Agency Financial Report

DEPARTMENT OF THE TREASURY
FISCAL YEAR 2012

November 15, 2012

The United States Department of the Treasury

Our Mission

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

enable economic growth and stability at home and abroad,

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

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

Strategic Goals

Goal 1
Repair and reform the financial system and support the recovery of the housing market

Goal 2
Enhance U.S. competitiveness and promote international financial stability and balanced global growth

Goal 3
Protect our national security through targeted financial actions

Goal 4
Pursue comprehensive tax and fiscal reform

Goal 5
Manage the government's finances in a fiscally responsible manner

Priority Goals

Increase voluntary tax compliance

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

THE DEPARTMENT OF THE TREASURY

Agency Financial Report

Fiscal Year 2012

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MESSAGE FROM THE SECRETARY OF THE TREASURY

Over the past four years, our main focus has been on helping to pull the U.S. economy out of the depths of the worst financial crisis since the Great Depression and to strengthen and sustain the economic recovery. While we've seen significant progress – including 32 straight months of job growth, increased access to credit, an improved housing market, and expanded opportunities for America's workers and businesses – we still face serious challenges.

Americans continue to live with the scars caused by the crisis. The unemployment rate is still too high, and our fiscal deficits are unsustainable. President Obama has proposed additional measures to accelerate economic growth and job creation and get our fiscal house in order. He has put forward a plan that will maintain tax cuts for middle class families, encourage manufacturing in the United States, increase domestic energy production, and reduce the deficit in a balanced way so that we can preserve room to make investments in infrastructure and education.

In addition to these challenges, we will continue to put in place financial reforms and consumer protections. We will move ahead with steps to further strengthen the housing market. The Treasury Department will also continue to work closely with our international partners, as well as the IMF and other international financial institutions, to support a strong and comprehensive response to Europe's financial crisis and to continue expanding export markets for our workers and businesses. We will continue to lead the global effort to impose tough sanctions on Iran, Syria, and terrorist organizations that pose a threat to our security, and we will collaborate internationally and domestically to protect financial systems around the globe from abuse. And the Treasury Department will continue to play an important role as key provisions of the Affordable Care Act are implemented and more Americans get access to health care.

The Treasury Department again received an unqualified opinion on its consolidated financial statements, and we also received another unqualified opinion on the financial statements of the Office of Financial Stability/Troubled Asset Relief Program. Rather than providing a single Performance and Accountability Report for fiscal year 2012, we are producing separate financial and performance reports. The Annual Performance Report will be included in the Congressional Budget Justification in February 2013.

We have validated the accuracy, completeness, and reliability of the financial and performance data in this report. Maintaining our commitment to continuous program and operational improvement, the Department also made progress in reducing management control weaknesses and in efforts to achieve federal financial systems and control objectives.

Timothy F. Geithner
November 15, 2012

PART 1:

Management's Discussion and Analysis

(UNAUDITED)

EXECUTIVE SUMMARY

In fiscal year 2012, the Department of the Treasury undertook a multitude of actions that helped strengthen the U.S. economy, increase job opportunities, and improve the housing market by taking important steps to restore confidence in the financial system while reinforcing U.S. international competitiveness. The Department continued to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act); took aggressive actions in the fight against financial crimes, money laundering, and threats to national security; continued its pursuit of comprehensive tax and fiscal reform; and strengthened efforts to improve stewardship over the U.S. Government's financial resources. Treasury worked to encourage lending to small businesses, promote economic prosperity, and monitor risk in the financial system. Treasury has also driven a departmental management agenda focused on governing strategically, working smarter, and leveraging advances in technology to gain greater cost savings for the American public, increase productivity, modernize operations, and support the Administration's management agenda.

This Agency Financial Report documents Treasury's operational and financial performance during fiscal year 2012, including Treasury's steady progress on its five Strategic Goals and two Agency Priority Goals (APGs), with positive results in support of the Department's 2012 - 2015 Strategic Plan.

ORGANIZATION

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 the Departmental Offices, eight operating bureaus, and three inspectors general. The Departmental Offices are primarily responsible for policy formulation, while the bureaus are primarily the operating units of the organization.

DEPARTMENTAL OFFICES

Domestic Finance 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. The staffs of the Financial Stability Oversight Council, Office of Financial Research (OFR) and the Federal Insurance Office (FIO), created under the Dodd-Frank Act, reside within Domestic Finance, as does the Office of Financial Stability (OFS), which is responsible for overseeing the Troubled Asset Relief Program (TARP). The Office of Financial Institutions oversees the Community Development Financial Institutions (CDFI) Fund, the Small Business Lending Fund (SBLF), and the State Small Business Credit Initiative (SSBCI) within Domestic Finance.

International Affairs protects and supports U.S. economic prosperity by working bilaterally and multilaterally to foster strong and balanced global growth; to promote stable international financial markets, high-quality financial regulatory standards, and a level playing field for U.S. businesses and financial institutions internationally; to encourage foreign investment in the U.S. while protecting national security; and to enhance U.S. competitiveness and job creation.

Terrorism and Financial Intelligence (TFI) marshals the Department's intelligence, enforcement, and economic sanction functions with the twin aims of safeguarding the financial system against illicit use and combating rogue regimes, terrorist facilitators, weapons of mass destruction (WMD) proliferators, money launderers, drug kingpins, and other national security and foreign policy 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 and the tariff laws, 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 has direct oversight over the United States Mint and the Bureau of Engraving and Printing, and is a key liaison with the Federal Reserve. In addition, the Treasurer serves as a senior advisor to the Secretary in the areas of community development and public engagement.

Other Offices

Internally, Treasury's Departmental Offices are responsible for overall management of the Department. The Office of Management and the Chief Financial Officer is responsible for managing the Department's financial resources and oversees Treasury-wide programs, including human capital, information technology (IT), and minority and women inclusion.

Other support offices include General Counsel, Legislative Affairs, and Public Affairs. Also, three inspectors general—the Office of the Inspector General (OIG), the Treasury Inspector General for Tax Administration (TIGTA), and the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) — provide independent audits, investigations, and oversight of the Department of the Treasury and its programs. While SIGTARP is organizationally placed in Treasury, it is not under the general supervision of the Secretary.

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 federal excise taxes on alcohol, tobacco, firearms, and ammunition, and assures compliance with tobacco permitting and alcohol permitting, labeling, and marketing requirements to protect consumers.

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

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

The Financial Management Service (FMS) provides central payment services to federal program agencies, operates the U.S. Government's collections and deposit systems, provides government-wide accounting and reporting services, and manages the collection of delinquent debt owed to the U.S. Government.

Effective October 2012, the BPD and FMS operating bureaus consolidated to form the Bureau of the Fiscal Service. The Department anticipates Congress to enact legislation to fund the new bureau's salaries and expenses through a single appropriation.

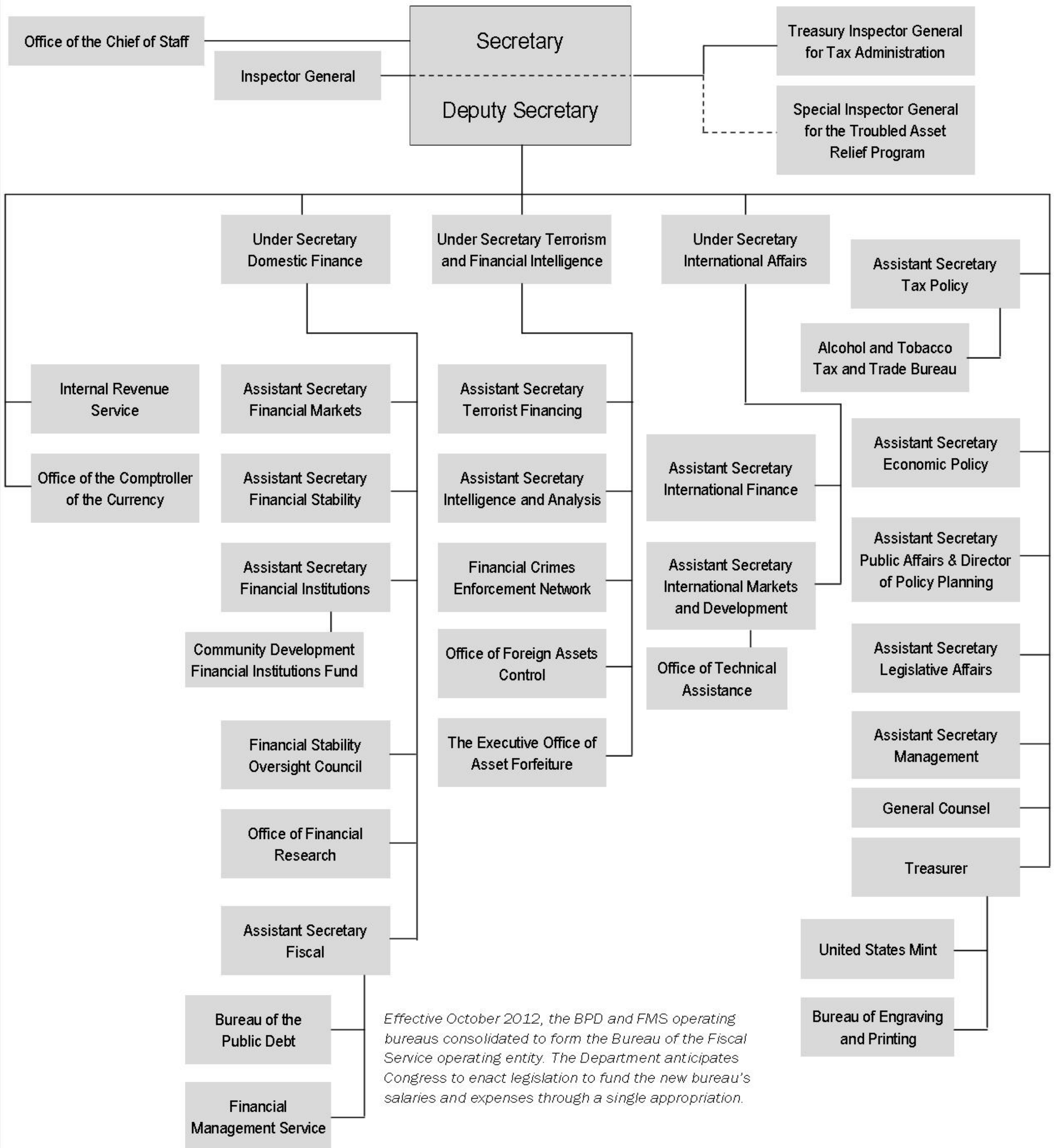
The Financial Crimes Enforcement Network (FinCEN) enhances the integrity of the financial system by facilitating the detection and deterrence of financial crime.

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

The United States Mint designs, mints, and issues circulating and bullion coins, prepares and distributes numismatic coins and other items, and strikes Congressional Gold Medals and other medals of national significance. The United States Mint maintains physical custody and protection of most of the nation's gold and all of its silver reserves.

The Office of the Comptroller of the Currency (OCC) charters, regulates, and supervises all national banks and federal savings associations to help ensure that they operate in a safe and sound manner and in compliance with laws requiring fair treatment of their customers and fair access to credit and financial products.

THE DEPARTMENT OF THE TREASURY ORGANIZATIONAL CHART



TREASURY'S FISCAL YEARS 2012-2015 STRATEGIC FRAMEWORK

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

	Strategic Goals	Strategic Objectives	Indicators and Measures
Economic	**Goal 1** Repair and Reform the Financial System and Support the Recovery of the Housing Market	Lead the Administration's efforts to continue to implement comprehensive regulatory reform to increase stability and strengthen accountability in the financial system Effectively manage and exit emergency programs Reform and strengthen the housing finance system Help prevent avoidable foreclosures and support the availability of affordable mortgage credit	TARP lifetime cost estimate Income received from dividends, interest, warrants, and repayments of TARP investments Rolling percent of investments remaining (overall and bank-only) Monthly mortgage-backed securities statement Housing scorecard indicators
Economic	**Goal 2** Enhance U.S. Competitiveness and Promote International Financial Stability and Balanced Global Growth	Protect global economic and financial stability and encourage market-determined exchange rates Promote strong international financial standards and a level playing field for U.S. financial institutions Pursue free trade and open markets Encourage foreign investment in the U.S. economy Enter into bilateral and multilateral tax agreements that encourage cross-border trade and investment Use leadership positions in the multilateral development banks and the International Monetary Fund to advance U.S. national security and economic interests Provide direct assistance to developing countries working to improve public financial management and strengthen their financial systems	Timely review of Committee on Foreign Investment in the United States (CFIUS) cases Percentage of grant and loan proposals containing performance measures Percentage of timely reviews of Multilateral Development Bank (MDB) grant and loan proposals Percentage of timely reviews of International Monetary Fund (IMF) lending proposals Traction and impact of technical assistance

	Strategic Goals	Strategic Objectives	Indicators and Measures
Security	**Goal 3** Protect our National Security through Targeted Financial Actions	Collect, analyze, and disseminate financial and other information concerning illicit financing and national security threats Disrupt and dismantle the financial networks of those who threaten national security or engage in illicit financing Shape policy, laws, and regulations to safeguard the U.S. and international financial systems Coordinate with partners, both at home and abroad, including the foreign policy, law enforcement, and intelligence communities, to combat illicit finance Assist partner countries in developing and implementing anti-money laundering and counter terrorist financing regimes compliant with international standards	Impact of economic sanctions Impact of policymaking, outreach, and diplomacy Impact of activities to create safer and more transparent financial systems Ability to effectively collect, disseminate, and analyze financial intelligence

	Strategic Goals	Strategic Objectives	Indicators and Measures
Financial	**Goal 4** Pursue Comprehensive Tax and Fiscal Reform	Develop comprehensive proposals to reform and simplify the tax code Increase voluntary tax compliance Promote policies to ensure a sound fiscal footing over the medium term	Voluntary tax compliance Number of tax proposals partially or completely enacted into law Number of administrative initiatives implemented Effects of fiscal policy
	Goal 5 Manage the Government's Finances in a Fiscally Responsible Manner	Optimize the cash and debt portfolio to manage the Government's borrowing costs effectively Expand the use of electronic transactions Modernize financial systems and standardize accounting practices Continuously improve our operations and processes to generate efficiency savings Attract and retain an exceptional workforce	Percentage of Treasury payments made electronically Percentage of vendor invoices processed electronically by Treasury Percentage of total federal government receipts collected electronically Percentage of individual tax returns filed electronically Amount of delinquent debt collected Mean absolute monthly forecast error on a cumulative basis for budget receipts, outlays, and non-marketable debt and mean absolute daily error in cash balance projections Percentage of small business procurement targets met Best Places to Work ranking Percentage of new hires retained after two years

TREASURY'S FISCAL YEAR 2012 PERFORMANCE BY STRATEGIC GOAL

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

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

In 2010, Congress passed and the President signed into law comprehensive financial regulatory reform: The Dodd-Frank Act. Those reforms led by Treasury are helping to make future financial shocks less likely and less damaging by addressing key gaps and weaknesses in the pre-crisis financial system and helping to better protect consumers against fraud and abuse.

Treasury also worked to support the process of repair and recovery of the housing market. The Department has worked with the White House and the Department of Housing and Urban Development (HUD) on the development of loan modification and refinancing programs designed to help prevent avoidable foreclosures and reduce mortgage costs for responsible homeowners as well as on reforms to help transition to a housing market where the private sector is the predominant source of mortgage credit.

DODD-FRANK ACT

During fiscal year 2012, Treasury continued to focus on building a more efficient, transparent, and stable financial system that contributes to the nation's economic strength and enhances its resiliency. The Dodd-Frank Act addressed key gaps and weaknesses in the financial regulatory structure that contributed to the onset and severity of the financial crisis.

These reforms were designed to help better protect taxpayers, businesses, and American families by:

- Constraining excessive risk taking to prevent financial instability from threatening the health of the economy as a whole
- Restoring investor confidence in the American financial system so that it can support savings and investment
- Leveling the playing field in the U.S. to permit community banks to compete fairly with the nation's largest financial firms
- Promoting and strengthening complementary financial regulatory policies with G-20 member countries to support the resilience of the international financial system, enhance U.S. competitiveness and level the playing field internationally
- Educating and protecting consumers, through authority granted to Treasury and to the new Consumer Financial Protection Bureau (whose mission is to implement and enforce federal consumer financial laws, including the prohibition against unfair, deceptive, or abusive practices relating to consumer financial products and services)

FINANCIAL STABILITY OVERSIGHT COUNCIL

The Dodd-Frank Act established the Financial Stability Oversight Council (Council), comprised of federal financial regulators, state regulators, and other financial experts, to identify risks to the financial stability of the United States, promote market discipline, and respond to emerging threats to the stability of the U.S. financial system. The Council, chaired by the Secretary of the Treasury, monitors threats to financial stability and facilitates coordination across the financial regulatory community. To that end, the Department of the Treasury has played an important role in a number of Dodd-Frank Act rulemakings.

The Secretary of the Treasury, as Chairperson of the Council, is coordinating the federal regulators' risk retention rulemaking process. This rule will help align interests among mortgage originators, securitizers (i.e. firms that create and sell groups of mortgage loans as securities), and other investors that participate in the housing finance market. The Secretary is also coordinating the rulemaking to implement the Volcker Rule, which prohibits banking entities from engaging in certain proprietary trading activities and limits hedge fund and private equity fund investments. The Council has been actively engaged in activities to identify risks, promote market discipline, and respond to emerging threats to U.S. financial stability. It released its second annual report on financial market and regulatory developments and potential emerging threats to financial stability in July 2012, and made progress on two of its direct responsibilities under the Dodd-Frank Act – designating certain financial market utilities (FMUs) as systematically important and publishing a final rule and interpretive guidance on the designation of nonbank financial companies for Federal Reserve Board supervision and enhanced prudential standards. In April 2012, the Council issued a final rule and interpretive guidance describing quantitative and qualitative criteria and procedures for designations of nonbank financial companies.

In July 2012, the Council unanimously voted to designate eight FMUs as systemically important. The Council has been working to apply the process described in the rule and guidance, and in September 2012 voted to advance an initial set of nonbank financial companies to stage three of the process, which involves an analysis of quantitative and qualitative information collected directly from the nonbank financial company in addition to the information considered during stages one and two.

The Council also actively facilitated information-sharing and coordination among its members regarding rulemakings, examinations, reporting requirements, and enforcement actions. Through meetings among its principals, as well as among the deputies and staffs of the Council members and their agencies, the Council has served as an important forum for increasing coordination among the member agencies.

OFFICE OF FINANCIAL RESEARCH

The Dodd-Frank Act established the Office of Financial Research (OFR) within the Treasury Department to serve the Council, its member agencies, and the public by improving the quality, transparency, and accessibility of financial data and information, conducting and sponsoring research related to financial stability, and promoting best practices in risk management. The OFR has established five strategic goals as part of its Fiscal Year 2012-2014 Strategic Plan:

- Support the Council through the secure provision of high-quality financial data and analysis needed to monitor threats to financial stability
- Develop and promote data-related standards and best practices
- Establish a center of excellence for research on financial stability and promote best practices for financial risk management
- Provide the public with key data and analysis while protecting sensitive information
- Establish the OFR as an efficient organization and world-class workplace

The OFR also defined more specific priorities focused on establishing mechanisms to support transparency and accountability; investing in core analytic, information security, and data management infrastructures; reinforcing protocols for efficient and secure collaboration and data-sharing; and deepening and expanding its research and data related outputs.

