to 100 percent of these oversight bodies' recommendations on time. Going forward, OFS will continue working to ensure that all recommendations from the oversight bodies are responded to efficiently and effectively.
- Average days to close a FOIA case (after received by OFS): During fiscal year 2009, OFS went to great lengths to reduce the time required to respond to FOIA requests, and by the end of the fiscal year, averaged 67 days to close a FOIA case, a response time faster than the overall Treasury average. Going forward, OFS will continue working to further reduce the time taken to respond to all incoming FOIA requests.

TFI began applying its composite performance metric "Impact of TFI programs and activities" during fiscal year 2009. This metric consists of four overall focus areas, with additional detailed focus area components. These components align to performance goals established by TFI. In fiscal year 2009 this metric achieved a 7.81 rating out of 10 possible points. The external review process for this measure still needs to be developed, but the implementation of this measure is a large step in the effort to measure performance for a policy office that also has operational responsibilities.

Summary of Management and Performance Challenges and High Risk Areas

Annually, the Treasury Office of Inspector General (OIG) and the Treasury Inspector General for Tax Administration (TIGTA) identify the most significant management and performance challenges facing the Department. The Government Accountability Office (GAO) identifies High Risk areas biennially. These challenges do not necessarily indicate deficiencies in performance; rather, some represent inherent risks that must be monitored continuously. Treasury made much progress on these issues in fiscal year 2009, and will continue to focus on resolving them during fiscal year 2010.

Summaries of the IG-identified management challenges and GAO-identified high risks are below, along with Treasury's progress and status ratings for each management challenge. For details, please refer to Appendix C for this year's OIG and TIGTA memoranda identifying major management and performance challenges, and the Secretary's responses.

TREASURY-WIDE MANAGEMENT CHALLENGES – AS IDENTIFIED BY OIG

MANAGEMENT CHALLENGE	IMPORTANCE	PROGRESS*	STATUS*
Treasury's New Authorities Related to Distressed Financial Markets	Protection of the taxpayer from unnecessary risk associated with the implementation of the program	Reasonable	Meets Expectations
Regulation of National Banks and Thrifts	Prevent or better mitigate unsafe and unsound practices and protect the financial health of the banking industry	Reasonable	Meets Expectations
Management of Recovery Act Programs	Ensure the programs achieve their intended purposes, provide for accountability and transparency, and are free from fraud and abuse	New	New
Management of Capital Investments	Effective use of taxpayer funds for large capital investments	Significant	Meets Expectations
Anti-Money Laundering and Terrorist Financing/ Bank Secrecy Act Reporting	U.S. and international financial systems that are safe	Reasonable	Meets Expectations
Information Security	Ensure compliance to federal standards for protection of systems and information	Closed	Closed
Corporate Management	Overall agency performance/improved value for the taxpayer	Closed	Closed

* Determined by management

IRS MANAGEMENT CHALLENGES – AS IDENTIFIED BY TIGTA

MANAGEMENT CHALLENGE	IMPORTANCE	PROGRESS*	STATUS*
Modernization	Improved taxpayer service and efficiency of operations	Reasonable	Meets Expectations
Security	Appropriate protection of financial, personal, and other information	Reasonable	Meets Expectations
Tax Compliance Initiatives	Improved compliance and fairness in the application of the tax laws	Reasonable	Meets Expectations
Implementing Tax Law Changes	Responsiveness to new tax provisions, including the Recovery Act, and adjusting to expiring ones	Reasonable	Meets Expectations
Providing Quality Taxpayer Service Operations	Improved taxpayer service	Reasonable	Meets Expectations
Human Capital	Enables the IRS to achieve its mission	Significant	Meets Expectations
Erroneous and Improper Payments and Credits	Effective use of taxpayer funds	Reasonable	Adequate
Globalization	Increased outreach efforts to foreign governments on cross border transactions	New	New
Taxpayer Protection and Rights	Fairness in the application of the tax laws	Reasonable	Meets Expectations
Leveraging Data to Improve Program Effectiveness and Reduce Costs	Resources that are focused on producing the best value for stakeholders	Significant	Exceeds Expectations

* Determined by management

LEGEND

Progress Rating	Description
New	A new management challenge in fiscal year 2009
None	No progress was made on the management challenge
Marginal	Minimal progress was made on the management challenge compared to the prior year
Reasonable	Progress was made in addressing the management challenge, improving from the prior year
Significant	A large amount of progress was made compared to the prior year assessment

LEGEND

Status Rating	Description
New	A new management challenge in fiscal year 2009
Inadequate	Regardless of progress made in fiscal year, the status of the management challenge remains incomplete and falls significantly short of expectations
Adequate	The current status of the management challenge is acceptable but falls slightly short of expectations set for the fiscal year
Meets Expectations	The current status of the management challenge meets expectations set for the fiscal year
Exceeds Expectations	The current status of the management challenge exceeds expectations set for the fiscal year
Closed	Actions taken resulted in the elimination of the management challenge

HIGH RISK AREAS – AS IDENTIFIED BY GAO

ENFORCEMENT OF THE TAX LAWS

Problem: The IRS needs to improve its enforcement of tax laws, not only to catch tax cheats, but also to promote broader compliance by giving taxpayers confidence that others are paying their fair share.