In fiscal year 2012, the OFR has made significant and accelerating progress in meeting its goals and priorities.

Council Support: The OFR is providing data for use by the Council for its Annual Report, as well as data and analysis relating to the designation of nonbank financial companies for supervision by the Federal Reserve Board and enhanced prudential standards. The OFR is also continuing to enhance its Financial Stability Monitor—a dashboard of financial stability metrics and indicators—in collaboration with staff from Council members and their agencies. Consistent with its objectives to avoid duplicating existing efforts and to create new efficiencies, the OFR has completed the first two phases of an initial inventory of metadata among Council member agencies, and a third phase is underway. The OFR has established data sharing agreements with a number of Council member agencies and is working on new ones, where needed. It is also supporting the Council's Data Committee, which supports data collection and information sharing.

Standards: The OFR has played a central role in the international initiative to establish a global Legal Entity Identifier (LEI), a code that uniquely identifies parties to financial transactions, with a planned launch of the global system in March 2013.

Center of Excellence for Research: In July 2012, the OFR issued its first Annual Report assessing the state of the U.S. financial system, the status of the efforts by the OFR to meet its mission, and key findings of the OFR's research and analysis. In addition, during fiscal year 2012, the new office launched a Research Seminar Series, initiated a Working Paper Series, co-sponsored with the Council a December 2011 conference, "The Macroprudential Toolkit: Measurement and Analysis," and hosted an August 2012 workshop on stress-testing. The Financial Research Advisory Committee is being established to provide advice, recommendations, analysis, and information to the OFR, with a first meeting scheduled for December 2012.

Public Information: To support transparent, accountable operations, the OFR has published key information on its website, including its inaugural Annual Report, its Strategic Framework, two working papers, and broader information about its core outputs and operations.

Building the Institution: The OFR has made substantial progress in its hiring (with 120 staff by the end of fiscal year 2012), building its institutional framework, establishing secure IT and business systems needed to carry out its mandate, and putting in place policies and procedures to support sound and efficient operations. As part of these efforts, the OFR has established, and is continuing to enhance, a comprehensive strategic planning and performance management system, with a foundational set of performance measures to be published as part of the President's fiscal year 2014 Budget.

Federal Insurance Office

Treasury's Federal Insurance Office (FIO), also established by the Dodd-Frank Act, is monitoring all aspects of the insurance industry, identifying issues or gaps in regulation that could contribute to a systemic crisis in the insurance industry or financial system. It is also monitoring the accessibility and affordability of non-health insurance products to traditionally underserved communities; coordinating and developing federal policy on prudential aspects of international insurance matters; and contributing expertise to the Council.

Until the establishment of FIO, the United States was not represented by a single, unified federal voice in the development of international insurance supervisory standards. FIO now provides important leadership in developing international insurance policy. In fiscal year 2012, FIO assumed a seat on the executive committee of the International Association of Insurance Supervisors (IAIS). The IAIS, in cooperation with the Financial Stability Board (FSB), is developing the methodology and indicators to identify global systemically important insurers. FIO is actively engaged in that process. Additionally, FIO established and has provided necessary leadership in the European Union-U.S. insurance dialogue regarding such matters as group supervision, capital requirements, reinsurance, and financial reporting. FIO has and will continue to work closely and consult with state insurance regulators and other federal agencies in its work.

Housing Finance, Government Sponsored Enterprises (GSEs)

Treasury is committed to strengthening the economy, including its work with the broader administration on housing finance reform to:

- Ensure access to credit
- Strengthen consumer protection
- Increase transparency for investors
- Improve underwriting standards
- Strengthen taxpayer protections

These reforms will help repair fundamental flaws in the mortgage market and provide support to creditworthy but underserved families who want to own or rent their own homes.

Capital support for the GSEs while those firms are in conservatorship has played an important role in preserving access to mortgage credit for American families in the wake of the financial crisis. However, Treasury also believes it is important to responsibly shrink the government's role in housing finance over time. The Administration is committed to working with Congress to foster the return of private capital to the housing market, subject to stronger oversight and standards for consumer and investor protection. Treasury has sold its Fannie Mae and Freddie Mac Mortgage Backed Securities (MBS) commensurate with improved mortgage availability and recovery in the housing market. During fiscal year 2012 the Treasury restructured its Senior Preferred Stock Purchase Agreements (SPSPAs) to accomplish faster wind-down and better protect taxpayer interests in the GSEs. Treasury also believes that a reformed housing finance market should maintain targeted, transparent support for creditworthy lower-income families who are underserved by the private market, as well as a range of options for the one-third of Americans who are renters.

Treasury is committed to working with Congress to help ensure that all communities and families – including those in rural and economically-distressed areas, and those with low or moderate incomes – have access to sustainable mortgage credit and adequate rental options.

TROUBLED ASSET RELIEF PROGRAM

The actions taken under TARP, along with other emergency measures put in place by the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation (FDIC) helped prevent the collapse of the U.S. financial system and stabilize the broader economy. TARP's direct fiscal cost is also expected to be much lower than many had anticipated during the financial crisis. TARP's authority to purchase troubled assets or make new commitments expired on October 3, 2010. Today, Treasury is focused on winding down TARP by exiting the remaining TARP investments as soon as practicable in a manner consistent with the duty to promote financial stability and protect taxpayers' interests. Treasury is also continuing to implement the various housing programs under TARP to support the housing market and prevent avoidable foreclosures.

Taxpayers have already realized a significant positive return on TARP's investments in banks. As of September 2012, taxpayers have recovered more than $267 billion in repayments and other income - more than $21.5 billion above the total funds that were invested under TARP's bank programs. The number of institutions that are remaining as part of the Capital Purchase Program (the largest bank program) has been reduced substantially through repayments, restructuring transactions, and sales.

Working with the Federal Reserve Bank of New York (FRBNY), Treasury made substantial progress winding down the investments in American International Group. Inc. (AIG). AIG drew a total of $160.2 billion in Federal assistance and has fully repaid the FRBNY with proceeds in excess of cost of $17.7 billion. In addition, Treasury has sold a total of 1.4 billion AIG shares resulting in proceeds in excess of costs for non-TARP shares of $15.0 billion and proceeds less cost of $11.8 billion for TARP shares and still holds 15.9 percent of AIG's outstanding common stock of which OFS holds 10.5 percent.

Treasury reduced the overall amount that remains outstanding in TARP's credit market programs by closing the SBA 7(a) Securities Purchase Program and making further progress winding down both the Term Asset Backed Securities Loan Facility (TALF) and the Public-Private Investment Program (PPIP). Additionally, OFS continued to manage the remaining investments in the Automotive Industry Financing Program (AIFP). Finally, using authority granted under the Emergency Economic Stabilization Act (EESA), Treasury established two central housing programs under TARP.

- The Making Home Affordable (MHA) program, which includes the Home Affordable Modification Program (HAMP) and several additional programs to help homeowners facing foreclosure
- The Hardest Hit Fund (HHF) which provides funds to the 18 hardest hit states, plus the District of Columbia, to develop locally-tailored programs to assist struggling homeowners in their communities

In addition, Treasury provided support for the Federal Housing Administration's (FHA) Short Refinance Program that assists borrowers who are current on their mortgage (or complete a trial payment plan) but owe more than their home is worth, to refinance into an FHA-insured loan.

While the housing market remains fragile, there have been more than 1.2 million homeowner assistance actions taken through MHA to assist struggling homeowners. In addition, TARP's housing programs have helped transform the mortgage servicing industry by changing industry standards and practices and have helped to make mortgage modifications become more sustainable and affordable.

OFS committed $45.6 billion to fund Treasury's housing programs under TARP. From inception through September 30, 2012, $5.5 billion has been disbursed under these programs. Based only on MHA permanent modifications in place as of September 30, 2012, OFS estimates that $10.5 billion in incentive fees out of the $29.9 billion originally committed to the program will ultimately be disbursed if all active modifications were to remain current and receive incentives for five years. More funds will be spent as additional homeowners enter into new modifications through December 31, 2013, the termination date of the program. The Hardest Hit Fund has disbursed $1.5 billion out of $7.6 billion as of September 31, 2012, and is expected to continue to disburse funds until December 31, 2017.

As of September 30, 2012, TARP investment programs (including additional Treasury AIG shares) taken as a whole—including financial support for banks, the domestic auto industry, the targeted initiatives to restart the credit markets, and the investments in AIG—are expected to result in a positive lifetime return of $3.5 billion excluding the cost related to housing programs. As of September 30, 2012, TARP investment programs are expected to cost $14.1 billion excluding the cost related to housing programs. Additional proceeds from non-TARP Treasury AIG shares are expected to more than offset TARP investment programs costs as they are projected to total $17.6 billion of which $15.0 billion has already been collected. The lifetime cost inclusive of TARP housing programs and Treasury AIG shares is estimated to be $42.1 billion.

Small Business Lending Fund

Established by the Small Business Jobs Act of 2010, the SBLF is a dedicated fund designed to provide capital to qualified community banks (banks, thrifts, and bank and thrift holding companies with consolidated assets of less than $10 billion) and community development loan funds in order to encourage small business lending. The purpose of the SBLF is to encourage Main Street banks and small businesses to work together, help create jobs, and promote economic growth in communities across the nation.

Since capital was disbursed to banks in October 2011, Treasury reports in the October 2012 SBLF "Use of Funds Report" that institutions participating in SBLF have made important progress in increasing their small business lending, helping to support small businesses and local economies across the nation. As of June 30, 2012,

- In total, SBLF participants have increased their small business lending by $6.7 billion over a $36.0 billion baseline Increases in small business lending are widespread across SBLF participants, with 89 percent of participants having increased their small business lending over baseline levels
- A substantial majority of SBLF participants – more than 76 percent – have increased their small business lending by 10 percent or more
- SBLF banks have increased business lending by substantially greater amounts than the comparison group of non-SBLF banks across median measures of size, geography, and loan type

Investments made through the SBLF program are presently expected to cost less than the originally projected cost of $1.3 billion. In addition, Treasury is currently projected to incur $23.6 million in fiscal year 2012 operating expenses for the SBLF program, $2 million less than the fiscal year 2012 operating expense estimate of $25.6 million included in the President's Budget for fiscal year 2013.

State Small Business Credit Initiative

The Small Business Jobs Act of 2010 also created the SSBCI, which was funded with $1.5 billion to strengthen State programs that support lending and investing to small businesses and small manufacturers. The SSBCI Program is expected to help spur up to $15 billion in new lending to and investment in small businesses. The SSBCI program builds on new and existing models for state small business programs, including Capital Access Programs (CAPs), loan participation programs, loan guarantee programs, collateral support programs, and state-run venture capital programs.

Goal #2: Enhance U.S. Competitiveness and Promote International Financial Stability and Balanced Global Growth

Enabling Domestic Economic Growth

Supporting Distressed Communities

In fiscal year 2012, the Community Development Financial Institutions Fund's core program (the CDFI Program) awarded $175.3 million in funding to 177 CDFIs to provide loans, investments, financial services, and technical assistance to underserved populations and low-income communities (LICs), including $23.1 million to 12 Healthy Food Financing Initiative awardees and $3 million to 33 technical assistance awardees. CDFI Program awardees reported originating 17,547 loans or investments totaling nearly $1.3 billion, based on their portfolio of activities in 2011. In addition, the Native American CDFI Assistance (NACA) Program awarded $11.4 million in financial and technical assistance to 33 Native CDFIs and other Native entities seeking to become or create Native CDFIs. Native CDFIs originated 1,170 loans or investments totaling $21,701,092 based on their portfolio of activities in 2011. The Bank Enterprise Award (BEA) Program, which provides monetary awards to CDFIs and banks for increasing their investments in LICs, received 71 eligible applications requesting a total of approximately $88.5 million.

The fiscal year 2012 performance information provided above pertains to each awardee's performance results for program year 2011. It should also be noted that the lag in performance reporting reflects the time it takes to deploy funds and make investments for which actual and projected results can be estimated and are based on information reported by CDFI Program awardees.

The New Markets Tax Credit (NMTC) Program, which provides tax credit allocation authority to Community Development Entities (CDEs) for targeted investments in LICs, competitively awarded $3.623 billion based on 2011 tax credit allocation authority.

Supporting Consumers

The Office of Consumer Policy advances developments that provide opportunities for the financial well-being of American consumers, especially in regard to financial products and services, including new and emerging ones. The office leads the Department's work to promote access to safe and affordable financial products and services, as well as clear information that enables individuals to make sound financial decisions. The office is engaged in policy development in the areas of consumer financial education and capability; emerging payments platforms; technology to improve consumers' financial choices; systems to further privacy and data security; and related topics. In support of this work, the office provides leadership for the Federal Financial Literacy and Education Commission, Federal interagency Task Force on Smart Disclosure, and coordinates the President's Advisory Council on Financial Capability.

International Stability and Global Growth

The Office of International Affairs maintains close communications with its bilateral and multilateral counterparts to monitor and respond to evolving risks in the global economic and financial systems to prevent financial instability abroad from spreading to the U.S. economy. To this end, Treasury engaged bilaterally with its counterparts in ministries of finance and through such forums as the U.S.-China Strategic & Economic Dialogue (S&ED) and the U.S. India Economic and Financial Partnership, and multilaterally through such forums as the G-7, the G-20, the FSB, the Basel Committee on Banking Supervision, and international financial institutions such as the International Monetary Fund (IMF) and the World Bank.

Continued concerns in fiscal year 2012 about financial stability in Europe posed a particular risk to the strength of the U.S. and global recoveries. Drawing on lessons learned from the U.S. response to the global financial crisis in 2008 and 2009, Treasury continued to assist and encourage its European counterparts to put in place a robust policy framework with sufficient firepower to stem the contagion to the larger economies in Europe and to restore confidence in the European banking system. By fall of 2012, Europe moved forward on establishing a stronger and larger firewall that supports sovereign access to sustainable market financing.

The Europeans also made progress on outlining a road map toward banking union and Spain took important steps on banking system repair.

Going forward, Treasury will continue to engage bilaterally and multilaterally to address problems that pose a risk to the U.S. economy and its continued growth, wherever and whenever they arise.

To support robust global growth, the countries of the G-20 need to implement economic policies that are consistent with the overarching goal of strong, sustainable, and balanced global growth. Treasury continues to encourage proactive near-term support for stability, growth, and jobs for economies with sufficient fiscal space to support the global recovery. Treasury also continues to work through the G-20 to encourage countries with external surpluses to implement policies that boost domestic demand. These actions should be reinforced by G-20 countries' commitments to move more rapidly toward market-determined exchange rates that better reflect underlying economic fundamentals, to avoid persistent exchange rate misalignments, to refrain from competitive devaluation of currencies, and to refrain from excessive foreign reserves accumulation.

These matters are of particular concern in Asia, where imbalances are most acute. Through the S&ED and related forums, including the Joint Economic Committee, the Investment Forum, and the U.S.-China Initiative on City-Level Economic Cooperation, we will continue to encourage China to move from an economy based on exports to one driven to a greater degree by domestic demand, and to provide a more level playing field for U.S. workers and firms. By September 2012, the renminbi had appreciated on real bilateral basis over 11 percent against the U.S. dollar since June, 2010. Through the S&ED, we secured new financial sector commitments to reduce market access barriers, boost consumption, reduce the unfair competitive advantage of state-owned enterprises, and began to loosen the chokehold that state-owned banks have on China's financial sector.

More broadly, Treasury seeks to promote sound economic policies among our trading partners. As chair of the G-7/G-8, Treasury led the multilateral Deauville Partnership for Arab Countries in Transition to help transitioning countries in the Middle East and North Africa maintain economic and financial stability, and promote more inclusive economic growth—especially for young people and women. We led the successful effort to provide Tunisia with a U.S. Government loan guarantee and conceived of and launched a Transition Fund to provide financing for transformational reforms in economic governance in transitioning countries in the Middle East and North Africa region. By supporting these political and economic transitions in the region, Treasury can support U.S. national security goals and boost global growth.

PROMOTING STABLE INTERNATIONAL FINANCIAL MARKETS

The United States is best served by the adoption and enforcement of high-quality financial standards that protect and strengthen our financial system and set an example for other nations. We actively engage and take a leading role in international discussions and forums, such as the G-20 and the FSB, and in negotiations with other major and emerging financial centers. Our objectives continue to be to lead a "race to the top" in the area of financial regulation that must be coordinated globally and to achieve consensus on strong and sensible reforms while protecting the competitiveness of U.S. firms.

Treasury's international financial regulatory agenda continues to focus on:

- Assuring international implementation of a global capital and liquidity standard that requires banks to maintain robust balance sheets that will withstand future financial shocks without government assistance
- Working with finance ministries and foreign regulators from key jurisdictions, as well as through the FSB, to enforce higher prudential standards, including additional internationally consistent capital requirements for Global Systemically Important Financial Institutions (G-SIFIs)
- Working with other countries so that they adopt strong national resolution authorities for G-SIFIs, as well as establishing a set of principles to develop an effective cross-border resolution system

- Establishing international convergence across derivatives markets to prevent risk in these markets from moving to jurisdictions with lower standards
- Establishing a global LEI system to uniquely identify counterparties to financial transactions in order to increase transparency and facilitate the cross-border assessment of risk

Encouraging Foreign Investment in the U.S. Economy

Foreign investment in the U.S. economy is vital to economic growth, job creation, and productivity. Treasury is strongly committed to an open investment policy with our counterparts around the world. Our objective is for the United States to continue to be the most attractive place for businesses to locate, invest, grow, and create jobs. At the same time, Treasury works to ensure that foreign investments in U.S. businesses do not compromise national security through our lead role on the CFIUS. We are committed to maintaining a CFIUS review process that is timely and efficient.

Pursuing Free trade and Open Markets

Treasury continues to work with the U.S. Trade Representative and other U.S. Government agencies to pursue a strong international trade and investment agenda to help the economy grow, increase U.S. exports, and support job creation.

In fiscal year 2012, the President signed legislation implementing the bilateral trade agreements with Korea, Colombia, and Panama, and Congress renewed a strong and robust Trade Adjustment Assistance program for American workers displaced by trade. The Administration also created a new Interagency Trade Enforcement Center to coordinate enforcement and focus tirelessly on challenging unfair trade practices around the world. This step will open up new opportunities for U.S. businesses to compete in the global marketplace

Our current priorities include pursuing normal trade relations with Russia as it joins the World Trade Organization, continuing to negotiate a high-standard 21st century Trans-Pacific Partnership trade agreement, and continuing to support the President's National Export Initiative to double exports over five years. In the last year alone, exports have reached historic highs and represent an increase of nearly 36 percent over the 2009 levels. We also will continue efforts to pursue a level playing field with China, including a focus on aligning export credit practices with international best practices standards, and will work to ensure that U.S. trade agreements and trade laws are enforced rigorously.