Goal: Improve research on noncompliance, increase the use of third party information reporting, focus on improving standards among tax return preparers, and increase emphasis on international noncompliance.

Challenges and Actions Taken/Planned:

Reduce the opportunity for evasion

- Offshore Private Banking Initiative – The largest bank in Switzerland agreed to provide the names of 4,450 of their U.S. account holders and to pay a $780 million fine, including $380 million to the IRS. Another bank entered into a deferred prosecution agreement to forfeit $340 million, the largest seizure in IRS history, in connection with violations of the International Emergency Economic Powers Act. Over 7,500 people submitted "voluntary disclosure" applications under the partial amnesty program that ended October 15, 2009.
- Offshore Merchant Account Initiative – A summons was issued to a large processor of merchant accounts to identify U.S. businesses that deposit unreported business receipts from debit and credit card sales in accounts in banks domiciled in secrecy jurisdictions.

Target specific areas of noncompliance and improve voluntary compliance with extensive research

- The IRS maintained its focus on high-net worth individuals, flow through entities, and large corporations (assets > $10 million). The IRS conducted over 145,000 high-net worth audits, an increase of 11.2 percent. Audits of large corporations increased by 3.6 percent and the number of flow through audits remained over 31,000.
- In fiscal year 2010, IRS will continue to expand its efforts to address international tax evasion, to expand the focus on corporate and high net-worth returns, to integrate significant new information reporting authorities into compliance programs, and to implement higher standards within the practitioner community to ensure that the proper amount of tax is paid.

IRS BUSINESS SYSTEMS MODERNIZATION

Problem: The Business Systems Modernization (BSM) program is developing and delivering a number of modernized systems to replace the aging business and tax processing systems currently in use. This effort is highly complex and scheduled to be carried out over a numbers of years, ultimately creating a more efficient and effective IRS. Though the IRS experienced delays and cost overruns in the early years of the effort, improved practices and oversight are now contributing to better delivery of outcomes.

Goal: Meet all BSM project milestones within a cost and schedule variance of 10 percent of the initial estimate.

Challenges and Actions Taken/Planned:

Fully implement all projects and programs for the BSM program

- In fiscal year 2009, the IRS revised its Customer Account Data Engine (CADE) strategy. BSM will continue the revised CADE strategy to implement the new taxpayer account database by the end of 2011 for the 2012 filing season. The new database will result in the migration of all 140 million individual taxpayers to a modernized, relational database that will support daily processing and result in faster refunds for all individual refund filers. Daily updating of all individual taxpayer accounts by 2012 also will improve taxpayer service and accuracy, reduce interest paid on late refunds, improve data security, and create new tools to combat fraud and improve enforcement activities. Completion of the taxpayer account database is the prerequisite for other major initiatives, including significant expansion of online services and transactions and the next generation of enforcement technologies.

MODERNIZING THE OUTDATED U.S. REGULATORY SYSTEM (NEWLY IDENTIFIED IN 2009)

Problem: The current financial system is a fragmented, complex arrangement of federal and state regulators that arose over the past 150 years, often in response to past crises.

Goal: Establish regulatory reform goals and a measurement plan.

Challenges and Actions Taken/Planned:

Promote robust supervision and regulation of financial firms

- A new Financial Services Oversight Council of financial regulators to identify emerging systemic risks and improve interagency cooperation.
- New authority for the Federal Reserve to supervise all firms that could pose a threat to financial stability, even those that do not own banks.
- Stronger capital and other prudential standards for all financial firms, and even higher standards for large, interconnected firms.
- A new National Bank Supervisor to supervise all federally chartered banks.
- Elimination of the federal thrift charter and other loopholes that allowed some depository institutions to avoid bank holding company regulation by the Federal Reserve.
- The registration of advisers of hedge funds and other private pools of capital with the Securities and Exchange Commission.

Establish comprehensive supervision of financial markets

- Enhanced regulation of securitization markets, including new requirements for market transparency, stronger regulation of credit rating agencies, and a requirement that issuers and originators retain a financial interest in securitized loans.
- Comprehensive regulation of all over-the-counter derivatives.
- A new regime to resolve nonbank financial institutions whose failure could have serious systemic effects.
- Revisions to the Federal Reserve's emergency lending authority to improve accountability.
- New authority for the Federal Reserve to oversee payment, clearing, and settlement systems.

Protect comprehensive supervision of financial markets

- A new Consumer Financial Protection Agency to protect consumers across the financial sector from unfair, deceptive, and abusive practices.
- Stronger regulations to improve the transparency, fairness, and appropriateness of consumer and investor products and services.
- A level playing field and higher standards for providers of consumer financial products and services, whether or not they are part of a bank.

Provide the government with the tools it needs to manage financial crises

- A new regime to resolve nonbank financial institutions whose failure could have serious systemic effects.
- Revisions to the Federal Reserve's emergency lending authority to improve accountability.

Raise international regulatory standards and improve international cooperation

- International reforms to support our efforts at home, including strengthening the capital framework; improving oversight of global financial markets; coordinating supervision of internationally active firms; and enhancing crisis management tools.

Analysis of Financial Statements

CONDENSED BALANCE SHEET: (in Millions)	2009	2008
Due From the General Fund	$ 11,992,719	$ 10,100,763
Other Intra-governmental Assets	923,457	551,115
Cash, Foreign Currency, and Other Monetary Assets	341,308	387,270
Gold and Silver Reserve	11,062	11,062
Investments and Related Interest	13,565	10,576
Tax, Other Related Interest Receivables, Net	30,408	30,878
Asset Guarantee	1,765	0
Investments-Credit Reform	203,141	0
Investments in Government Sponsored Enterprises	64,679	7,032
Credit Program Receivables, Direct Loans	219,170	3,385
Beneficial Interest in Trust	23,472	0
Other Assets	21,855	14,957
Total Assets	**$ 13,846,601**	**$ 11,117,038**
Federal Debt and Interest Payable	$ 11,962,385	$ 10,075,108
Other Intra-governmental Liabilities	1,275,613	681,621
Other Liabilities	180,547	50,598
Total Liabilities	**13,418,545**	**10,807,327**
Unexpended Appropriations	455,144	271,968
Cumulative Results of Operations	(27,088)	37,743
Total Net Position	**$ 428,056**	**$ 309,711**
Total Liabilities and Net Position	**$ 13,846,601**	**$ $11,117,038**

CONDENSED STATEMENT OF NET COST: (in Millions)	2009	2008
Net Financial Program Cost	$ 13,055	$ 12,287
Net Economic Program (Revenue)/Cost	195,705	14,048
Net Security Program Cost	322	342
Net Management Program Cost	509	466
Total Net Cost of Treasury Operations	209,591	27,143
Net Federal Costs (primarily interest on the Federal Debt)	**$ 313,341**	**$ 442,208**

CONDENSED STATEMENT OF CUSTODIAL ACTIVITY: (in Millions)	2009	2008
Individual and FICA Taxes	$ 2,036,557	$ 2,294,326
Corporate Income Taxes	225,482	354,063
Other Revenues	139,648	144,218
Total Revenue Received	**2,401,687**	**2,792,607**
Less Refunds	(437,972)	(426,074)
Net Revenue Received	**1,963,715**	**2,366,533**
Beneficial Interest in Trust	23,472	–
Accrual Adjustment	(1,097)	3,132
Total Custodial Revenue	**1,986,090**	**2,369,665**
Amounts Provided to Fund the Federal Government	1,963,228	2,366,126
Other Agencies	487	407
Beneficial Interest in Trust	23,472	–
Accrual Adjustment	(1,097)	3,132
Total Disposition of Custodial Revenue	**1,986,090**	**2,369,665**
Net Custodial Revenue Activity	**$ 0**	**$ 0**

CONDENSED STATEMENT OF CHANGES IN NET POSITION: (in Millions)	2009	2008
Beginning Balance	$ 37,743	$ 48,782
Budgetary Financing Sources	668,894	482,150
Other Financing Sources (Uses)	(210,793)	(23,838)
Total Financing Sources	458,101	458,312
Net Cost of Operations	(522,932)	(469,351)
Net Change	(64,831)	(11,039)
Cumulative Results of Operations	**(27,088)**	**37,743**
Beginning Balance	$ 271,968	$ 72,317
Appropriations Received	855,762	681,473
Appropriations Used	(668,153)	(481,735)
Other	(4,433)	(87)
Total Budgetary Financing Sources	183,176	199,651
Total Unexpended Appropriations	**455,144**	**271,968**
Net Position - Year End	**$ 428,056**	**$ 309,711**