Entering into Bilateral and Multilateral Tax Agreements

Treasury also negotiated international tax agreements that promote cross-border trade and investment. Income tax treaties and tax information exchange agreements (TIEAs) eliminate tax barriers to cross-border trade and investment by providing greater certainty to taxpayers regarding foreign tax liabilities, and by reducing the risk of double taxation. The Department will strengthen its network of tax treaties and TIEAs by modernizing existing agreements and by negotiating agreements with new treaty partners that will foster cross-border trade and investment and facilitate enforcement of U.S. tax laws.

Use Leadership Positions in the Multilateral Development Banks and the IMF to Advance U.S. National Security and Economic Interests

In fiscal year 2012, the United States contributed to general capital increases at the multilateral development banks (MDBs), which were necessitated by the landmark actions taken by the MDBs to help stabilize the global economy during the recent economic crisis. These resources reached countries representing 31 percent of U.S. export markets. The United States continues to use its leadership position in the MDBs to: (1) mitigate emerging threats to the U.S. and global economies, support trade and investment, and open new opportunities for American firms, thus helping to promote job creation in the United States; (2) further reinforce our national security interests in fragile and war-torn countries, reducing the dangers inherent in economic instability; and (3) advocate for MDB assistance in countries that are undergoing profound economic and political transitions, such as those in the Middle East and North Africa, in order to foster freedom, opportunity, and greater economic growth, thus fighting global poverty and providing critical support.

We have placed a special focus on addressing the global challenges of food security and environmental concerns. Treasury plays an important role in addressing food insecurity through its leadership in the Global Agriculture and Food Security Program (GAFSP), an innovative multi-donor food trust fund called for by G-20 leaders. In fiscal year 2012, we successfully brought three new donor countries into GAFSP and contributed to GAFSP's new private sector lending window.

In fiscal year 2012, Treasury also held the first annual Development Impact Honors competition to recognize and promote excellence and effectiveness at the MDBs.

The United States continues to use its leadership position in the IMF to promote global economic and financial stability, which supports U.S. economic growth and job creation. The IMF's crisis-response efforts continue to be critical for promoting the global and domestic economic recoveries. The United States will use its leadership position in the IMF to promote consistent IMF surveillance over its members' exchange rate policies and to support our G-20 objectives of encouraging flexible, market-determined exchange rates, and achieving strong, sustainable, and balanced global growth. Fiscal year 2012 saw advancements in the IMF's score surveillance function through the establishment of a new Integrated Surveillance Decision.

Direct Assistance to Developing Countries

The Department of the Treasury's Technical Assistance program (OTA) continues to provide direct assistance to developing countries that have demonstrated strong commitments to reforming their financial systems or public financial management. This work encourages prosperity and stability in other parts of the world and supports broader U.S. Government international objectives — such as increasing transparency and accountability, reducing corruption, and strengthening the development of market-based policies and practice — while helping to create more stable international markets for U.S. exports.

In fiscal year 2012, Treasury made special investments through technical assistance in Administration priority programs such as the Partnership for Growth countries of Philippines, El Salvador, and Tanzania, and strengthened its engagement with countries in transition in the Middle East and North Africa.

Goal #3: Protect our National Security through Targeted Financial Actions

Treasury is devoted to deploying its full range of financial authorities to track, degrade, and disrupt threats to national security from state and non-state actors, including terrorists, Weapons of Mass Destruction (WMD) proliferators, drug traffickers, rogue regimes, and transnational criminal organizations.

As the Department works to enhance the accessibility of the financial system to legitimate users, it also works to prevent its exploitation by illicit actors. Financial and other forms of intelligence information, whether from the U.S. Government, law enforcement, administrative, regulatory, or proprietary sources, has been critical to Treasury efforts to stem the flow of funding to terrorist groups and disrupt weapons proliferation and other illicit networks around the world. Money is the common denominator in these networks, and hence understanding how it moves and is used to support their endeavors creates new opportunities for Treasury action.

New Security Council Resolutions and Executive Orders

Through the Executive Order on Assignment of National Security and Emergency Preparedness Communications Functions, the U.S. Government must be able to communicate domestically and internationally, at all times and under all circumstances, to implement critical and time sensitive missions. An Executive Committee was established to:

- Advise and make policy recommendations to the President to enhance the survivability, resilience, and future architecture of national security and emergency preparedness (NS/EP) communications
- Develop a long-term strategic vision for NS/EP communications and propose funding requirements

and plans to the President and the Director of the Office of Management and Budget (OMB)

- Coordinate the planning for, and provision of, NS/EP communications for the U.S. Government under all hazards

Efforts to Combat Mortgage Fraud

FinCEN continues its work to combat mortgage fraud. FinCEN closed a gap in the regulatory sector by issuing a final rule that made non-bank regulatory mortgage lenders and originators (RMLOs) subject to FinCEN's reporting and recordkeeping regulations. As of August 13, 2012, RMLOs must comply with FinCEN's final rule requiring the establishment of anti-money laundering programs and the filing of suspicious activity reports (SARs). To help RMLOs identify and report suspicious activity related to potential mortgage fraud, FinCEN issued an advisory on red flags that may signal mortgage fraud, and has updated its website with numerous resources for the industry. The new requirements for RMLOs will augment the information available to law enforcement about suspicious activity in this sector.

FinCEN also continues to work with its law enforcement partners to combat mortgage fraud. Law enforcement authorities used FinCEN reports extensively in an investigation that involved a large-scale mortgage fraud scheme resulting in major financial losses and numerous foreclosures. Investigators queried FinCEN data and found multiple SARs, which assisted in obtaining search warrants and led to multiple interviews with borrowers. Federal and local authorities arrested more than a dozen individuals linked to mortgage fraud schemes that involved the filing of fraudulent loan applications with several banks and other lenders, generated millions of dollars in loan fees and real estate commissions, and caused millions of dollars in losses when homes went into foreclosure.

As a participant in the federal loan modification and foreclosure rescue fraud initiative, FinCEN has supported more than 150 mortgage fraud cases with more than 1,200 subjects and has disseminated more than 190 analytical reports since April 2009.

E-Filing

FinCEN enhanced data quality and significantly reduced costs for the U.S. Government, financial institutions, and U.S. taxpayers by requiring mandatory electronic filing of most FinCEN forms. This new requirement became effective on July 1, 2012. Mandatory E-Filing has enhanced the quality of FinCEN's electronic data, improved its analytical capabilities, and ultimately made it quicker and easier for law enforcement to track criminal money.

Several years ago, FinCEN started encouraging financial institutions to use its free, Web-based system known as the Bank Secrecy Act Electronic Filing System (BSA E-Filing) in an attempt to cut down on paper reports. FinCEN is no longer accepting most paper filings and has considered extensions and exemptions only in certain circumstances. Over the past 20 years, banks, casinos, brokerages, and many other financial businesses have filed millions of paper forms with FinCEN. Last year alone, financial institutions and individuals filed more than 17 million separate reports with FinCEN and more than 2 million of those were on paper.

FinCEN reports create a financial trail that law enforcement and intelligence agencies use to track criminal and terrorist networks and their activities and assets. These reports help detect and deter illicit activity, including money laundering, the financing of terrorist activity, and many other types of fraud.

Mandatory E-Filing supports Treasury's flagship initiative of moving toward a paperless Treasury. It also allows for greater data security and privacy compared with paper forms, ensures compatibility with future versions of FinCEN reports, and allows quicker access to investigators. E-Filing is positively impacting the public by reducing government and industry costs and the environmental waste of paper forms, potentially saving the U.S. Government millions of dollars per year through the reduction of expenditures associated with paper processing, in particular the physical intake and sorting of incoming reports and the manual keying of reported information into FinCEN's database.

Efforts to Combat Health Care Fraud

Continuing its successful collaboration with the Department of Health & Human Services, Office of Inspector General, and the Department of Justice, FinCEN provided support to the Health Care Fraud Prevention and Enforcement Action Team (HEAT) Task Force. The Task Force was formed in 2009 to combat health care fraud abuse in the Medicare and Medicaid programs.

FinCEN researched and analyzed data collected under the provisions of the Bank Secrecy Act (BSA) pertaining to subjects identified by the Task Force as suspects in health care fraud schemes. These schemes have been defrauding the U.S. Government of an estimated $98 billion dollars per year.

FinCEN has provided analytical support to more than 200 cases and continues to develop intelligence to further disrupt and dismantle major health care fraud networks in cities such as Miami, Tampa, Brooklyn, Los Angeles, Houston, Detroit, and Atlanta. By identifying commonalities and shared entities in these cases, FinCEN, the Department of Justice's Asset Forfeiture and Money Laundering Section, and the Federal Bureau of Investigation initiated a project to identify third party money launderers who service the perpetrators of health care fraud and other crimes. Through this initiative, FinCEN will be able to provide the investigators with an overall assessment of the targeted jurisdictions, individuals, and sophisticated and complex organizations that are suspected of being engaged in health care fraud schemes.

Treasury Executive Office for Asset Forfeiture

TEOAF manages the Treasury Forfeiture Fund (TFF). The mission of the TFF is to promote the strategic use of asset forfeiture in order to disrupt and dismantle criminal enterprises. TEOAF and its member agencies focus on investigations that result in high impact forfeitures, leading to the greatest disruption to criminal organizations that engage in money laundering, financial fraud and a myriad of other illegal acts. Accordingly, through its efforts to protect the integrity of the U.S. financial system, the TFF supports Treasury's goal to protect U.S. national security through targeted financial actions.

Financial Sanctions (Iran and Syria)

Treasury exercises a broad range of intelligence, regulatory, policy, and enforcement authorities to track and disrupt illicit finance networks. Treasury also implements economic sanctions against various foreign threats to protect U.S. national security and foreign policy interests. Through these means, Treasury seeks to degrade the financial and other support networks of terrorists, weapons proliferators, drug traffickers, rogue regimes, and other illicit actors. The Treasury Department's identification of these networks reinforces foreign or domestic efforts against these targets.

The Department of the Treasury administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals through the Office of Foreign Assets Control (OFAC).

The United States is imposing additional sanctions and publicly exposing numerous Iranian front companies, in order to convince Iran to address the international community's concerns about its nuclear program and to prevent the circumvention of international sanctions on Iran. Continuing to target Iran's nuclear and missile proliferation activities, the Treasury Department has issued successive rounds of aggressive designations under Executive Order 13382, with significant impact on proliferation networks. Treasury is leading efforts to bring an end in Syria to the Assad regime's abhorrent campaign of violence against the Syrian people by working to apply sanctions on those involved in human rights abuses. Treasury hosted the Friends of the Syrian People International Working Group on Sanctions, a working session in which countries strove to harmonize restrictive measures against the Syrian regime.

The Treasury.gov website is the main source providing the OFAC sanctions information to banks, financial institutions, and the public. This information is the most commonly sought content on Treasury.gov according to data from ForeSee and Google Analytics measured from April through September 2012:

- 28 percent of all visits to the Treasury.gov website went to sanctions pages
- 20 percent of customer satisfaction survey respondents specifically cite the purpose of their visit was to find content related to OFAC/Sanctions/Specially Designated Nationals

Goal #4: Pursue Comprehensive Tax and Fiscal Reform

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

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

Tax Reform Efforts

Treasury, in conjunction with the White House, has developed a framework for business tax reform that reduces the statutory tax rate, eliminates provisions that are inefficient, increases the incentives for job creation and retention in the United States, simplifies the tax system, and does this in a fiscally responsible manner. Treasury is also committed to utilizing traditional and innovative ways to improve communication with policymakers, interested parties, and the public about matters related to tax policy.

Increase Voluntary Tax Compliance

The tax gap is the difference between taxes paid and taxes owed in any given year. Reliance on a voluntary compliance tax system requires effective taxpayer services to enable taxpayers to understand and meet their tax obligations as well as effective enforcement to ensure that all businesses and individuals pay the tax they owe. Improvement of both service and enforcement, along with reforms to simplify the tax law, are essential to ensure that the U.S. tax system remains the most effective and fairest voluntary compliance system in the world. This goal is one of Treasury's two APGs and is discussed more thoroughly later in this report.

To encourage voluntary compliance with the tax laws, Treasury has sought to reduce the burden of compliance by reducing record keeping requirements and expanding the use of simplified "safe harbor" rules that eliminate liability for unintentional tax underpayment. Treasury has also published administrative guidance that clearly explains the tax law and illustrates its application to common situations.

New Collaborations with International Partners

The Treasury Department has jointly issued statements with Japan, Switzerland, the United Kingdom, France, Spain, Italy, and Germany expressing mutual intent to pursue a framework for intergovernmental cooperation to facilitate the implementation of the Foreign Account Tax Compliance Act (FATCA) and to improve international tax compliance. The Treasury and the United Kingdom have already signed a bilateral agreement and the Treasury will continue to work with other governments to conclude bilateral agreements. FATCA is an important part of the U.S. Government's effort to improve tax compliance. The Treasury and the IRS continue to move forward with joint efforts to combat offshore tax evasion and make our tax systems more efficient and fair by implementing FATCA in a way that is targeted and effective.

Goal 5: Manage the Government's Finances in a Fiscally Responsible Manner

The Treasury Department is responsible for managing the finances of the U.S. Government and strives to maintain public trust and confidence in U.S. and international economic and financial systems. The Department's ability to be efficient, effective, accountable, and transparent enables the smooth, continuous operation of essential governmental services and meeting the U.S. Government's financial obligations. To that end—and while supporting and maintaining governmental operations—during fiscal year 2012, the Department has focused on achieving greater cost savings for the American public, increasing productivity, modernizing operations, and supporting the Administration's management agenda. It has done this by developing systems, tools, and a culture of governing strategically, working smarter, and leveraging technologies.

GOVERNING STRATEGICALLY

Treasury has employed a robust suite of tools and processes to perform data-driven, performance-focused, and outcome-based strategic oversight and management of all its component organizations. These continually evolving processes are embedded in the way the Department does its business and within its corporate culture. They serve as the foundation for Treasury's leadership and stewardship agenda.

Treasury's Quarterly Performance Reviews

Treasury's management and performance agenda are set by the Deputy Secretary serving as the Chief Operating Officer who, with the Assistant Secretary for Management and Performance Improvement Officer, conducts quarterly performance reviews of each bureau. These quarterly reviews were recognized by OMB as a best practice and codified in law as part of the Government Performance Results Act Modernization Act.

These sessions bring key Treasury leaders together for regular, formal discussions with the Deputy Secretary to focus on management challenges and priority projects. These meetings drive accountability to make and sustain improvements, align expectations and priorities across Treasury bureaus and offices, and encourage data-driven decision-making. The Department has strengthened its partnership with OMB and the federal Performance Improvement Council through open dialogue and consultative problem-solving on numerous government performance matters, including Treasury's two APGs: (1) increasing voluntary tax compliance, and (2) increasing electronic transactions with the public to improve services, prevent fraud, and reduce costs.

An example of a positive outcome from these reviews is that Treasury earned an A+ rating from the Small Business Administration (SBA) for small business contracting achievement in fiscal year 2011. Treasury was the only federal agency to achieve and substantially exceed all five statutory small business goals—Small Business, Women Owned Small Business, Small Disadvantaged Business, Service Disabled Veteran Owned Small Business, and Historically Underutilized Business (HUB) Zones. By all indications, Treasury has exceeded these small business goals again in fiscal year 2012, demonstrating the continuing success of the quarterly performance reviews.

Shared Services Council

In addition to the quarterly performance reviews, Treasury's "shared services first" approach to managing across organizational boundaries has resulted in increased transparency, cost savings, and improved operational effectiveness as management support services are provided by those with demonstrated expertise and Treasury bureaus focus on mission accomplishment. The Treasury Shared Services Council (SSC) provides a portfolio-wide approach to shared services across the Department, optimizing capability stewardship and services delivery and driving accountability for performance and risk management.

In addition to providing additional accountability for cost and performance issues, the SSC provides a common governance structure for Treasury's multiple shared services programs and advocates for and promotes the value of shared services. This group has tackled numerous issues, including discussing how to reduce Treasury's office space footprint as well as providing insight into the strategic direction of Treasury's various shared services providers—notably the Bureau of Public Debt's Administrative Resource Center (ARC) and HR Connect (both government-wide shared service providers).

Cost Savings Guidance

Treasury's Office of Financial Innovation and Transformation (OFIT) aims to achieve government-wide financial management savings by leveraging new technologies and the shared service provider model. For example, the Centralized Receivables Service (CRS), an end-to-end billing and collections capability for federal agency receivables in the pre-delinquency stage (e.g., fees and penalties due to an agency) allows agencies to focus on their core mission by outsourcing certain receivables collection activities. Once fully implemented, CRS will deliver an estimated $350 million in annual cost savings government-wide from increased collections and reduced financial systems costs.

WORKING SMARTER

Treasury is reducing spending and improving the way business is conducted at all levels—from reduction of the

Department's real estate footprint to improving how information is being managed; and from the employment of Treasury's Procurement Savings Program and strategic sourcing efforts, to taking the lead role in implementing the President's initiative to reduce improper payments through the *Do Not Pay* Business Center.

Improper Payments

Following the President's June 2010 memorandum directing agencies to improve payment accuracy by using a "Do Not Pay List," the Department of the Treasury established the Do Not Pay Business Center for all federal agencies to prevent ineligible recipients from receiving federal payments or awards. Do Not Pay uses key data sources to review eligibility, including data to verify that the beneficiary is not deceased or debarred and meets employment/income requirements and provides trend analysis and fraud alert capabilities. In the short time since the Do Not Pay Business Center was launched in fiscal year 2012, significant progress has been made towards providing agencies with a one-stop-shop to verify eligibility prior to issuing a payment. To date, all 24 CFO Act agencies have finalized and submitted plans to Treasury and OMB specifically describing how they will use Do Not Pay to prevent payments from being made to dead people, debarred contractors, or incarcerated individuals.

In its ongoing efforts to combat tax refund fraud, the IRS is using data analytics to help identify tax preparers who submit incorrect or fraudulent tax returns. This year, the IRS conducted a pilot which identified tax preparers from the previous year that were associated with the most erroneous tax returns claiming refundable credits.

Procurement

The Department has launched multiple initiatives to broaden efficiency within its procurement operations. In fiscal year 2011, Treasury established an enterprise-wide strategic sourcing program governed by a Quad Council comprised of Department-wide representatives from procurement, IT, human resources, and financial organizations and chaired by the Assistant Secretary for Management. In fiscal year 2012, the Department brought all procurement spend under management by designated category leaders. Procurement obligations are analyzed, opportunities for consolidation and leveraging of the Department's buying power are identified, and targeted contract actions are directed to the most appropriate strategic sourcing methodology. Approximately 16 procurement spending categories were targeted for improvement and $80 million in savings were achieved through the Department's strategic sourcing efforts.