CONDENSED STATEMENT OF BUDGETARY RESOURCES: (in Millions)	2009	2008
Unobligated Balances, Brought Forward	$ 284,630	$ 57,450
Recoveries of Prior Year Obligations	8,096	413
Budget Authority	1,814,086	722,859
Other Budget Authority	(271,778)	(8,558)
Total Budgetary Resources	$ 1,835,034	$ 772,164
Obligations Incurred	1,387,195	487,534
Unobligated Balance	413,998	273,235
Unobligated Balance, Not Available	33,841	11,395
Total Status of Budgetary Resources	$ 1,835,034	$ 772,164
Total Unpaid Obligated Balances, Net	$ 56,977	$ 57,393
Obligations Incurred, Net	$ 1,387,195	$ 487,534
Gross Outlays	$ (1,248,916)	$ (487,608)
Recoveries of Prior Year Unpaid Obligations, Actual	$ (8,096)	$ (413)
Changes in Uncollected Customer Payments Federal	$ (28,748)	$ 71
Total Unpaid Obligated Balance, Net, End of Year	$ 158,412	$ 56,977
Net Outlays	$ 922,165	$ 462,868

SUMMARY OF AUDITOR'S REPORT ON THE TREASURY DEPARTMENT'S FINANCIAL STATEMENTS

The Department received an unqualified audit opinion on its fiscal year 2009 financial statements. As summarized in the table below, the auditor reported two material weaknesses. The auditor also reported significant deficiencies related to financial reporting at the Office of Financial Stability and information system controls at the Financial Management Service. The auditor also reported an instance of noncompliance with laws and regulations related to Section 6325 of the Internal Revenue Code and that the Department's financial management systems did not substantially comply with the requirements of the *Federal Financial Management Improvement Act of 1996*.

SUMMARY OF FINANCIAL STATEMENT AUDIT

AUDIT OPINION	UNQUALIFIED				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Financial Systems and Reporting at the IRS Financial Management Practices at the Departmental Level (new)	1	1	0	0	2

LIMITATIONS ON THE PRINCIPAL FINANCIAL STATEMENTS

The principal financial statements have been prepared to report the financial position and results of operations of the Department of the Treasury, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the Department of the Treasury, in accordance with generally accepted accounting principles (GAAP) for federal entities and the formats prescribed by OMB, the 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 a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

MAJOR HIGHLIGHTS

The following provides the highlights of Treasury's financial position and results of operations for fiscal year 2009.

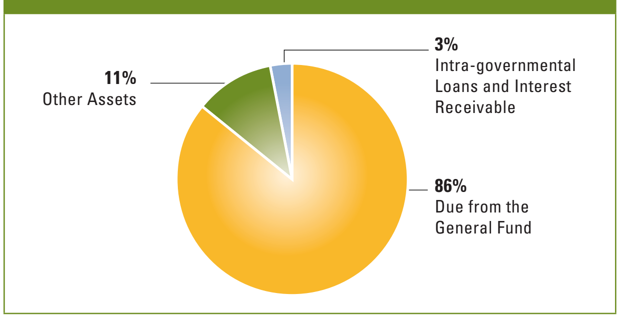
MAJOR HIGHLIGHTS

The following provides the major highlights of Treasury's financial position and results of operations for fiscal year 2009.

Assets. Total assets increased from $11.1 trillion at September 30, 2008 to $13.8 trillion at September 30, 2009. The primary reason for the increase is the rise in the federal debt, which causes a corresponding rise in the "Due from the General Fund of the U.S. Government" account ($12.0 trillion). This account represents future funds required from the General Fund of the U.S. Government to pay borrowings from the public and other federal agencies.

The majority of loans and interest receivable ($410.6 billion) included in "Intra-governmental" assets are the loans issued by the Bureau of the Public Debt to other federal agencies for their own use or to private sector borrowers, whose loans are guaranteed by the federal agencies.

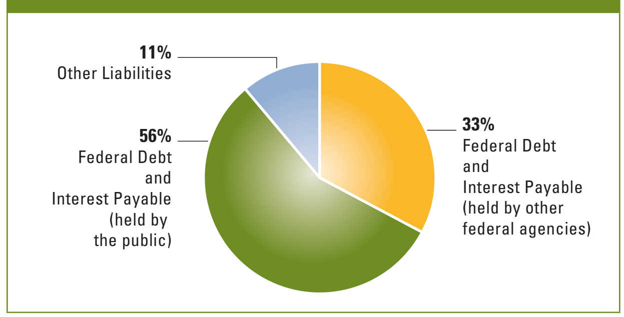
Total Assets



Liabilities. Intra-governmental liabilities totaled $5.7 trillion, and include $4.4 trillion of principal and interest payable to various federal agencies, such as the Social Security Trust Fund. These borrowings do not include debt issued separately by other governmental agencies, such as the Tennessee Valley Authority or the Department of Housing and Urban Development.