Treasury Procurement exceeded its fiscal year 2011 OMB-mandated goals for acquisition-related savings and reduction of high-risk contracting obligations. The Department achieved $326 million in acquisition savings versus its goal of $319 million and decreased high risk contracting by 21 percent, well above the targeted 10 percent reduction. In fiscal year 2012, Treasury elected to continue both the acquisition savings and high risk contracting reduction initiatives in the absence of a continuing OMB mandate. The Department exceeded its internal savings goal of $92 million by achieving over $240 million in acquisition-related savings (including strategic sourcing savings).

Treasury made significant advancement against its internal goal of ten percent reduction in high risk contracting obligations. The Department achieved a ten percent or greater reduction in two of four high risk categories. Based on cumulative achievements in fiscal year 2011-2012, the average annual reduction in high risk contracting exceeded ten percent.

In fiscal year 2012, Treasury launched a strategic initiative for a single Department-wide contract writing system and enhanced communication between contract and financial systems. The effort will be developed and implemented through a multi-year phased approach as funding becomes available.

Leveraging Technology

Treasury has a long history of identifying and leveraging commodity IT opportunities. In 1996, the Administrative Resource Center (ARC) began operation, offering commodity business services across organizations. Since that time, Treasury has launched several enterprise initiatives, including: (1) HR Connect, a government HR Line of Business; (2) Treasury Enterprise Identity Credential and Access Management (TEICAM), which has expanded to other departments including Homeland Security; and (3) Enterprise Content Management, which has already garnered interest from other departments. Other commodity IT initiatives are ongoing such as developing an Invoice Processing Platform (IPP), formerly known as Internet Payment Platform and a *Do Not Pay* platform as a government-wide shared services.

Information Technology

Implementation of Mobile Treasury, Treasury's technology modernization campaign, has been the key enabler for transforming Treasury's business and services delivery systems, resulting in streamlined business processes, costs savings, and employee empowerment. Through a combination of governance and management oversight initiatives, the Department has developed innovative E-Government enterprise architecture for bridging the gap between business processes and their supporting IT. As a result, numerous opportunities for performance improvement and business transformation have been identified, including the elimination of redundant and duplicative IT investments. This has focused Treasury's lines of businesses to facilitate better business alignment and cross-bureau collaboration in investments.

Treasury's investment in leading and planning these efforts has already yielded results, both in terms of financial savings and operational efficiencies, allowing the Department to further leverage other opportunities for improvement. For example, the Department's footprint reduction efforts have led to business process redesign, which is leading to installation of collaborative office spaces and even greater ability to leverage the federal telework program. TTB has established one of the most robust telework programs at the Department. TTB's workforce is widely dispersed, with many personnel working from home full time and over 80 percent of the workforce regularly teleworking. Advancements in TTB's IT network completed in 2012 have both furthered the effectiveness of its telework program and contributed to the Administration's goals under the "Bring Your Own Device" (BYOD) initiative of improving mobile work capabilities and reducing IT costs across government.

TTB achieved significant savings by reducing the cost of refreshing employee IT hardware, such as PCs and laptops. Replacing desktop and laptop computers every 3 to 4 years costs TTB about $2 million and disrupts the IT program and business users for several months.

TTB determined that the best solution was to create a "virtual desktop" by centralizing all computing power, applications, user data, and user settings and allow access to TTB resources by thin client computing devices. A thin client is a computing device or program that relies on another device for computational power. Currently about 70 percent of TTB personnel use thin client devices to access all TTB applications and data.

In August, TTB's virtual desktop implementation was cited by the White House as a case study for the federal BYOD initiative. TTB's virtual desktop solution is a major achievement that resulted in $1.2 million in IT savings, as well as additional savings in phone and fax lines and potential reductions to dedicated office space. Additional benefits include enhanced IT security, as the virtual desktop/thin client infrastructure eliminates the need to have information stored locally on a user's machine, and reduced data loss, as the virtual desktop provides for the centralization of information.

Treasury's Fiscal Year 2012-2013 Agency Priority Goals and Status

The Treasury Department established two APGs to support improvements in near-term outcomes related to the Strategic Plan.

Increase Voluntary Tax Compliance

Helping taxpayers understand their obligations under the tax law is critical to improving compliance and addressing the tax gap. Therefore, the IRS is committed to making tax law easier to access and understand. The IRS remains committed to improving voluntary compliance and reducing the tax gap through both taxpayer service and enforcement programs.

The IRS continued to increase the amount of tax information and services available to taxpayers online and through social media. IRS.gov provides alternative online and self-help service options. Through September 30, 2012, taxpayers viewed IRS.gov web pages more than 1.7 billion times as they used the website to:

- Get forms and publications. Beginning in fiscal year 2011, the IRS reduced the number of forms and publications that were mailed to taxpayers. For this reason, during the fiscal year 2012 filing season, more than 347 million tax products were downloaded, an increase of 51 percent from fiscal year 2011
- Link to the Electronic Federal Tax Payment System (EFTPS). EFTPS processed more than 132.4 million electronic tax payments totaling $2.1 trillion
- Get answers. More than 1.1 million visits to the Interactive Tax Assistant introduction page where taxpayers can receive answers to tax law questions
- Use "Where's My Refund?" Taxpayers used "Where's My Refund?" more than 132.3 million times to check on the status of their tax refunds

The IRS is increasing communications with taxpayers who may not get their information from traditional sources, such as newspapers and broadcast cable news. By employing social and new media, such as YouTube, Twitter, and iTunes, the IRS can reach these taxpayers and provide important service and compliance messages. In February 2012, the IRS released a new version of IRS2Go, a Smartphone application that lets taxpayers check on the status of their tax refund and obtain tax information including requesting their tax return or account transcripts. Since its February 2012 release, the new features helped attract more than 6.2 million application launches from IRS2GO.

In October 2011, the IRS began a pilot of Virtual Service Delivery (VSD) to test a new means of service delivery in Taxpayer Assistance Centers (TACs) and partner sites. VSD provided face-to-face contact with more than 16,000 taxpayers at 15 IRS locations using video communication technology. Preliminary participant feedback from the survey through December 31, 2011 indicated they were very satisfied with VSD technology and 92 percent reported they would be willing to use video assistance again during a future visit.

During the 2012 filing season, through September 30, 2012, the IRS received more than 147.6 million individual returns (113.8 million electronically filed) and issued more than 121.6 million refunds totaling $333 billion.

In fiscal year 2012, the IRS continued to implement its Return Preparer Initiative, the foundation of which is mandatory registration for all paid tax return preparers. Through September 2012, more than 860,000 preparers requested Preparer Tax Identification numbers (PTINs) using the online registration system. The process gives the IRS an important and improved view of the return preparer community from which the IRS can leverage information to improve communications, analyze trends, spot anomalies, and detect potential fraud. The IRS also leveraged real time data during the 2012 filing season to improve the compliance of more than 1,400 preparers with high numbers of Earned Income Tax Credit (EITC) errors.

The IRS also launched the Registered Tax Return Preparer (RTRP) competency test in November 2011 for all paid tax return preparers except attorneys, certified public accountants, and enrolled agents. More than 31,000 tests were conducted, and applications from approximately 570 continuing education providers were approved. All RTRPs are also required to complete 15 hours of Continuing Education (CE) courses annually beginning in 2012. To address this requirement, the IRS deployed a registration system for CE providers, issued Revenue Procedures outlining the IRS standards for CE accreditors and providers, and launched a webpage for CE accreditors, providers, and preparers.

In January 2012, the IRS announced a third Offshore Voluntary Disclosure Program due to continued interest from taxpayers after the closure of the 2011 and 2009 programs. As part of an overall strategy to improve offshore compliance, taxpayers who voluntarily come forward and file all original and amended tax returns and pay taxes, interest, and accuracy-related and/or delinquency penalties, can avoid criminal prosecution. The offshore voluntary disclosure programs have resulted in over 38,000 disclosures and the collection of more than $5.5 billion in back taxes, interest, and penalties.

The IRS modernization efforts focus on building and deploying advanced IT systems, processes, and tools to improve efficiency and productivity. In 2012, the IRS delivered the most significant update to its core tax processing system in decades with the deployment of the initial phase of the Customer Account Data Engine 2 (CADE 2), modernizing tax processing. After more than 50 years of posting returns and transactions on a weekly batch cycle, in January 2012, CADE 2 moved the IRS to a daily cycle for tax processing of individual taxpayer accounts. For the first time, the IRS processing systems are accepting all 1040-related schedules and forms electronically through a modernized e-filing capability, which will feed into a single consolidated taxpayer account database, and reduce the handling/mailing of voluminous paper returns. In the coming years CADE 2 will provide the IRS with significantly expanded service and enforcement capabilities that will drive additional voluntary compliance.

Increase Electronic Transactions with the Public to Improve Service, Prevent Fraud, and Reduce Costs

The safety, security, efficiency, and reliability of Treasury transactions are paramount to maintaining public trust. Billions of transactions, including payments to federal benefits recipients, savings bonds purchases, and tax collections, are executed by Treasury each year. The paper processes associated with these transactions can be slow, unsecure, inaccurate, and wasteful. In an effort to improve customer service, decrease the public's vulnerability to fraud, and efficiently manage resources, the Secretary of the Treasury approved several initiatives to move towards electronic transactions, including discontinuing the sale of paper savings bonds, increasing electronic benefit payments, and increasing electronic tax collection. Treasury has already discontinued the issuance of paper savings bonds through traditional employer-sponsored payroll savings plans, and the sale of over-the-counter paper savings bonds ended on December 31, 2011. Treasury will continue to make progress toward a fully paperless set of processes by paying benefits electronically and encouraging businesses to pay taxes electronically rather than by paper coupon. This priority goal is related to the strategic goal of "Manage the Government's Finances in a Fiscally Responsible Manner."

Payments

In support of the goal to increase electronic payments government-wide, the FMS has a number of efforts underway. In December 2010, Treasury announced a final rule to extend the safety and convenience of electronic payments to all Americans receiving federal benefit and non-tax payments. Anyone who applied for benefits on or after May 1, 2011, was required to begin receiving their payments electronically, while those who were already receiving paper checks need to switch to direct deposit by March 1, 2013. This important change will provide significant savings to American taxpayers who will no longer incur the price tag associated with paper checks.

As a result of the final rule, the Go Direct® campaign shifted from a marketing focus to a national public education effort building on previous successes to provide federal benefit recipients with the tools and resources they need to transition to Electronic Funds Transfer payments. The campaign reaches current check recipients as well as people who will apply for federal benefits soon. Benefit checks have declined from 10.3 million per month in January 2011 to 5.5 million as of August 2012, saving millions of dollars for the United States Treasury and taxpayers in the years to come.

A big part of the success of the All-Electronic Treasury is the Direct Express® card. The Direct Express® card offers the convenience and security of receiving benefit payments electronically for those who prefer a debit card or do not have a bank account. Instead of receiving a paper check, the benefit payment is automatically deposited into the recipient's card account on the payment date. It is currently available to Social Security, Supplemental Security Income, Veterans, and other federal benefit types. To date, more than 3.8 million benefit recipients have signed up for the Direct Express® card.

The U.S. Debit Card Program has expanded to 36 separate and distinct uses by federal agencies, including uses in criminal investigations, Native American trust disbursements, and international student per diem reimbursements, since program inception in 2000. At present, the program that has delivered the largest savings to the taxpayer has been the Department of Transportation's TRANServe debit card for the disbursement of federal transit subsidies encouraging federal workers to utilize public transportation. Since Program inception (July 2011) TRANServe has deployed 60,000 cards and has recouped $11.9 million in unspent funds.

The Stored Value Card (SVC) Program is a joint program by the Departments of Treasury and Defense with major goals to enhance security, improve processing of financial transactions, and reduce the float loss associated with the coin and currency in circulation at military bases in the U.S. and overseas, on ships at sea, and at other "closed" Government locations around the world. SVCs reduce the high costs of securing, transporting, and accounting for cash. Through fiscal year 2012, SVCs have replaced more than $6 billion in cash or other paper payment mechanisms used in military environments. Additionally, SVCs streamline and help automate the otherwise manually intensive back end operations that were necessary to support cash and cash equivalents. The SVC Program has saved the Government more than $48 million in operating costs.

Treasury is also exploring the feasibility of extending E-Wallet and mobile payment technology to our payments area. As payment technology advances, Treasury is looking to meet the expectations of citizens in how they wish to interact with the U.S. Government.

Also in support of President Obama's "Campaign to Cut Waste" across the U.S. Government, Treasury has mandated the IPP for all Treasury offices and bureaus. IPP will reduce Treasury's invoice processing costs by 50 percent, saving approximately $7 million annually. Implementation by all Treasury bureaus will be complete by November 2012. OFIT estimates that adopting electronic invoicing across the U.S. Government will reduce the cost of entering invoices and responding to invoice inquiries by $450 million annually. In addition to Treasury, IPP currently supports 45 agencies, with eight additional agencies beginning implementation. The program continues to advocate its cloud-based shared service government-wide to improve government efficiency and cut costs for taxpayers.

Collections

As part of this effort to increase electronic collections, FMS has undertaken the Non-Tax Paperless Initiative (NTPI), aimed at moving all collections and remittances processed by FMS to electronic means, resulting in greater efficiencies for FMS and its agency partners and greater convenience for the public. Working with the Federal Reserve Banks and a consultant, cash flows (including both collections and remittances, processes, and remitter databases) will be analyzed to develop a transition strategy. Best practices in government and the private sector and emerging payment technologies (online banking, mobile payments, E-Wallets) will be investigated as part of the project. NTPI also will include a high-level communications strategy.

Debt Collections

FMS collects delinquent Government and child support debt by providing centralized debt collection, oversight, and operational services to Federal Program Agencies (FPAs) and states pursuant to the Debt Collection Improvement Act of

1996 and related legislation. FMS uses two debt collection programs: Treasury Offset Program and Cross Servicing.

In fiscal year 2012, FMS increased debt collections by (1) repurposing the Austin Payment Center as a debt collection center, (2) undertaking three management and administrative reforms, which include improving the offset match process, improving analytic tools, and expanding Administrative Wage Garnishment, (3) enhancing the FedDebt system, and (4) expanding offset services by increasing debt referral, adding new debt types such as unemployment insurance compensation debts and expanding the usage to federal agencies and states.

Finally, FMS, in partnership with OFIT, is developing a CRS Pilot. Treasury's long-term vision is to provide a centralized receivables service to federal agencies that will increase collections on current receivables and delinquent debt.

Government-wide Accounting (GWA) and Reporting

The GWA Program supports the FMS's strategic goal to produce timely and accurate financial information that contributes to the improved quality of financial decision making by operating and overseeing the Government's central accounting and reporting system. The GWA Program also works with FPAs to adopt uniform accounting and reporting standards and systems. It provides support, guidance, and training to assist FPAs in improving their Government-wide accounting and reporting responsibilities. The FMS collects, analyzes, and publishes Government-wide financial information, which is used by the U.S. Government to establish fiscal and debt management policies and by the public and private sectors to monitor the Government's financial status. Publications include the Daily Treasury Statement, the Monthly Treasury Statement, the Treasury Bulletin, the Combined Statement of the United States Government, and the Financial Report of the U.S. Government.

DEPARTMENT'S KEY PERFORMANCE MEASURES FOR 2012

The following table contains key performance metrics providing a representative overview of the department's performance for 2012. 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.

Performance Measure Official Title	Bureau	2008 Target	2008 Actual	2009 Target	2009 Actual	2010 Target	2010 Actual	2011 Target	2011 Actual	2012 Target	2012 Actual
Percentage Collected Electronically of Total Dollar Amount of Federal Government Receipts (%)	FMS	79.0	80.0	80.0	84.0	80.0	85.0	82.0	96.0	96	97
Percentage of Treasury Payments and Associated Information Made Electronically (%)	FMS	79.0	79.0	80.0	81.0	81.0	82.0	83.0	84.0	85	88
Amount of Delinquent Debt Collected Through All Available Tools	FMS	3.4	4.41	3.9	5.03	4.65	5.45	4.84	6.17	6.67	6.17
Customer Service Representative (CSR) Level of Service (%)	IRS	82.0	52.8	70.0	70.0	71.0	74.0	71.0	70.1	61.0	67.6
Taxpayer Self-Assistance Rate	IRS	51.5	66.8	64.7	69.3	61.3	64.4	68.7	70.1	72.2	78.5
Percentage of Business Returns Processed Electronically (%)	IRS	20.8	19.4	21.6	22.8	24.3	25.5	27.0	31.8	32.0	36.7
Percentage of Individual Returns Processed Electronically (%)	IRS	61.8	57.6	64.0	65.9	70.2	69.3	74.0	76.9	79.0	80.5
Affordable Housing Units Created by CDFI Fund Programs (data starting 2011)	CDFI Fund	-	-	-	-	-	-	Baseline	19,083	16,419	27,433
OTA Scope and Intensity of Engagement (Traction)	DO	Baseline	3.6	3.6	3.7	3.6	3.5	3.6	3.7	3.6	3.9
Impact of TFI Programs and Activities	DO	-	-	Baseline	7.81	7.4	7.4	7.6	8.4	7.8	8.1*

Note: Performance measures were not audited.

**Estimated value.*

On December 7, 2010, Treasury published a regulation that required businesses with an annual tax liability of at least $10,000 to pay their taxes electronically. The new requirement, combined with FMS's efforts to transition taxpayers to electronic payments, resulted in FMS processing over 132.5 million payments electronically during fiscal year 2012. Accordingly, Treasury significantly exceeded its performance target on the measure: "Percentage collected electronically of total dollar amount of federal government receipts." With continued emphasis on the All Electronic Treasury initiative, FMS has undertaken the NTPI, aimed at moving all collections and remittances processed by FMS to electronic means, resulting in greater efficiencies for FMS and its agency partners and greater convenience for the public.

In support of the All Electronic Treasury initiative, FMS also continued to expand and market the use of electronic funds transfer to deliver federal payments, improve service to payment recipients, and reduce government program costs. In fiscal year 2012, FMS made 88 percent of payments electronically, exceeding its performance goal of 85 percent. FMS attributes the performance outcome to considerable success in implementing its nationwide Go Direct® campaign to encourage current check recipients to switch to direct deposit. As a result, benefit checks have declined from 10.3 million per month in January 2011 to 5.5 million as of August 2012, saving millions of dollars for the United States Treasury and the taxpayers in the years to come.

In fiscal year 2012, the IRS achieved a 67.6 percent - "Customer Service Representative Level of Service," exceeding its performance target of 61 percent. The IRS answered more than 30 million assistor calls and 59.2 million automated calls, with an accuracy rate of 93.2 percent of tax law and 95.6 percent of account questions received via the telephone. Moving forward, the IRS will staff telephone service as effectively as possible to meet anticipated telephone demand.

The IRS exceeded its performance target and achieved a 78.5 percent "Taxpayer Self Assistance Rate," as a result of the increased popularity of IRS web-based applications. The self-assistance rate is expected to increase in future years as more taxpayers choose automated customer service methods over more traditional methods such as telephone and paper correspondence.

The IRS achieved an electronic-filing rate of 36.7 percent for business returns, exceeding its performance target by more than four percentage points. The IRS also exceeded the target on its electronic filing metric, "Percentage of Individual Returns Processed Electronically." Performance in this area continues to be driven by increased demand for the overall benefits of e-file, such as its accuracy; quick acknowledgement of receipt; the ability to file amended, and/or prior year returns.

The CDFI Fund programs developed or produced 27,433 housing units across all programs, reflecting the impact of Recovery Act investments in 2012. Targets will be adjusted upward for fiscal year 2014 based on the increase in housing portfolio loans to reflect the results of new awardee reporting.

OTA developed its Traction goal based on project evaluations to measure the degree to which financial technical assistance programs bring about changes in behavior of counterpart countries. In fiscal year 2011, OTA slightly exceeded its target. The nature of the OTA program is such that country projects that reach performance goals and objectives are concluded and new projects are begun where the challenges are significant. The effect of this dynamic keeps the target goal always challenging but reachable if performance remains high across all teams and projects.

TFI created a composite measure that consists of three overall program office focus areas related to its mission and strategic goals. TFI estimated that it exceeded its performance target of 7.81 on its composite measure, "Impact of TFI Programs and Activities." Note that the fiscal year 2012 outcome is an estimate as of the publication of this report because a customer service survey that contributes to the composite score has not been fully completed.

HIGHLIGHTS OF MANAGEMENT AND PERFORMANCE CHALLENGES

Annually, in accordance with the *Reports Consolidation Act of 2000*, OIG and TIGTA identify the most significant management and performance challenges facing the Department. These challenges do not necessarily indicate deficiencies in performance; rather, some represent inherent risks that must be monitored continuously. Treasury made much progress on these issues in fiscal year 2012, and will continue to focus on resolving them during fiscal year 2013 and beyond. Refer to Section C of Part 3, Other Accompanying Information, for a detailed discussion of these challenges, listed below.

Note: SIGTARP does not provide the Secretary with an annual report on management and performance challenges.

TREASURY-WIDE MANAGEMENT CHALLENGES – AS IDENTIFIED BY OIG

- Transformation of Financial Regulation
- Management of Treasury's Authorities Intended to Support and Improve the Economy
- Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement
- Gulf Coast Restoration Trust Fund Administration (new)

IRS MANAGEMENT CHALLENGES – AS IDENTIFIED BY TIGTA

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

FINANCIAL HIGHLIGHTS

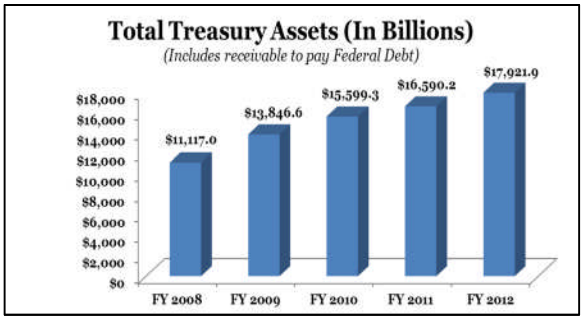


Figure 1

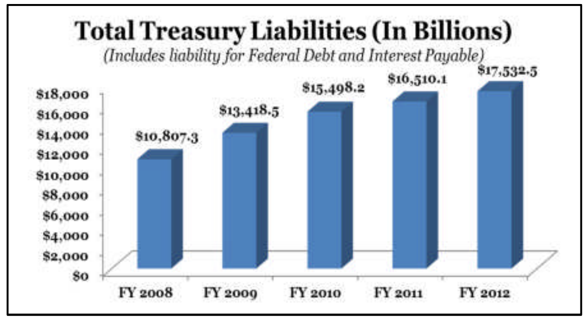
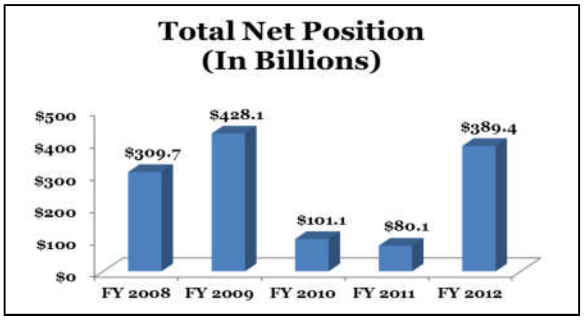


Figure 2



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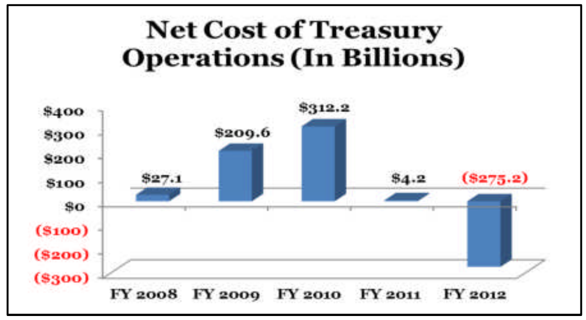

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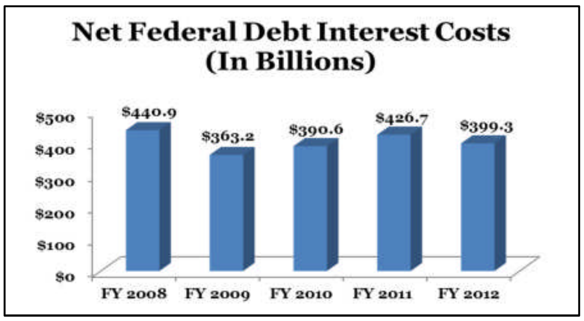


Figure 5

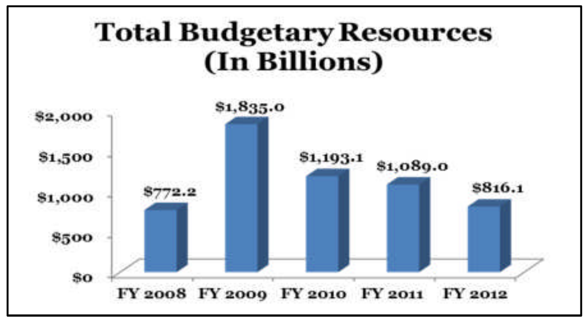


Figure 6

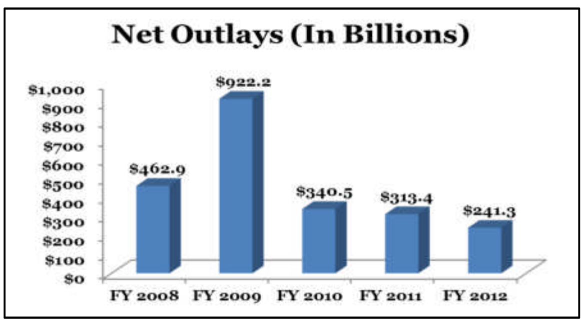


Figure 7

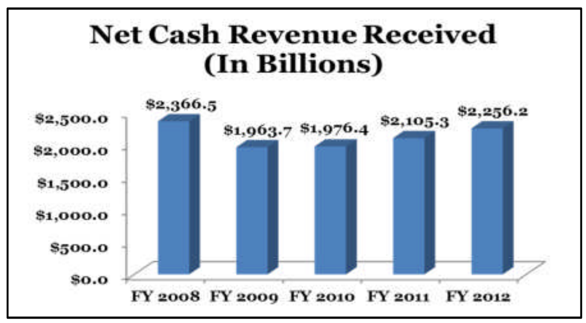


Figure 8

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

The chart below presents changes in key financial statement line items as of and for the fiscal year ended September 30, 2012 compared to September 30, 2011.

Summary Financial Information *(dollars in billions)*

		2012		2011		$ Change	% Change
Total Treasury Assets	$	**17,921.9**	$	16,590.2	$	1,331.7	8.0%
Total Treasury Liabilities	$	**17,532.5**	$	16,510.1	$	1,022.4	6.2%
Net Position	$	**389.4**	$	80.1	$	309.3	386.1%
Net Cost of (Revenue From) Treasury Operations	$	**(275.2)**	$	4.2	$	(279.4)	6652.4%
Net Federal Debt Interest Costs	$	**399.3**	$	426.7	$	(27.4)	(6.4)%
Total Budgetary Resources	$	**816.1**	$	1,089.0	$	(272.9)	(25.1)%
Net Agency Outlays	$	**241.3**	$	313.4	$	(72.1)	(23.0)%
Net Revenue Received (Custodial)	$	**2,256.2**	$	2,105.3	$	150.9	7.2%

Financial Overview. The Department's financial performance as of and for the fiscal year ended September 30, 2012 reflects several major trends. Most significantly, the outstanding federal debt, including interest, rose by $1.3 trillion to finance the U.S. Government's budget deficits.

Additionally, the Department amended its Senior Preferred Stock Purchase Agreements (SPSPAs) with the two GSEs in 2012 which, among other things, changes the basis by which quarterly dividends are paid by the GSEs to the U.S. Government commencing with the quarter ending March 31, 2013. This amendment impacted the end-of-year valuation of the Department's senior preferred stock investment and contingent liability associated with the GSE program. At the end of 2012, the Department reduced its estimated future liability to the GSEs over the life of the SPSPA program by $307.2 billion, and reduced the fair value of its GSE senior preferred stock and other related investment holdings by $42.2 billion. This compares to the $22.9 billion reduction in the estimated liability and $3.1 billion increase in the fair value of the GSE investment holdings recorded at the end of 2011. The declines in both the asset and liability at the end of 2012 were primarily due to lower anticipated future quarterly dividend payments by the GSEs to the Department, as a result of the SPSPA amendment, which are expected to drive downward the amount of future draws needed by the GSEs.

The Department's 2012 financial performance also reflects the ongoing wind-down of both the GSE MBS and TARP credit programs, principally through sales of securities and principal repayments of loans made under these programs. In fiscal year 2012, the Department completed the sale of its entire MBS portfolio; these sales commenced in mid-2011. TARP's wind-down activity included, among other things, continued sales of its AIG common stock held. The wind-down of the GSE MBS and TARP programs drove significant fluctuations in the subsidy costs associated with these programs during both fiscal years 2012 and 2011 caused by program modifications and end-of-year reestimates. Subsidy costs recorded in connection with each credit program represent the difference between the projected costs of the program and the future cash flows anticipated to be received from the program. Reestimates may occur due to changes in a program's estimated future cash flows caused by changes in market conditions and actual program performance, thereby resulting in an upward or downward reestimate in the credit program receivable to reflect an increase or decrease, respectively, in the estimated total cost of the program.

Total Treasury Assets of $17.9 trillion at September 30, 2012 consist of a receivable due from the General Fund of the U.S. Government of $16.2 trillion, intra-governmental loans and interest receivable of $914.3 billion, and fund balance and various other assets which totaled $805.4 billion (Figure 9). The $1.3 trillion (or 8.0 percent) increase in total assets at the end of fiscal year 2012 over the prior year is primarily due to a $1.3 trillion rise in the federal debt and related interest payable, which caused a corresponding rise in the "Due from the General Fund of the U.S. Government" account. 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.

Intra-governmental loans and interest receivable represent loans issued primarily by the BPD to other federal agencies for their own use or for the agencies to loan to private sector borrowers whose loans are guaranteed by the federal agencies. This receivable grew by $185.7 billion (or 25.5 percent) to $914.3 billion at the end of fiscal year 2012 due to increased borrowings by various federal agencies – such as the Departments of Education, Agriculture, and Energy – to fund their existing programs.

Other assets include, among other things, TARP and non-TARP credit program receivables due from, and other investments in, certain financial institutions for which the Department provided financial assistance in an effort to stabilize financial markets. Other assets decreased by almost $153.5 billion primarily due to the ongoing wind-down of these programs through sales of securities or principal repayments of loans made under these programs, as well as from declines in the fair value of the GSE preferred stock investments held principally due to the SPSPA amendment.

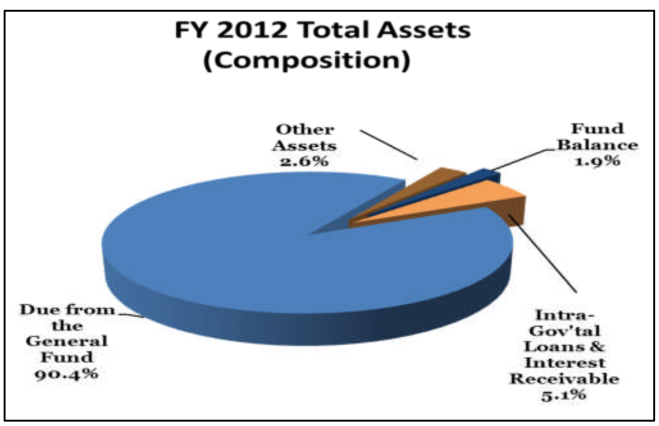


Figure 9

Total Treasury Liabilities of $17.5 trillion at September 30, 2012 principally consist of the federal debt held by the public, including interest, of $11.3 trillion which were mainly issued as Treasury Notes and Bills (Figure 10). Liabilities also include intra-governmental liabilities totaling $6.1 trillion (of which $4.9 trillion represent principal and interest of federal debt in the form of Treasury securities held by federal agencies), and various other liabilities totaling $98.4 billion. The $1.0 trillion (or 6.2 percent) increase in total liabilities at the end of fiscal year 2012 over the prior year is attributable to a $1.3 trillion increase in federal debt, including interest, held by the public and federal agencies that was needed to finance the U.S. Government's budget deficits. This was partially offset by a $307.2 billion decrease in the estimated future liability to the GSEs.

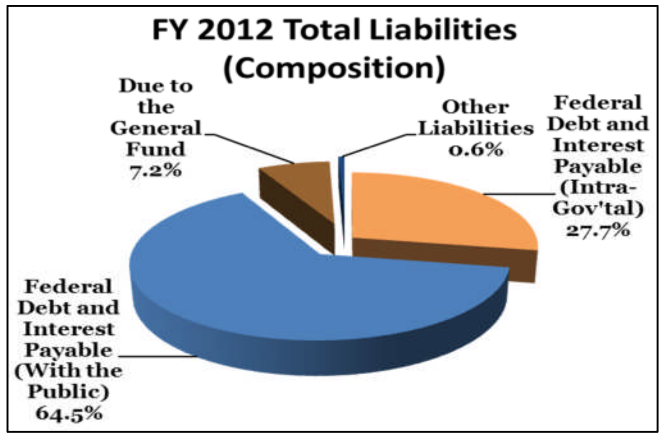


Figure 10

Net Position of $389.4 billion at September 30, 2012 represents the combined total of the Department's cumulative results of operations and unexpended appropriations at the end of the fiscal year. The $309.3 billion increase in the net position at the end of fiscal year 2012 was principally attributable to a$279.4 billion increase in net revenue from Treasury operations, combined with a $27.4 billion decrease in net federal debt interest costs, as discussed below.

Net Revenue From Treasury Operations, as presented on the Department's Consolidated Statements of Net Cost, represents the Department's gross and net costs by strategic program. There are three main categories of strategic programs: financial, economic, and security. The Department generated $275.2 billion in total net revenue from its operations for 2012 compared to a net cost of $4.2

billion in the prior year, primarily due to increased net revenue associated with the Department's economic programs, and lower net costs from its financial programs.

Economic programs generated net revenue of $288.8 billion in 2012 compared to $9.9 billion in fiscal year 2011 (Figure 11). The $278.9 billion increase in economic program net revenue in fiscal year 2012 is primarily due to a $307.2 billion reduction in the Department's estimated future liability to the GSEs in 2012, via a reduction in expense, as a result of the SPSPA amendment, as compared to a $22.9 billion reduction in this liability in 2011. Fiscal year 2012 net revenue was also favorably impacted by changes in subsidy costs associated with the ongoing wind-down of both the GSE MBS and TARP programs, offset by increased foreign currency exchange losses incurred by ESF due to the strengthening of the U.S. dollar in the world market.

The net cost of financial programs was $11.8 billion, down $1.8 billion from fiscal year 2011. Fiscal year 2012 reflects increased interest earnings on higher levels of intra-governmental loans issued to other federal agencies, as discussed under the section "Total Treasury Assets" above.

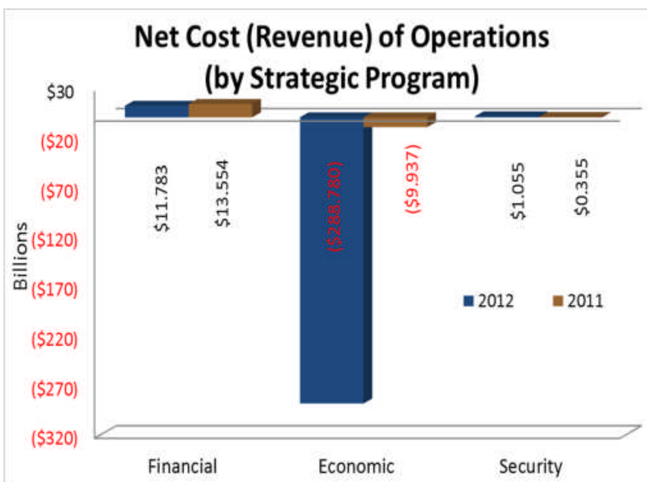


Figure 11

Net Federal Debt Interest Costs primarily reflect interest expense on the federal debt. Federal interest costs declined by $27.4 billion (or 6.4 percent) in fiscal year 2012 despite the rise in the federal debt, due to a decline in the average interest rate on the Treasury debt securities.

Total Budgetary Resources of $816.1 billion were lower in fiscal year 2012 by $272.9 billion (or 25.1 percent) primarily due to decreases in both borrowing authority and appropriations. Borrowing authority resources decreased $146.0 billion principally related to the IMF and TARP programs. IMF established two new credit reform programs in fiscal year 2011 for which it received $107.5 billion in borrowing authority in that year when compared to fiscal year 2012. Additionally, TARP's borrowing authority requirement fell by $32.9 billion for fiscal year 2012 due to a reduction in downward reestimates of credit reform subsidies associated with certain of its programs. Total budgetary resources also reflect reduced appropriations of $66.7 billion primarily due to less funding needed in fiscal year 2012 to service the federal debt.

Net Agency Outlays of $241.3 billion were lower in fiscal year 2012 by $72.0 billion (or 23.0 percent) primarily due to fewer program disbursements associated with the TARP, GSE MBS, and SBLF programs due to the wind-down of certain of these programs.

Net Revenue Received (Custodial), representing net revenue collected by Treasury on behalf of the U.S. Government, includes various taxes, primarily income taxes, as well as user fees, fines and penalties, and other revenue. Over 90 percent of these revenues are related to income and social security taxes. Net revenue received was $2.3 trillion for fiscal year 2012, an increase of $150.9 billion (or 7.2 percent) over the prior fiscal year. This increase is attributed mainly to an overall improvement in individual and corporate income tax collections, coupled with a reduction in tax refunds.