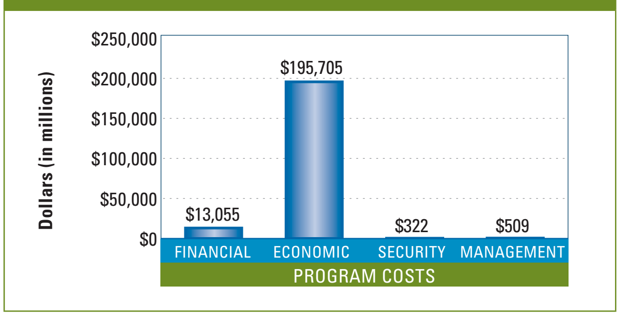
Liabilities also include federal debt held by the public, including interest, of $7.6 trillion; this debt was mainly issued as Treasury Notes. The increase in total liabilities in fiscal year 2009 over fiscal year 2008 ($2.6 trillion and 24.2 percent), is the result of increases in borrowings from various federal agencies ($140.7 billion), and federal debt held by the public, including interest, ($1.75 trillion). Debt held by the public increased primarily because of the need to finance budget deficits.

Total Liabilities

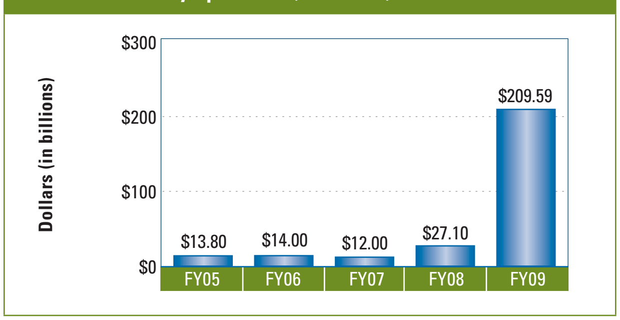


Net Cost of Treasury Operations. The Consolidated Statement of Net Cost presents the Department's gross and net cost for its four strategic missions: financial program, economic program, security program, and management program. The majority of the Net Cost of Treasury Operations is in the economic program which includes Troubled Asset Relief Program (TARP) activity and investments in the Government Sponsored Enterprises (GSEs). Financial program costs include costs associated with Treasury's role as the primary fiscal agent for the Federal Government in managing the nation's finances by collecting revenue, making federal payments, managing federal borrowing, performing central accounting functions, and producing coins and currency sufficient to meet the demand.

Net Cost of Treasury Operations (in millions)

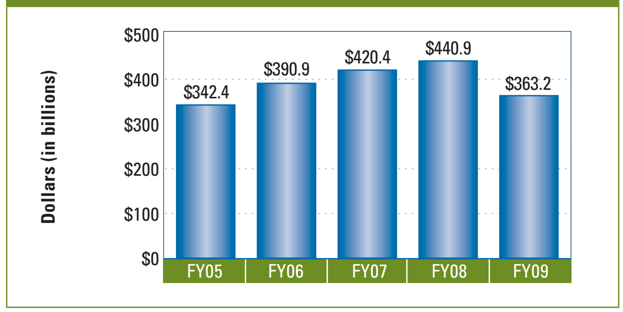


Net Cost of Treasury Operations (in billions)



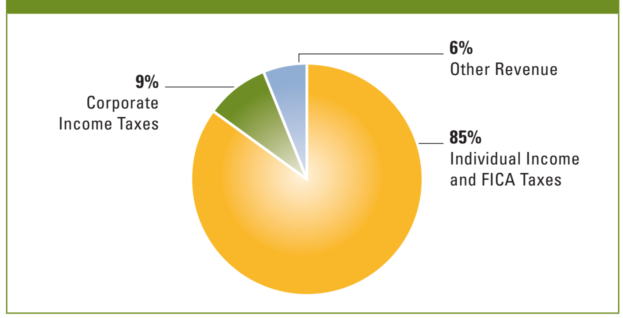
Net Federal Debt Interest Costs. The decrease of $77.7 billion in net interest paid on the federal debt is due to the decrease in the average interest rate for debt held by federal entities and federal debt held by the public.

Net Federal Debt Interest Cost (in billions)

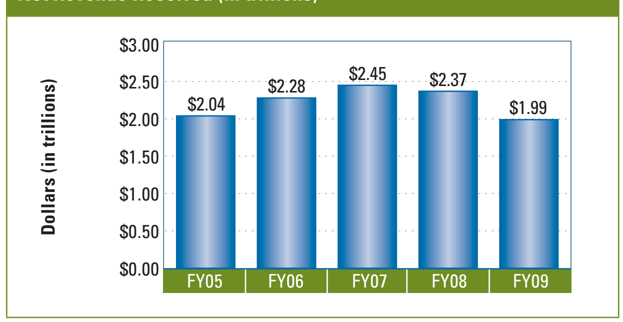


Custodial Revenue. Total net revenue collected by Treasury on behalf of the Federal Government includes various taxes, primarily income taxes, user fees, fines and penalties, and other revenue. Over 94.2 percent of the revenues are from income and social security taxes.

Total Revenue



Net Revenue Received (in trillions)



Improper Payments Information Act and Recovery Auditing Act

IMPROPER PAYMENTS INFORMATION ACT

BACKGROUND

The Improper Payments Information Act of 2002 (IPIA) requires agencies to review their programs and activities annually to identify those susceptible to significant improper payments. According to Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments* (A-123, Appendix C), "significant" means that an estimated error rate and a dollar amount exceed the threshold of 2.5 percent and $10 million of total program funding. A-123, Appendix C also requires the agency to implement a corrective action plan that includes improper payment reduction targets.

However, some federal programs are so complex that developing an annual error rate is not feasible. The government-wide Chief Financial Officers Council developed an alternative for such programs to assist them in meeting the IPIA requirements. 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.

TREASURY'S RISK ASSESSMENT METHODOLOGY AND RESULTS FOR FISCAL YEAR 2009

Each year, Treasury develops a comprehensive inventory of all funding sources and conducts a risk assessment for improper payments on all of its programs and activities. The risk assessment performed on all of Treasury's programs and activities in fiscal year 2009 resulted in low and medium risk susceptibility for improper payments except for the Internal Revenue Service's (IRS) Earned Income Tax Credit (EITC) program. The high-risk status of this program is well-documented and has been deemed a complex program for the purposes of the IPIA.

EARNED INCOME TAX CREDIT

The EITC is a refundable tax credit that offsets income tax owed by low-income taxpayers and, if the credit exceeds the amount of taxes due, provides a lump-sum payment in the form of a refund to those who qualify. The fiscal year 2009 estimate is that a maximum of 28 percent ($13.3 billion) and a minimum of 23 percent ($11.2 billion) of the EITC total program payments are overclaims.

The IRS has a robust base enforcement program for the EITC which consists of examinations (audits), math error notices, and document matching. In fiscal year 2009 the IRS expanded its approach to decrease improper payments.

RECOVERY AUDITING ACT

BACKGROUND

In accordance with the *Recovery Auditing Act of 2002*, OMB Circular A-123, Appendix C, requires agencies issuing $500 million or more in contracts to establish and maintain recovery auditing activities and report on the results of those recovery efforts annually. Recovery auditing activities include the use of (1) contract audits, in which an examination of contracts pursuant to the audit and records clause incorporated in the contract is performed, (2) contingency contracts for recovery services in which the contractor is paid a percentage of the recoveries, and (3) internal review and analysis in which payment controls are employed to ensure that contract payments are accurate.

For Recovery Auditing Act compliance, Treasury requires each bureau and office to review their post-payment controls and report on recovery auditing activities, contracts issued, improper payments identified, and recoveries achieved. Bureaus and offices may use recovery auditing firms to perform many of the steps in their recovery program and identify candidates for recovery action.

RESULTS FOR FISCAL YEAR 2009

During fiscal year 2009, $5.3 billion in contracts (defined as issued and obligated contracts, modifications, task orders, and delivery orders) were issued. Improper payments in the amount of $1.5 million were identified from recovery auditing efforts and $1.4 million has been recovered, including prior year recoveries, with $117,630 outstanding as accounts receivable on September 30, 2009.

Note: Additional detail on Treasury's IPIA and Recovery Auditing Act Programs can be found in Appendix B.

Management Assurances

THE SECRETARY'S LETTER OF ASSURANCE

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, we considered results of extensive testing and assessment across the Department and independent audits.

Treasury provides assurance that the objectives of the Federal Managers' Financial Integrity Act over operations have been achieved, except for the material weaknesses noted below. In accordance with OMB Circular A-123, Appendix A, we provide qualified assurance on internal control over financial reporting based on the results of the assessment for the period ending June 30, 2009. Treasury is not in substantial compliance with the Federal Financial Management Improvement Act due to the material weakness involving revenue accounting systems.