MANAGEMENT ASSURANCES

The Secretary's Assurance Statement

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

Treasury provides assurance that the objectives of Section 2 of the FMFIA (Financial Reporting and Operations) have been achieved, except for the material weaknesses noted below. Treasury is in substantial conformance with Section 4 (Financial Management Systems) of the FMFIA. Also, in accordance with Office of Management and Budget Circular No. A-123, *Management's Responsibility for Internal Control, Appendix A, Internal Control over Financial Reporting*, Treasury provides qualified assurance that internal control over financial reporting was operating effectively based on the results of the assessment as of June 30, 2012. Treasury's financial management systems are not in substantial compliance with the *Federal Financial Management Improvement Act* (FFMIA) due to the Internal Revenue Service's (IRS's) material weaknesses related to unpaid tax assessments and information security.

As of September 30, 2012, Treasury had three FMFIA material weaknesses as follows (with origination/planned resolution timeframes indicated):

Operations:

- IRS – Computer Security (Fiscal Year 2001/2014)
- Financial Management Service – Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements (Fiscal Year 2001/2014)

Financial Reporting:

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

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

Timothy F. Geithner
Secretary of the Treasury
November 15, 2012

FMFIA

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

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

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

In fiscal year 2012, Treasury continued to make progress on closing its three material weaknesses, as listed in the Secretary's assurance statement. Treasury includes resolution of material weaknesses as a performance requirement for every executive, manager, and supervisor. Additional information on Treasury's material weaknesses and progress can be found in Section F of Part 3, Other Accompanying Information.

FFMIA and Financial Management Systems

FFMIA

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

During fiscal year 2012, Treasury bureaus and offices used a risk-based approach to assess their financial management systems' compliance with FFMIA, as required by OMB. The bureaus and offices conducted self-assessments to determine their risk levels. With the exception of the IRS, all Treasury bureau and office financial management systems are in compliance with FFMIA. As required, the IRS has a remediation plan in place to correct the identified deficiencies. The IRS management updates this plan quarterly and Treasury management reviews it. In addition, TIGTA audits the plan annually.

The IRS made significant progress in fiscal year 2012 toward attaining FFMIA compliance by implementing the splitting of individual unpaid assessment (UA) accounts to improve the financial classification. The IRS sub-ledger for UA (i.e., Custodial Detail Data Base (CDDB)) is now capable of providing more granularity into Trust Fund Recovery Penalty (TFRP) multi-officer/multi-corporation accounts.

To address the Unpaid Tax Assessments material weakness, the IRS implemented programming changes in the CDDB in June 2012, to improve the financial classification in situations when there are: 1) unpaid tax assessments requiring amounts to be reported in more than one financial classification when the taxpayer agrees to a portion of the tax (taxes receivable) but does not agree to the remaining portion (compliance assessment), 2) unpaid tax assessments where a portion of the assessment has expired by statute, 3) TFRP assessments involving multiple companies and officers, and 4) payroll tax assessments where no officers will be assessed a TFRP. In addition, the IRS is making changes to the Automated Trust Fund Recovery system to increase the number of TFRP cases that can be completely worked without user intervention and eliminate errors inherent to these complex cases.

GAO reported a downgrade of the Computer Security material weakness to a significant deficiency during the fiscal year 2012 financial statement audit, based on the results of its audit of the IRS financial statements, which are presented in conformity with U.S. generally accepted accounting principles. The IRS will continue to track Information Security internally based on the results of its testing, and recognizing the larger scope of the IRS's work as a result of FMFIA requirements and management's responsibility for the integrity of IRS internal controls. As such, IRS will continue conducting internal control testing to determine the ongoing status of its internal control over information security.

To address the Computer Security material weakness, the Computer Security Material Weakness Program Office developed continuous monitoring activities to identify risks and confirm compliance with policies and procedures over internal controls, and an executive governance process to provide sustained improvements during fiscal year 2012 toward downgrading this material weakness. The IRS also commissioned a cross-functional working group to test and validate corrective actions to ensure they fully address the weakness to prevent premature closure. The group also provided evidence and assurance of continuous monitoring and controls for IT systems owned or operated by external entities for risks to IRS financial systems or access to taxpayer or other sensitive information the IRS maintains.

Financial Management Systems Framework

The Department of the Treasury's financial management systems framework consists of core financial and mixed systems maintained by the Treasury bureaus, and the Department-wide Financial Analysis and Reporting System (FARS). The bureau systems process and record detailed financial transactions and submit summary-level data to FARS, which maintains the key financial data necessary for Treasury-wide consolidated financial reporting. This framework satisfies both the bureaus' diverse financial operational and reporting needs, as well as the Department's internal and external reporting requirements. It enables Treasury to receive an unqualified audit.

FARS consists of the following components:

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

Bureaus submit summary-level financial data to TIER monthly, within three business days of the month-end. CFOV uses these data to produce financial statements and reports on both a Department-wide and bureau-level basis, including Treasury's audited annual financial statements and monthly management reports.

Fourteen Treasury bureaus and offices use centralized financial operations and budget execution services and systems support provided by the BPD's ARC. This cross-servicing enables these bureaus to have access to core financial systems without having to maintain the necessary technical and systems architectures. BPD/ARC also provides administrative services in the areas of accounting, travel, payroll, human resources, and procurement to Treasury bureaus and offices and to other federal entities to support core business activities. Using these services reduces the need for Treasury to maintain duplicative financial management systems; enhances the quality, timeliness, and accuracy of financial management processes; and provides a more efficient and cost-effective business model.

Goals and The Supporting Financial System Strategies

Treasury's financial system goals and supporting strategies focus on improving and streamlining the current FARS foundation so it will support new financial requirements and continue to provide management with accurate and timely financial information.

Throughout fiscal year 2012, Treasury updated TIER and CFOV to meet new and evolving reporting requirements. These include updates to TIER to comply with the data standard reflected in FMS's planned Government-wide Treasury Account Symbol Adjusted Trial Balance System (GTAS). In addition, Treasury enhanced TIER to improve the efficiency of financial reporting activities as well as internal control over financial management. Treasury also enhanced FARS in 2012, to take advantage of emerging technology and streamline processes by automating the process for tracking, managing, and establishing FARS user accounts and access. The TIER Focus Group continued to meet to improve communication with the bureaus and coordinate changes impacting financial management systems and financial operations.

Treasury continued and nearly completed its adoption of FMS's IPP in fiscal year 2012. IPP automates many manual activities related to receiving, verifying, approving, and paying invoices. Bureaus will benefit from efficiency improvements as more of their vendors participate in IPP and as they process more invoices through IPP.

In fiscal year 2013, Treasury plans to continue to upgrade its FARS applications to support new financial reporting requirements and improve the technology infrastructure. GTAS-related updates will continue throughout fiscal year 2013, with plans to make FARS fully GTAS-compliant by the first quarter of fiscal year 2013.

After over 50 years of weekly posting of returns, payments, and other types of transactions, on January 17, 2012, IRS delivered the first component of its CADE 2 program by moving the IRS to a daily cycle for tax processing and posting of individual taxpayer accounts and for feeding downstream systems. This means application programs that formerly took hours or days to complete now run in minutes or seconds. The new CADE 2 daily processing capability enhances IRS's tax administration and improves service by enabling faster refunds for more taxpayers. Processing over 20 percent more refunds daily in 2012 than during 2011, CADE 2 continues to run without issue. It allows more timely account updates (taxpayer account updates to IRS customer service representatives within 48 hours versus an average of nine days in Filing Season 2011), and faster issuance of taxpayer notices (2.7 million notices sent to taxpayers with accounts processed daily versus 284,000 in Filing Season 2011).

The second key component of the CADE 2 program is the implementation of a modernized relational database. The relational database is a central source of trusted taxpayer data for the IRS's 140 million individual taxpayers and over a billion tax modules. CADE 2 is scheduled to begin live data feeds directly from the fully loaded database to key downstream systems (Corporate Files On-Line, Individual Master File On-Line) in early November 2012. This new functionality supports the IRS customer service representatives with on-line viewing of taxpayer account data stored in the new CADE 2 modernized database.

In fiscal year 2012, BPD/ARC upgraded one instance of its core financial management system to meet compliance expectations, adopt the Common Government-wide Accounting Classification structure, and offer additional functionality. BPD/ARC also completed its implementation of IPP.

In fiscal years 2013 and 2014, the Department and BPD/ARC plan to complete the upgrade to the second instance of the core financial management system to meet compliance expectations, adopt the Common Government-wide Accounting Classification structure, and offer additional functionality. In addition, BPD/ARC will continue to expand its use of IPP.

BEP successfully completed the final phase in the replacement of its legacy mainframe-based manufacturing system. In 2012, BEP fully implemented a cloud-based, fully integrated enterprise resource planning system which included the conversion of supply chain management, manufacturing management, project accounting, and contract lifecycle management modules to the new system. BEP plans no major upgrades for fiscal year 2013.

The OCC expanded its management and accountability reporting application in fiscal year 2012, automating the calculation and recording of its semi-annual bank assessment. The OCC plans to continue to integrate its applications with its customers and to implement a system-based governance, risk, and compliance tool.

PART 2:

Annual Financial Report

PART II - TABLE OF CONTENTS

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

Nani A. Coloretti
Acting Assistant Secretary for Management

Dorrice C. Roth
Deputy Chief Financial Officer

In fiscal year 2012, the Department of the Treasury advanced its commitment to accomplish the following strategic goals:

- Repair and reform the financial system and support the recovery of the housing market
- Enhance U.S. competitiveness and promote international financial stability and balanced global growth
- Protect our national security through targeted financial actions
- Pursue comprehensive tax and fiscal reform
- Manage the U.S. Government's finances in a fiscally responsible manner

These focus areas, and the continued promise to relentlessly pursue them, have improved the fiscal stewardship of the American taxpayers' resources, promoted the security and safety of our people at home and abroad, restored confidence in our nation's financial systems and stimulated economic and job growth. Through these efforts, Treasury will continue to deliver better management of our nation's finances and better results to the American taxpayer.

With an aggressive set of management programs and initiatives designed to manage the U.S. Government's finances responsibly, Treasury has led and supported government-wide financial management efforts to increase productivity, reduce waste and non-essential expenses, and modernize processes and systems. Our comprehensive approach focused on governing strategically, working smarter, and leveraging technology to address and support improvements across the breadth and scope of the Department's mission and functions. This agenda has led to enhanced decision-making and ability to innovate and deliver a higher quality and volume of results.

With the economy continuing to recover, Treasury is winding down the Troubled Asset Relief Program (TARP). Treasury now estimates the lifetime cost of the program will be $60 billion -- less than one-tenth of the $700 billion originally authorized by Congress. TARP helped stabilize the economy during the financial crisis by helping restore the flow of credit, save jobs, aid homeowners, and rescue the American auto industry. As of September 30, 2012, American taxpayers have already recovered more than 88 percent of the TARP funds disbursed.

In efforts to make doing business with the U.S. Government as easy as possible, the Department is leading the U.S. Government in implementing the use of electronic transactions with the public. In fiscal year 2012, 88 percent of Treasury payments and associated information was made electronically. Through Treasury's longstanding push towards electronic payments, Treasury saved $600 million in costs in one year alone. As the number of Social Security recipients increases, the savings from electronic payments will also increase while providing beneficiaries a safer, more reliable, and convenient way to receive their payments.

In fiscal year 2012, Treasury demonstrated leadership in fiscal prudence and financial reform by:

- Advancing engagement of small businesses by exceeding all small business contracting goals to jump-start job creation and stimulate local economies
- Implementing a shared services approach to management by establishing the Shared Services Council which provides a portfolio-wide approach to shared services across the Department to optimize services and drive accountability
- Further reducing administrative expenses as directed by the President's Executive Order to cut waste, in which we exceeded the 20 percent reduction goal a year early and garnered more than $241 million in savings
- Delivering real property savings by better utilization of existing real property through space realignment efforts, space reductions from increased employee telework arrangements, and the elimination of expiring leases, resulting in an estimated $24 million in cumulative cost savings from fiscal years 2010 through 2012
- Reducing time and materials/labor hour contracts by over ten percent from fiscal year 2011
- Driving additional contracting savings estimated at over $240 million in savings in fiscal year 2012, including $80 million achieved through better leveraging of buying power

The Department again received an unqualified audit opinion on both the Treasury-wide and Office of Financial Stability/TARP fiscal year 2012 financial statements. Treasury made steady progress toward resolving the three Federal Managers' Financial Integrity Act material weaknesses remaining open as of September 30, 2012 (IRS – Computer Security, IRS – Unpaid Tax Assessments , and FMS – Preparation of the Government-wide Financial Statements). The complexity of Treasury's financial systems contributes greatly to these material weaknesses; however, we have made great strides toward resolving the issues.

Nani A Coloretti

Nani A. Coloretti
Acting Assistant Secretary for Management
November 15, 2012

Dorrice C. Roth

Dorrice C. Roth
Deputy Chief Financial Officer
November 15, 2012

INSPECTOR GENERAL'S TRANSMITTAL LETTER

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

November 15, 2012

OFFICE OF
INSPECTOR GENERAL

INFORMATION MEMORANDUM FOR SECRETARY GEITHNER

FROM: Eric M. Thorson
Inspector General

SUBJECT: Audit of the Department of the Treasury's Financial Statements for Fiscal Years 2012 and 2011

INTRODUCTION

I am pleased to transmit KPMG LLP's report on the Department of the Treasury's (the Department) financial statements as of and for the fiscal years (FY) ending September 30, 2012 and 2011.

The Chief Financial Officer's Act, as amended, requires the Department of the Treasury Office of Inspector General or an independent auditor, as determined by the Inspector General, to audit the Department's financial statements. Under a contract monitored by my office, KPMG LLP, an independent certified public accounting firm, performed an audit of the Department's FY 2012 and 2011 financial statements. The contract required that the audit be performed in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States; Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended; and the *GAO/PCIE Financial Audit Manual*.

RESULTS OF INDEPENDENT AUDIT

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

- the financial statements were fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles;

- a material weakness related to unpaid tax assessments and a significant deficiency related to financial reporting systems identified by the auditor of the Internal Revenue Service collectively represent a material weakness for the Department as a whole;

- weaknesses related to information systems controls at the Bureau of the Fiscal Service represent a significant deficiency for the Department as a whole;

- the Department's financial management systems did not substantially comply with the requirements of the Federal Financial Management Improvement Act of 1996 (FFMIA) related to Federal financial management systems requirements and applicable Federal accounting standards; and
- no instances of reportable noncompliance with laws and regulations , exclusive of FFMIA, that are required to be reported under government auditing standards and Office of Management and Budget Bulletin No. 07-04;
- an instance of a potential Anti-deficiency Act violation related to voluntary services provided to the Departmental Offices, also reported in the prior year report.

EVALUATION OF AUDITORS' PERFORMANCE

To ensure the quality of the audit work performed, we reviewed KPMG LLP's approach and planning of the audit, evaluated the qualifications and independence of the auditors, monitored the progress of the audit at key points, reviewed and accepted KPMG LLP's audit report, and performed other procedures that we deemed necessary. Additionally, we provide oversight of the audits of financial statements and certain accounts and activities conducted at 12 component entities of the Department. Our review, as differentiated from an audit performed in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the financial statements or conclusions about the effectiveness of internal control or on whether the Department's financial management systems substantially complied with the Federal Financial Management Improvement Act or conclusions on compliance with laws and regulations. KPMG LLP is responsible for the attached auditors' report dated November 15, 2012, and the conclusions expressed in that report. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with generally accepted government auditing standards.

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

Attachment

cc: Nani A. Coloretti
Acting Assistant Secretary for Management

Dorrice C. Roth
Deputy Chief Financial Officer

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

Independent Auditors' Report

Inspector General
U.S. Department of the Treasury:

We have audited the accompanying consolidated balance sheets of the U.S. Department of the Treasury (Department) as of September 30, 2012 and 2011, and the related consolidated statements of net cost and changes in net position, combined statements of budgetary resources, and statements of custodial activity (hereinafter referred to as "consolidated financial statements" or "basic consolidated financial statements") for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these consolidated financial statements.

We did not audit the amounts included in the consolidated financial statements related to the Internal Revenue Service (IRS) and the Office of Financial Stability (OFS), component entities of the Department. The financial statements of IRS and OFS were audited by another auditor whose reports have been provided to us. Our opinion, insofar as it relates to the amounts included for IRS and OFS, is based solely on the reports of the other auditor.

In connection with our fiscal year 2012 audit, we also considered the Department's internal control over financial reporting and tested the Department's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these consolidated financial statements. This report includes our consideration of the results of the other auditor's testing of internal control over financial reporting and compliance and other matters for IRS and OFS that are reported on separately by the other auditor. However, this report, insofar as it relates to the results of the other auditor, is based solely on the reports of the other auditor.

Summary
As stated in our opinion on the consolidated financial statements, based on our audits and the reports of the other auditor, we concluded that the Department's consolidated financial statements as of and for the years ended September 30, 2012 and 2011, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles.

As discussed in our Opinion on the Financial Statements:

- The Department is a participant in significant legislation and transactions whose purpose is to assist in stabilizing the financial markets. The consolidated financial statements do not include the assets, liabilities, or results of operations of commercial entities in which the Department has a significant equity interest. The value of certain investments, loans, commitments, and asset guarantees is based on estimates that are inherently subject to substantial uncertainty. As such, there will be differences between the net estimated value of these investments, loans, commitments, and asset guarantees at September 30, 2012, and the amounts that will ultimately be realized from these assets or be required to pay to settle these commitments and guarantees.

- The Department changed the accounting for certain debt related budgetary transactions in fiscal year 2012.

- The Department changed its presentation for reporting the Combined Statement of Budgetary Resources in fiscal year 2012.

Our, and the other auditor's, consideration of internal control over financial reporting resulted in identifying certain deficiencies that we consider to be a material weakness and other deficiencies that we consider to be a significant deficiency, as defined in the Internal Control Over Financial Reporting section of this report, as follows:

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

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

The results of our tests, and the tests performed by the other auditor, of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instance of noncompliance and other matter that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended.

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

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

The following sections discuss our opinion on the Department's consolidated financial statements; our, and the other auditor's, consideration of the Department's internal control over financial reporting; our, and the other auditor's tests of the Department's compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements; and management's and our responsibilities.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of the U.S. Department of the Treasury as of September 30, 2012 and 2011, and the related consolidated statements of net cost and changes in net position, the combined statements of budgetary resources, and statements of custodial activity for the years then ended.

We did not audit the amounts included in the consolidated financial statements related to IRS, a component entity of the Department, which consist of total assets of $46.8 billion and $43.3 billion, net cost of operations of $12.8 billion and $13.0 billion before applicable eliminating entries, budgetary resources of $13.2 billion and $13.5 billion, and custodial revenues of $2,528 billion and $2,415 billion, as of and for the years ended September 30, 2012 and September 30, 2011, respectively. The IRS financial statements were audited by another auditor whose report dated November 5, 2012 has been furnished to us, and our opinion, insofar as it relates to the amounts included for IRS, is based solely on the report of the other auditor.

We did not audit the amounts included in the consolidated financial statements related to OFS, a component entity of the Department, which consist of total assets of $116.7 billion and $164.2 billion, net cost of (income from) operations of ($7.7) billion and $9.5 billion before applicable eliminating entries, and budgetary resources of $67.8 billion and $103.0 billion, as of and for the years ended September 30, 2012 and September 30, 2011, respectively. The OFS financial statements were audited by another auditor whose report dated November 5, 2012 has been furnished to us, and our opinion, insofar as it relates to the amounts included for OFS, is based solely on the report of the other auditor.

In our opinion, based on our audits, and the reports of the other auditor, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the U.S. Department of the Treasury as of September 30, 2012 and 2011, and its net costs, changes in net position, budgetary resources, and custodial activity for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Notes 7, 8, 11 and 26, the Department is a participant in significant legislation and transactions whose purpose is to assist in stabilizing the financial markets. Also as discussed in note 1A, the consolidated financial statements do not include the assets, liabilities, or results of operations of commercial entities in which the Department has a significant equity interest as it has determined that none of these entities meet the criteria for inclusion as a federal entity and are therefore not included in the consolidated financial statements. Furthermore, as discussed in notes 1V, 7, 8, and 11, the value of certain investments, loans, commitments, and asset guarantees is based on estimates. These estimates are inherently subject to substantial uncertainty arising from the likelihood of future changes in general economic, regulatory, and market conditions. In addition, there are significant uncertainties related to the amounts that the Department will realize from its investments. As such, there will be differences between the net estimated value of these investments, loans, commitments, and asset guarantees at September 30, 2012, and the amounts that will ultimately be realized from these assets or be required to pay to settle these commitments and guarantees. Such differences may be material and will also affect the ultimate cost of these programs.

As discussed in Note 22 to the consolidated financial statements, the Department changed the accounting for certain debt related budgetary transactions based on guidance from OMB.

As discussed in Note 1B to the consolidated financial statements, the Department changed its presentation for reporting the Combined Statement of Budgetary Resources in fiscal year 2012, based on new reporting requirements under OMB Circular No. A-136, *Financial Reporting Requirements*. As a result, the Department's Combined Statement of Budgetary Resources for fiscal year 2011 has been reclassified to conform to the current year presentation.

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

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

Internal Control Over Financial Reporting

Our consideration of internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

In our fiscal year 2012 audit, the other auditor identified deficiencies in internal control over financial reporting that we consider to be a material weakness and we identified other deficiencies that we consider to be a significant deficiency that are described below.

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

IRS needs to establish internal controls for financial reporting and systems in accordance with OMB Circular A-123, *Management's Responsibility for Internal Control* to ensure reliable and timely financial information is obtained, maintained, and reported. IRS continued to make progress in addressing its deficiencies in internal control over financial reporting. However, a material weakness in internal control over unpaid tax assessments and significant deficiency in internal control over financial reporting systems continued to exist in fiscal year 2012 and are collectively considered a material weakness at the Department level. The other auditor performed an audit of IRS's internal control over financial reporting for the purpose of providing an opinion on the effectiveness of internal controls. Because of the material weakness, the other auditor's opinion on IRS's internal control over financial reporting stated that IRS did not maintain effective internal control over financial reporting as of September 30, 2012, and thus did not provide reasonable assurance that losses and misstatements that were material in relation to the IRS's financial statements would be prevented or detected and corrected on a timely basis. The deficiencies are summarized as follows:

- Internal control deficiencies continued to exist that caused errors in unpaid tax assessment amounts. Specifically, the IRS was unable to 1) rely on its general ledger system for tax transactions and underlying subsidiary records to report federal taxes receivable, compliance assessments, and write-offs in accordance with federal accounting standards without significant compensating procedures, 2) trace reported balances for taxes receivable from its general ledger to underlying source documents, and 3) effectively prevent or timely detect and correct errors in taxpayer accounts.

- Internal control deficiencies over financial reporting systems continued to exist, including 1) access control weaknesses and database software issues related to its procurement system, and 2) inadequate database security for various systems. In addition, IRS had not performed sufficient monitoring of internal control over its financial reporting system. Furthermore,

> IRS did not always set sufficiently restrictive security-related parameters and users' rights and privileges for certain operating environments, including a key financial application; allowed inappropriate and unlogged access to system files; and did not effectively manage certain privileged accounts on servers. Finally, IRS did not effectively implement all aspects of its information security program framework, and did not update the security standards policy for IRS's main tax processing environment, to include current software versions and control capabilities.

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

Recommendation

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

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

The Bureau of the Fiscal Service (BFS) was established on October 7, 2012, by consolidating the Financial Management Service and the Bureau of the Public Debt. BFS relies on an extensive array of information technology (IT) systems to perform its primary mission. Effective information system controls and security programs over its financial systems is essential to protecting information resources in accordance with OMB Circular No. A-130, *Management of Federal Information Resources*. BFS made progress in several areas in its efforts to address prior year deficiencies in its information systems controls. Despite these improvements, our tests revealed that the necessary policies and procedures to detect and correct control and functionality weaknesses have not been consistently documented, implemented, or enforced. Specifically, deficiencies continue to exist in the areas of 1) security management program, 2) access to computer resources (i.e., data, equipment, and facilities), 3) changes to information system resources and system configurations, 4) segregation of duties, and 5) contingency plans. These deficiencies could compromise BFS's ability to ensure security over sensitive financial data and reliability of the financial systems.

Recommendation

We separately provided BFS management with recommendations to address the above significant deficiency. We recommend that the ASM and DCFO ensure that BFS takes corrective action to improve controls over its information system controls.

Exhibit I presents the status of the prior year findings. We noted certain additional matters that we will report to management of the Department in a separate letter.

Compliance and Other Matter

The results of our tests of FFMIA, and the tests performed by the other auditor, disclosed instances, described below, where the Department's financial management systems did not substantially comply with the (1) federal financial management systems requirements, and (2) applicable Federal accounting standards. The results of our tests of FFMIA, and the tests performed by the other auditor, disclosed no instances in which the Department's financial management systems did not substantially comply with the United States Government Standard General Ledger at the transaction level.

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

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

1. Federal Financial Management Systems Requirements

As discussed in finding A. Material Weakness in Internal Control Over Financial Reporting at the IRS (Repeat Condition), the Department continues to have deficiencies in the IRS's automated systems for tax-related transactions.

2. Federal Accounting Standards

As discussed in finding A. Material Weakness in Internal Control Over Financial Reporting at the IRS (Repeat Condition), the Department has a material weakness related to the IRS that affected the Department's ability to prepare its financial statements in accordance with federal accounting standards. Specifically, IRS automated systems for tax-related transactions did not support the net federal taxes receivable amount on the consolidated balance sheet and required supplementary information disclosures for uncollected taxes – compliance assessments and write-offs – as required by Statement of Federal Financial Accounting Standards No. 7, *Accounting for Revenue and Other Financing Sources and Concepts for Reconciling Budgetary and Financial Accounting*.

Recommendation

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

The results of certain of our tests, and the tests performed by the other auditor, of compliance as described in the Responsibilities section of this report, exclusive of those referred to in the *Federal Financial Management Improvement Act of 1996* (FFMIA), disclosed the following other matter that is required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

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

As stated in our prior year auditors' report, the Department informed us of an instance of a potential violation of the *Anti-Deficiency Act* related to voluntary services provided to the Departmental Offices in the prior year. The Department is reviewing this matter to determine whether or not the matter is a violation of the *Anti-Deficiency Act*.

The results of our other tests, and the tests performed by the other auditor, of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin No. 07-04.

Department's Response to Internal Control and Compliance Findings

The Department indicated in a separate letter immediately following this report that it concurs with the findings presented in our report. Further, the Department responded that it will take corrective action, as necessary, to ensure the respective component management within the Department address the matters presented. We did not audit the Department's response and, accordingly, we express no opinion on it.

* * * * * * *

Responsibilities

Management's Responsibilities. Management is responsible for the consolidated financial statements; establishing and maintaining effective internal control over financial reporting; and complying with laws, regulations, contracts, and grant agreements applicable to the Department.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2012 and 2011 consolidated financial statements of the Department based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Bulletin No. 07-04, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

- Examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements;
- Assessing the accounting principles used and significant estimates made by management; and
- Evaluating the overall consolidated financial statement presentation.

We believe that our audits, and the reports of the other auditor related to the amounts included for IRS and OFS, provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2012 audit, we considered the Department's internal control over financial reporting, by obtaining an understanding of the design effectiveness of the Department's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting. We did not test all controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*.

As part of obtaining reasonable assurance about whether the Department's fiscal year 2012 consolidated financial statements are free of material misstatement, we performed tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the consolidated financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the Department. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended solely for the information and use of the Department's management, the Department's Office of Inspector General, OMB, the U.S. Government Accountability Office, and the U.S. Congress and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 15, 2012

Exhibit I

U.S. Department of the Treasury

Status of Prior Year Findings

September 30, 2012

Fiscal Year 2011 Findings	**Status of Fiscal Year 2011 Findings**
Material Weakness: Financial Systems and Reporting at the IRS	This condition has not been corrected and is repeated in fiscal year 2012. See finding A.
Significant Deficiency: Financial Reporting Practices at the Departmental Level	This condition has been corrected.
Significant Deficiency: Financial Accounting and Reporting at the Office of Financial Stability	This condition has been corrected.
Significant Deficiency: Information Systems Controls at the Financial Management Service	This condition has not been corrected and is repeated in fiscal year 2012. See finding B.
Noncompliance with *Internal Revenue Code Section 6325*	This condition has been corrected.
Substantial noncompliance with *Federal Financial Management Improvement Act of 1996*	This condition has not been corrected and is repeated in fiscal year 2012. See finding C.
Other Matter of Potential Violation of the Anti-Deficiency Act	This condition has not been resolved and is repeated in fiscal year 2012. See finding D.

MANAGEMENT'S RESPONSE TO INDEPENDENT AUDITORS' REPORT

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

ASSISTANT SECRETARY

November 15, 2012

KPMG LLP
1801 K Street, NW
Washington, DC 20006

Ladies and Gentlemen:

On behalf of Secretary Geithner, we are responding to your draft audit report on the Department of the Treasury's fiscal year 2012 consolidated financial statements. Our bureaus and program offices are proud of the Department's success in achieving an unqualified audit opinion on the Department's financial statements for the thirteenth consecutive year. We are also proud of the fourth unqualified audit opinion from the Government Accountability Office (GAO) on the Office of Financial Stability's (OFS) financial statements.

The high level of professionalism, technical expertise, and partnership demonstrated by KPMG in conducting this year's audit contributed greatly to Treasury's successful fiscal year 2012 results. We also appreciate the expertise and commitment demonstrated by the other organizations involved in the audit process – the Office of the Inspector General, GAO, and the firm that audited several of our bureaus.

We made substantial progress this past year in enhancing our internal controls and eliminating two significant deficiencies – a significant deficiency in financial reporting practices at the Departmental level and a significant deficiency in accounting and financial reporting processes at OFS. Additionally, as reported by GAO, the Internal Revenue Service continued to make important progress this past year in addressing its internal control deficiencies. GAO downgraded the material weakness in computer security at the Internal Revenue Service (IRS) to a significant deficiency, and IRS corrected an Internal Revenue Code compliance issue. We are very proud of these accomplishments.

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

Nani A. Coloretti

Dorrice C. Roth

Nani A. Coloretti
Acting Assistant Secretary for Management

Dorrice C. Roth
Deputy Chief Financial Office

Consolidated Balance Sheets
As of September 30, 2012 and 2011
(In Millions)

	2012	2011
ASSETS		
Intra-governmental Assets		
Fund Balance (Note 2)	**$ 344,346**	$ 381,784
Loans and Interest Receivable (Note 3)	**914,304**	728,650
Advances to the Unemployment Trust Fund (Note 4)	**32,932**	42,773
Due From the General Fund (Note 4)	**16,202,179**	14,902,717
Other Intra-governmental Assets	**1,495**	1,148
Total Intra-governmental Assets	**17,495,256**	16,057,072
Cash, Foreign Currency, and Other Monetary Assets (Note 5)	**145,551**	117,121
Gold and Silver Reserves (Note 6)	**11,062**	11,062
Troubled Asset Relief Program (TARP) - Credit Program Receivables, Net (Note 7)	**40,231**	80,104
Investments in Government Sponsored Enterprises (Notes 4 and 8)	**109,342**	133,043
Investments in International Financial Institutions (Note 9)	**6,043**	5,707
Non-TARP Investments in American International Group, Inc. (Note 26)	**2,611**	10,862
Other Investments and Related Interest (Note 10)	**15,436**	15,798
Other Credit Program Receivables, Net (Note 11)	**19,888**	92,820
Loans and Interest Receivable (Note 12)	**10,334**	6,248
Reserve Position in the International Monetary Fund (Note 12)	**21,573**	20,682
Taxes, Interest and Other Receivables, Net (Note 13)	**41,463**	36,690
Property, Plant, and Equipment, Net (Note 14)	**2,435**	2,266
Other Assets	**637**	751
Total Assets (Note 15)	**$ 17,921,862**	$ 16,590,226

Heritage Assets (Note 14)

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

Consolidated Balance Sheets
As of September 30, 2012 and 2011
(In Millions)

	2012	2011
LIABILITIES		
Intra-governmental Liabilities		
Federal Debt and Interest Payable (Notes 4 and 16)	$ 4,861,005	$ 4,720,165
Other Debt and Interest Payable (Note 17)	7,194	8,539
Due to the General Fund (Note 4)	1,257,752	1,226,475
Other Intra-governmental Liabilities (Note 19)	541	453
Total Intra-governmental Liabilities	6,126,492	5,955,632
Federal Debt and Interest Payable (Notes 4 and 16)	11,307,583	10,148,963
Certificates Issued to the Federal Reserve (Note 5)	5,200	5,200
Allocation of Special Drawing Rights (Note 5)	54,463	55,150
Gold Certificates Issued to the Federal Reserve (Note 6)	11,037	11,037
Refunds Payable (Notes 4 and 23)	3,255	3,983
D.C. Pensions and Judicial Retirement Actuarial Liability (Note 18)	10,059	9,671
Liability to Government Sponsored Enterprises (Note 8)	9,003	316,230
Other Liabilities (Note 19)	5,374	4,222
Total Liabilities (Note 19)	17,532,466	16,510,088
Commitments and Contingencies (Note 28)		
NET POSITION		
Unexpended Appropriations:		
Earmarked Funds (Note 24)	200	200
Other Funds	317,309	342,778
Subtotal	317,509	342,978
Cumulative Results of Operations:		
Earmarked Funds (Note 24)	43,023	43,611
Other Funds	28,864	(306,451)
Subtotal	71,887	(262,840)
Total Net Position (Note 20)	389,396	80,138
Total Liabilities and Net Position	$ 17,921,862	$ 16,590,226

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

Consolidated Statements of Net Cost
For the Fiscal Years Ended September 30, 2012 and 2011
(In Millions)

Cost of Treasury Operations: (Note 21)	**2012**	2011
Financial Program		
Gross Cost	**$ 14,883**	$ 16,244
Less Earned Revenue	**(3,100)**	(2,690)
Net Program Cost	**11,783**	13,554
Economic Program		
Gross Cost (Note 8)	**(280,045)**	4,704
Less Earned Revenue	**(8,735)**	(14,641)
Net Program Revenue	**(288,780)**	(9,937)
Security Program		
Gross Cost	**1,059**	360
Less Earned Revenue	**(4)**	(5)
Net Program Cost	**1,055**	355
Total Program Gross Costs (Revenue)	**(264,103)**	21,308
Total Program Gross Earned Revenues	**(11,839)**	(17,336)
Total Net Program Cost (Revenue) before Changes in Actuarial Assumptions	**(275,942)**	3,972
Loss on Pension, ORB, or OPEB Assumption Changes	**695**	195
Total Net Cost of (Revenue From) Treasury Operations (Note 21)	**(275,247)**	4,167
Non-Entity Costs		
Federal Debt Interest	**432,265**	452,616
Restitution of Foregone Federal Debt Interest (Note 16)	**59**	875
Less Interest Revenue from Loans	**(33,073)**	(26,815)
Net Federal Debt Interest Costs	**399,251**	426,676
Other Federal Costs (Note 21)	**16,290**	13,743
GSEs Non-Entity Cost (Revenue) (Note 8)	**5,322**	(39,415)
Other, net	**(435)**	(1,016)
Total Net Non-Entity Costs	**420,428**	399,988
Total Net Cost of Treasury Operations and Non-Entity Costs	**$ 145,181**	$ 404,155

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

Consolidated Statement of Changes in Net Position
For the Fiscal Year Ended September 30, 2012
(In Millions)

	Combined Earmarked Funds	Combined All Other Funds	Elimi-nation	Consolidated Total
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balance	$ 43,611	$ (306,451)	$ -	$ (262,840)
Budgetary Financing Sources				
Appropriations Used (Note 22)	492	427,987	-	428,479
Non-Exchange Revenue	423	200	(3)	620
Donations and Forfeitures of Cash/Equivalent	186	-	-	186
Transfers In/Out Without Reimbursement	(129)	129	-	-
Other	15	133	-	148
Other Financing Sources (Non-Exchange)				
Donation/Forfeiture of Property	174	-	-	174
Accrued Interest and Discount on Debt (Note 22)	-	95,877	-	95,877
Transfers In/Out Without Reimbursement	(87)	40	-	(47)
Imputed Financing Sources (Note 21)	64	1,266	(518)	812
Transfers to the General Fund and Other (Note 20)	101	(46,442)	-	(46,341)
Total Financing Sources	1,239	479,190	(521)	479,908
Net Cost of Treasury Operations and Non-Entity Costs	(1,827)	(143,875)	521	(145,181)
Net Change	(588)	335,315	-	334,727
Cumulative Results of Operations	43,023	28,864	-	71,887
UNEXPENDED APPROPRIATIONS				
Beginning Balance	200	342,778	-	342,978
Budgetary Financing Sources				
Appropriations Received (Notes 20 and 22)	492	418,638	-	419,130
Appropriations Transferred In/Out	-	142	-	142
Other Adjustments	-	(16,262)	-	(16,262)
Appropriations Used (Note 22)	(492)	(427,987)	-	(428,479)
Total Budgetary Financing Sources	-	(25,469)	-	(25,469)
Total Unexpended Appropriations	200	317,309	-	317,509
Net Position	$ 43,223	$ 346,173	$ -	$ 389,396

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

Consolidated Statement of Changes in Net Position
For the Fiscal Year Ended September 30, 2011
(In Millions)