As of September 30, 2009, Treasury has five material weaknesses as follows (with resolution time frames indicated):

Operations:

Internal Revenue Service

- Improved Modernization Management Controls Processes (fiscal year 2011)
- Computer Security (fiscal year 2012)

Financial Management Service

- Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements (fiscal year 2012)

Financial Reporting:

Internal Revenue Service

- Financial Accounting of Revenue-Custodial (fiscal year 2010)

Treasury Departmental Offices

- Financial Management Practices (fiscal year 2010)

The external auditors identified one new material weakness in 2009. Treasury is taking action to address this issue in fiscal year 2010. Overall, Treasury continues to make progress in reducing management and control weaknesses and in meeting federal financial systems requirements.

Timothy F. Geithner
December 15, 2009

Material Weaknesses, Audit Follow-up, and Financial Systems

SUMMARY OF MANAGEMENT ASSURANCES

SUMMARY OF MATERIAL WEAKNESSES						
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS - Financial Accounting of Revenue - Custodial	1	0	0	0	0	1
IRS - Improve Modernization Management Controls and Processes	1	0	0	0	0	1
IRS - Computer Security	1	0	0	0	0	1
FMS - Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements	1	0	0	0	0	1
DO - Financial Management Practices	0	1	0	0	0	1
Total Material Weaknesses	4	1	0	0	0	5

As of September 30, 2009, Treasury has five material weaknesses under Section 2 of the *Federal Managers' Financial Improvement Act* as shown in the tables below.

EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING (FMFIA § 2)						
Statement of Assurance	**Qualified**					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS - Financial Accounting for Revenue - Custodial	1	0	0	0	0	1
DO - Financial Management Practices	0	1	0	0	0	1
Total Material Weaknesses	1	1	0	0	0	2

EFFECTIVENESS OF INTERNAL CONTROL OVER OPERATIONS (FMFIA § 2)						
Statement of Assurance	**Qualified**					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS - Improve Modernization Management Controls and Processes	1	0	0	0	0	1
IRS - Computer Security	1	0	0	0	0	1
FMS - Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements	1	0	0	0	0	1
Total Material Weaknesses	3	0	0	0	0	3

CONFORMANCE WITH FINANCIAL MANAGEMENT SYSTEM REQUIREMENTS (FMFIA § 4)						
Statement of Assurance	**Systems conform to financial management system requirements**					
Non-Conformances	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
Overall Substantial Compliance	No	No
1. System Requirements	No	
2. Accounting Standards	No	
3. USSGL at Transaction Level	No	

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)

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

- programs achieve their intended results
- resources are used consistent with overall mission
- programs and resources are free from waste, fraud, and mismanagement
- laws and regulations are followed
- controls are sufficient to minimize any improper or erroneous payments
- performance information is reliable
- system security is in substantial compliance with all relevant requirements
- continuity of operations planning in critical areas is sufficient to reduce risk to reasonable levels
- financial management systems are in compliance with federal financial systems standards

Deficiencies that seriously affect an agency's ability to meet these objectives are deemed "material weaknesses." Treasury can provide assurance that the objectives of the FMFIA have been achieved, except for the material weaknesses noted in the Secretary's Letter of Assurance, which include one new weakness identified by the external auditors in November 2009. Although the last open material weakness is targeted to be closed in fiscal year 2012, Treasury is focusing on making sufficient progress to downgrade the weakness sooner.

Each year material weaknesses, both the resolution of existing ones and the prevention of new ones, receive special attention from management. In fiscal year 2009, Treasury continued to make resolution of material weaknesses a performance requirement for every executive, manager, and supervisor.

OFFICE OF MANAGEMENT AND BUDGET CIRCULAR A-123, APPENDIX A

The Department continues to strengthen and improve the execution of the Treasury mission through the application of sound internal controls over financial reporting. In response to Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, Appendix A, Internal Control over Financial Reporting, Treasury developed and implemented an extensive annual testing and assessment methodology that identified and documented internal controls over financial reporting at the transaction level integrated with the Government Accountability Office's Standards for Internal Control. The testing and assessment were completed across all material Treasury bureaus and offices by June 30, 2009. Treasury provides qualified assurance that internal controls over financial reporting are effective as of June 30, 2009, due in large part to the computer security and financial accounting of revenue - custodial weaknesses at the Internal Revenue Service.

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT (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 at the transaction level." FFMIA also requires that remediation plans be developed for any entity that is unable to report substantial compliance with these requirements.

As of September 30, 2009, the Treasury Department's financial management systems were not in substantial compliance with FFMIA due to deficiencies with the IRS's financial management systems. The IRS has a remediation plan in place to correct the deficiencies. For each FFMIA recommendation, the remediation plan identifies specific remedies, target dates, responsible officials, and resource estimates required for completion. This plan is reviewed and updated quarterly. (Refer to Appendix D for detailed information.)

AUDIT FOLLOW-UP

During fiscal year 2009, Treasury continued its efforts to improve both the general administration of management and internal control issues throughout the Department and the timeliness of the resolution of all findings and recommendations identified by the Office of the Inspector General (OIG), the Treasury Inspector General for Tax Administration (TIGTA), the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), the Government Accountability Office, and external auditors.

Treasury management at every level will maintain the momentum on accomplishing Planned Corrective Actions (PCAs) to resolve and implement sound solutions for all audit recommendations. Although Treasury has made great progress, considerably more work remains. Specifically, Treasury must provide timely and accurate performance to address PCA schedules and implementation and integrate the effects of those actions more fully into management decision-making processes. Treasury needs to identify more precisely what it costs to accomplish its varied missions and develop ways to improve overall performance. This will entail building upon the progress made in expanding the communication and coordination among offices variously involved in strategic planning, budget formulation, budget execution, performance management, and financial management.

FINANCIAL MANAGEMENT SYSTEMS FRAMEWORK

The Department's overall financial management systems framework consists of a Treasury-wide financial data warehouse, supported by a financial reporting tool and separate bureau financial systems. Currently, 14 bureaus are serviced by the Bureau of the Public Debt's Administrative Resource Center (BPD ARC) for core financial system processing. Bureaus submit their monthly financial data to the data warehouse within three business days of the month-end. The Department then produces monthly financial statements and reports for management analysis. This framework satisfies both the bureaus' diverse financial operational and reporting needs, as well as the Department's internal and external reporting requirements. The financial data warehouse is part of the overarching Treasury-wide Financial Analysis and Reporting System (FARS), which also includes applications for the bureaus to report the status of their performance measures and the status of their planned audit corrective actions. In addition to the existing FARS applications, the Department is reviewing options for implementing a new fleet management application. The fleet application would maintain a consolidated inventory of Treasury vehicles to enhance management control and reporting. Treasury is evaluating existing government owned and operated systems to support this functionality.

Treasury's FARS applications operate at a contractor operated hosting facility. In accordance with the guidance contained in the American Institute of Certified Public Accountants' Statement of Auditing Standards (SAS) No. 70, *Service Organizations,* the service provider's independent auditors examined the controls for the dedicated hosting service. In the opinion of the auditors, the description of the controls presents fairly, in all material respects, the relevant aspects of the provider's controls that had been placed in operation as of September 30, 2009. Also, the controls described are suitably designed to provide reasonable assurance that the specified control objectives would be achieved if the described controls were complied with satisfactorily and customer organizations applied the controls contemplated in the design of the provider's controls.

The Department continues to eliminate redundant and outdated financial management systems with the goal of consolidating financial management activities to improve productivity. As of September 30, 2009, the number of financial management systems decreased to 55, down from 60 at the end of fiscal year 2008. Many of these systems support bureau-specific program functions, while others support internal bureau financial management. These systems are either maintained and operated by the individual bureaus, or provided on a cross-serviced basis by BPD ARC.

BPD ARC has been designated by OMB as a Financial Management Line of Business Shared Service Provider (SSP). A SSP provides financial management systems and services for other federal organizations. BPD ARC currently services 29 federal entities for core financial systems, including 14 Treasury bureaus and reporting entities. Using a SSP enables the bureaus to streamline their financial management activities and achieve more efficient and cost effective business performance by reducing maintenance and operational costs. Treasury will continue to evaluate opportunities to consolidate financial management systems and better utilize existing federal resources. The Department will work with the remaining bureaus to develop plans to migrate to Treasury's SSP for core financial systems in accordance with the Financial Management Line of Business requirements.

As part of the Department's E-Government initiative, BPD ARC also provides systems and service support to 14 Treasury bureaus in the processing of their human resources and travel activities. BPD ARC's human resource management system supports the bureaus' specific human resources needs and provides consolidated systems and resources. BPD ARC's consolidated travel system and activity processing has reduced redundant systems and merged travel processes.

The Department's FARS applications have also been used to support other federal agencies. Since the initial start of the Department of Homeland Security (DHS), Treasury serviced DHS in the preparation of its consolidated financial statements. Beginning with fiscal year 2009, DHS implemented the FARS financial applications in its own systems environment and is now generating its financial statements and reports. As a result of this arrangement, DHS was able to take advantage of existing government systems and did not have to develop new systems to support its financial reporting requirements.

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