	Combined Earmarked Funds	Combined All Other Funds	Elimi- nation	Consolidated Total
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balance	$ 41,426	$ (340,887)	$ -	$ (299,461)
Budgetary Financing Sources				
Appropriations Used	536	547,593	-	548,129
Non-Exchange Revenue	230	154	(5)	379
Donations and Forfeitures of Cash/Equivalent	586	-	-	586
Transfers In/Out Without Reimbursement	(51)	51	-	-
Other	-	4,550	-	4,550
Other Financing Sources (Non-Exchange)				
Donation/Forfeiture of Property	163	-	-	163
Accrued Interest and Discount on Debt	-	14,042	-	14,042
Transfers In/Out Without Reimbursement	(97)	37	-	(60)
Imputed Financing Sources (Note 21)	75	1,265	(415)	925
Transfers to the General Fund and Other (Note 20)	249	(128,187)	-	(127,938)
Total Financing Sources	1,691	439,505	(420)	440,776
Net Cost of Treasury Operations and Non-Entity Costs	494	(405,069)	420	(404,155)
Net Change	2,185	34,436	-	36,621
Cumulative Results of Operations	43,611	(306,451)	-	(262,840)
UNEXPENDED APPROPRIATIONS				
Beginning Balances	200	400,357	-	400,557
Budgetary Financing Sources				
Appropriations Received (Note 20)	536	498,187	-	498,723
Appropriations Transferred In/Out	-	129	-	129
Other Adjustments	-	(8,302)	-	(8,302)
Appropriations Used	(536)	(547,593)	-	(548,129)
Total Budgetary Financing Sources	-	(57,579)	-	(57,579)
Total Unexpended Appropriations	200	342,778	-	342,978
Net Position	$ 43,811	$ 36,327	$ -	$ 80,138

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

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

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

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

Combined Statement of Budgetary Resources
For the Fiscal Year Ended September 30, 2011
(In Millions)

BUDGETARY RESOURCES	Budgetary	Non-Budgetary Financing	2011 Total
Unobligated balance brought forward, October 1	$ 348,424	$ 23,819	$ 372,243
Recoveries of prior year unpaid obligations	11,058	5,671	16,729
Other changes in unobligated balance	(329)	(22,697)	(23,026)
Unobligated balance from prior year budget authority, net	359,153	6,793	365,946
Appropriations (discretionary and mandatory) (Note 20)	508,591	(12,403)	496,188
Borrowing authority (discretionary and mandatory) (Note 22)	1	157,059	157,060
Spending authority from offsetting collections	11,048	58,759	69,807
Total Budgetary Resources	$ 878,793	$ 210,208	$ 1,089,001
STATUS OF BUDGETARY RESOURCES			
Obligations incurred (Note 22)	$ 538,409	$ 181,638	$ 720,047
Unobligated balance, end of year:			
Apportioned	246,296	510	246,806
Exempt from apportionment	23,980	-	23,980
Unapportioned	70,108	28,060	98,168
Total unobligated balance brought forward, end of year	340,384	28,570	368,954
Total Status of Budgetary Resources	$ 878,793	$ 210,208	$ 1,089,001
CHANGE IN OBLIGATED BALANCE			
Unpaid obligations, gross, brought forward, October 1	$ 182,707	$ 49,491	$ 232,198
Uncollected customer payments from federal sources, brought forward, October 1	(192)	(23,817)	(24,009)
Obligated balance, net, start of year	182,515	25,674	208,189
Obligations incurred (Note 22)	538,409	181,638	720,047
Outlays, gross	(561,707)	(101,655)	(663,362)
Change in uncollected customer payments from federal sources	(9)	22,847	22,838
Recoveries of prior year unpaid obligations	(11,058)	(5,671)	(16,729)
Obligated balance, end of year:			
Unpaid obligations gross, end of year	148,351	123,802	272,153
Uncollected customer payments from federal sources, end of year	(201)	(969)	(1,170)
Obligated balance, End of Year	$ 148,150	$ 122,833	$ 270,983
BUDGET AUTHORITY AND OUTLAYS, NET			
Budget authority, gross (discretionary and mandatory)	$ 519,640	$ 203,415	$ 723,055
Actual offsetting collections (discretionary and mandatory)	(11,048)	(219,002)	(230,050)
Change in uncollected customer payments from federal sources (discretionary and mandatory)	(9)	22,847	22,838
Budget Authority, net (Discretionary and Mandatory)	$ 508,583	$ 7,260	$ 515,843
Outlays, gross (discretionary and mandatory)	$ 561,707	$ 101,655	$ 663,362
Actual offsetting collections (discretionary and mandatory)	(11,048)	(219,002)	(230,050)
Outlays, net (discretionary and mandatory)	550,659	(117,347)	433,312
Distributed offsetting receipts	(119,958)	-	(119,958)
Agency Outlays, Net (Discretionary and Mandatory)	$ 430,701	$ (117,347)	$ 313,354

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

Statements of Custodial Activity
For the Fiscal Years Ended September 30, 2012 and 2011
(In Millions)

	2012	2011
Sources of Custodial Revenue (Note 23)		
Individual Income and FICA Taxes	$ **2,159,990**	$ 2,102,030
Corporate Income Taxes	**281,462**	242,848
Estate and Gift Taxes	**14,450**	9,079
Excise Taxes	**79,554**	72,794
Railroad Retirement Taxes	**4,773**	4,692
Unemployment Taxes	**7,159**	6,893
Deposit of Earnings, Federal Reserve System	**81,957**	82,546
Fines, Penalties, Interest, and Other Revenue	**623**	591
Total Revenue Received	**2,629,968**	2,521,473
Less Refunds	**(373,752)**	(416,221)
Net Revenue Received	**2,256,216**	2,105,252
Non-Cash Accrual Adjustment	**5,543**	(150)
Non-TARP Investments in American International Group, Inc. (Note 26):		
Cash Proceeds from Sale of Stock	**12,992**	1,973
Non-Cash Market Adjustments	**(8,251)**	(9,944)
Total Custodial Revenue	**2,266,500**	2,097,131
Disposition of Custodial Revenue (Note 23)		
Amounts Provided to Fund Non-Federal Entities	**386**	462
Amounts Provided to Fund the Federal Government	**2,255,830**	2,104,790
Non-Cash Accrual Adjustment		
Amounts to be Provided to the General Fund	**4,000**	-
Accrual Adjustment	**1,543**	(150)
Non-TARP Investments in American International Group, Inc. (Note 26):		
Cash Proceeds from Stock Sales Provided to Fund the Federal Government	**12,992**	1,973
Non-Cash Market Adjustment	**(8,251)**	(9,944)
Total Disposition of Custodial Revenue	**2,266,500**	2,097,131
Net Custodial Revenue	**$ -**	$ -

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. REPORTING ENTITY

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

The Department was created by an Act (1 Stat.65) on September 2, 1789. Many subsequent acts affected the development of the Department, delegating new duties to its charge and establishing the numerous bureaus and divisions that now comprise the Department. As a major policy advisor to the President, the Secretary of the Treasury (Secretary) has primary responsibility for formulating and managing the domestic and international tax and financial policies of the U.S. Government.

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

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

As of September 30, 2012, the Department's eight operating bureaus were: Bureau of Engraving and Printing (BEP); Bureau of the Public Debt (BPD); Financial Crimes Enforcement Network (FinCEN); Financial Management Service (FMS); Internal Revenue Service (IRS); United States Mint (Mint); Office of the Comptroller of the Currency (OCC); and the Alcohol and, Tobacco Tax and Trade Bureau (TTB). Effective in October 2012, the BPD and FMS operating bureaus merged to form one new operating bureau, Bureau of the Fiscal Service, thereby reducing the Department's total number of operating bureaus to seven. The President's Budget for fiscal year 2013 requests Congressional enactment of a single appropriation to fund the new bureau. The Department's financial statements reflect the reporting of its own entity activities comprising both the Department's operating bureaus and DO that are consolidated with the Department, which include appropriations it receives to conduct its operations and revenue generated from those operations. They also reflect the reporting of certain non-entity (custodial) functions it performs on behalf of the U.S. Government and others. Non-entity activities include collecting federal revenue, servicing the federal debt, disbursing certain federal funds, and maintaining certain assets and liabilities for the U.S. Government, as well as for other federal entities. The Department's reporting entity does not include the General Fund of the U.S. Government (General Fund), which maintains receipt, disbursement, and appropriation accounts for all federal agencies.

Following generally accepted accounting principles (GAAP) for federal entities, the Department has not consolidated into its financial statements the assets, liabilities, or results of operations of any financial organization or commercial entity in which it holds either a direct, indirect, or beneficial majority equity investment. Even though some of the equity investments are significant, these entities meet the criteria of "bailed out" entities under paragraph 50 of the Statement of

Federal Financial Accounting Concepts (SFFAC) No. 2, *Entity and Display* which directs that such "bailout" investments should not be consolidated into the Financial Reports of the U.S. Government, either in part or as a whole.

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

B. Basis of Accounting and Presentation

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

These financial statements consist of the Consolidated Balance Sheets, the Consolidated Statements of Net Cost, the Consolidated Statements of Changes in Net Position, the Combined Statements of Budgetary Resources, and the Statements of Custodial Activity. The statements and the related notes are prepared in a comparative form to present both fiscal years 2012 and 2011 information.

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

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

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

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

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

Certain fiscal year 2011 activity and balances on the financial statements and related notes to the financial statements have been reclassified to conform to the presentation in the current year. Specifically, certain fiscal year 2011 activity on the Consolidated Statements of Net Cost and related notes to the financial statements is reclassified to conform to the presentation in the current fiscal year, the effects of which are immaterial. Furthermore, in fiscal year 2012, changes to OMB Circular No. A-136 resulted in changes to the presentation of the Combined Statements of Budgetary Resources. All fiscal year 2011 activity and balances reported on the Combined Statement of Budgetary Resources are reclassified to conform to the presentation in the current year.

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

C. Fund Balance

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

D. Loans and Interest Receivable, Intra-Governmental

Intra-governmental entity loans and interest receivable from other federal agencies represent loans and interest receivable held by the Department, through FFB. No credit reform subsidy costs are recorded for loans purchased from federal agencies or for guaranteed loans made to non-federal borrowers because the outstanding balances are guaranteed (interest and principal) by those agencies. Intra-governmental non-entity loans and interest receivable from other federal agencies represent loans issued by the Department, through BPD, to federal agencies on behalf of the U.S. Government. The Department acts as an intermediary issuing these loans because the agencies receiving these loans will lend these funds to third parties to carry out various programs of the U.S. Government. Because of the Department's intermediary role in issuing these loans, the Department does not record an allowance related to these intra-governmental loans. Instead, loan loss allowances and subsidy costs are recognized by the ultimate lender, the federal agency that issued the loans to the public.

E. Advances to the Unemployment Trust Fund

Advances are issued to the Department of Labor's (DOL) Unemployment Trust Fund from the General Fund for states to pay unemployment benefits. BPD accounts for the advances on behalf of the General Fund. As outlined in the United States Code (USC) 42 USC §1323, these advances bear an interest rate that is computed as the average interest rate as of the end of the calendar month preceding the issuance date of the advance for all interest-bearing obligations of the United States that form the public debt, to the nearest lower one-eighth of one percent. Interest on the advances is due on September 30th of each year. Advances are repaid by transfers from the Unemployment Trust Fund to the General Fund when the Secretary, in consultation with the Secretary of Labor, determines that the balance in the Unemployment Trust Fund is adequate to allow repayment.

F. Cash, Foreign Currency, and Other Monetary Assets

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

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

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

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

G. Investments

Investments in GSEs

The Department holds senior preferred stock and warrants for the purchase of common stock of two GSEs, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). These non-federal investment holdings are presented at their fair value as permitted by OMB Circular No. A-136. This circular includes language that generally requires agencies to value non-federal investments at acquisition cost, but permits the use of other measurement basis, such as fair value, in certain situations. Changes in the valuation of these investments are recorded as non-entity exchange transactions on the Consolidated Statements of Net Cost. Dividends are also recorded as non-entity exchange transactions and accrued when declared; therefore, no accrual is made for future dividends.

The GSE Senior Preferred Stock Purchase Agreements (SPSPAs) requires the Department to increase its investment in the GSEs' senior preferred stock if, at the end of any quarter, the Federal Housing Finance Agency (FHFA), acting as the conservator, determines that the liabilities of either GSE exceed its respective assets. As funding to the GSEs to pay their excess liabilities is appropriated directly to the Department, such payments are treated as entity expenses and reflected as such on the Consolidated Statements of Net Cost and Cumulative Results of Operations. These payments also result in an increase to the non-entity investment in the GSEs' senior preferred stock, with a corresponding increase in Due to the General Fund, as the Department holds the investment on behalf of the General Fund.

Investments in International Financial Institutions

The Department, on behalf of the United States, invests in Multilateral Development Banks (MDBs) to support poverty reduction, private sector development, transitions to market economies, and sustainable economic growth and development, thereby advancing the United States' economic, political, and commercial interests abroad. As a participating member country, the Department, on behalf of the United States, provides a portion of the capital base of the MDBs, through subscriptions to capital, which allows the MDBs to issue loans at market-based rates to middle income developing countries. These paid-in capital investments are considered non-marketable equity investments valued at cost on the Department's Consolidated Balance Sheets.

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

Non-TARP Investment in American International Group, Inc.

The Department holds American International Group, Inc. (AIG) common stock, a non-federal investment, on behalf of the General Fund which are considered "available-for-sale" securities and recorded at fair value. Changes in the valuation of these investments held are non-entity, non-exchange transactions reported on the Statements of Custodial Activity. The revenue or loss associated with sales of these investments are non-entity, exchange transactions reported on the Statements of Custodial Activity rather than on the Consolidated Statements of Net Cost as the Department does not incur costs related to these investments.

Other Investments and Related Interest

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

H. Credit Program Receivables

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

To account for the Department's TARP and other credit program receivables, the Department applies the accounting provisions of SFFAS No. 2, *Accounting for Direct Loans and Loan Guarantees,* as amended by SFFAS No. 18, *Amendments to Accounting Standards for Direct Loans and Loan Guarantees,* and SFFAS No. 19, *Technical Amendments to Accounting Standards for Direct Loans and Loan Guarantees*. SFFAS No. 2, as amended, requires measurement of the asset or liability at the net present value of the estimated future cash flows. The cash flow estimates for each credit program transaction reflect the actual structure of the instruments. For each of these instruments, the Department estimates cash inflows and outflows related to the program over the estimated term of the instrument.

Further, each cash-flow estimate reflects the specific terms and conditions of the program, technical assumptions regarding the underlying assets, risk of default or other losses, and other factors as appropriate. The measurement of assets within these programs is primarily derived from inputs which generally represent market data and, when such data is not available, management's best estimate of how a market participant would assess the risk inherent in the asset.

SFFAS No. 2, as amended, was promulgated as a result of the Federal Credit Reform Act of 1990 (FCRA). The primary purpose of the FCRA is to more accurately measure the cost of federal credit programs, and to place the cost of such credit programs on a basis equivalent with other federal spending. The FCRA requires that the ultimate costs of a credit program be calculated and the budgetary resources obtained before the direct loan obligations are incurred. To accomplish this, the Department first predicts or estimates the future performance of direct and guaranteed loans when preparing its annual budget. The data used for these budgetary estimates are reestimated at the fiscal year-end to reflect changes in actual loan performance and actual interest rates in effect when the loans were issued. The reestimated data reflect adjustments for market risks, asset performance, and other key variables and economic factors. The reestimated data are then used to report the cost of the loans disbursed under the direct or guaranteed loan program as a "Program Cost" in the Department's Consolidated Statements of Net Cost.

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

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

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

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

I. Taxes, Interest, and Other Receivables, Net

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

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

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

J. Property, Plant, and Equipment, Net

General

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

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

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

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

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

Heritage Assets

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

K. Federal Debt and Interest Payable

Debt and associated interest are reported on the accrual basis of accounting. Interest costs are recorded as expenses when incurred, instead of when paid. Certain Treasury securities are issued at a discount or premium. These discounts and premiums are amortized over the term of the security using an interest method for all long-term securities and the straight-line method for short-term securities. The Department also issues Treasury Inflation-Protected Securities (TIPS). The principal for TIPS is adjusted daily over the life of the security based on the Consumer Price Index for all Urban Consumers, a widely used measurement of inflation.

L. Commitments and Contingencies

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

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

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

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

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

M. Special Drawing Rights

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

Allocations and Holdings

The Department records the SDR holdings as part of "Cash, Foreign Currency, and Other Monetary Assets," and the SDR allocations as the "Allocation of Special Drawing Rights" liability when the IMF allocates SDRs to the Department. The liabilities represent the amount that is payable in the event of liquidation of, or withdrawal by the United States from, the SDR department of the IMF or cancellation of the SDRs.

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

Certificates Issued to the Federal Reserve

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

N. Refunds Payable

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

O. Federal Employee Benefits Payable – FECA Actuarial Liability

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

P. Annual, Sick, and Other Leave

Annual and compensatory leave earned by the Department's employees, but not yet used, is reported as an accrued liability. The accrued balance is adjusted annually to reflect current pay rates. Any portion of the accrued leave for which funding is not available is recorded as an unfunded liability as reported in "Other Liabilities" on the Consolidated Balance

Sheets. Sick and other leave are expensed as taken, and the Department does not record a liability for such amounts because employees do not vest in sick and other leave benefits.

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

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

Most employees of the Department hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS), to which the Department contributes seven percent of pay. On January 1, 1987, the Federal Employees' Retirement System (FERS) went into effect pursuant to Public Law (P.L.) 99-335. Employees hired after December 31, 1983 are automatically covered by FERS and Social Security. A primary feature of FERS is that it offers a savings plan to which the Department automatically contributes one percent of base pay and matches any employee contributions up to an additional four percent of base pay. For most employees hired after December 31, 1983, the Department also contributes the employer's matching share for Social Security. For the FERS basic benefit, the Department contributes 11.2 percent for regular FERS employees.

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

R. Revenue and Financing Sources

The Department's activities are financed either through exchange revenue it receives from others or through non-exchange revenue and financing sources (such as appropriations provided by the Congress and penalties, fines, and certain user fees collected). User fees primarily include collections from the public for the IRS costs to process installment agreements and accompanying photocopy and reproduction charges. Exchange revenues are recognized when earned; i.e., goods have been delivered or services have been rendered. Revenue from reimbursable agreements is recognized when the services are provided. Non-exchange revenues are recognized when received by the respective collecting bureau. Appropriations used are recognized as financing sources when related expenses are incurred or assets are purchased.

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

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

S. Custodial Revenues and Collections

Non-entity revenue reported on the Department's Statements of Custodial Activity includes cash collected by the Department, primarily from taxes. It does not include revenue collected by other federal agencies, such as user fees and other receipts, which are remitted for general operating purposes of the U.S. Government or are earmarked for certain trust funds. The Statements of Custodial Activity are presented on the "modified accrual basis." The Department recognizes revenues as cash is collected, and records a "non-cash accrual adjustment" representing the net increase or decrease during the reporting period in net revenue-related assets and liabilities, mainly taxes receivable. The Department also records as revenues non-cash market valuation changes related to the U.S. Government's holdings in American International Group, Inc. (Note 26).

T. Permanent and Indefinite Appropriations

Permanent and indefinite appropriations are used to disburse tax refunds, income tax credits, and child tax credits. These appropriations are not subject to budgetary ceilings established by Congress. Therefore, refunds payable at year end are not subject to funding restrictions. Refund payment funding is recognized as appropriations are used. Permanent indefinite authority for refund activity is not stated as a specific amount and is available for an indefinite period of time. Although funded through appropriations, refund activity, in most instances, is reported as a custodial activity of the Department, since refunds are, in substance, a custodial revenue-related activity resulting from taxpayer overpayments of their tax liabilities.

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

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

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

U. Income Taxes

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

V. Use of Estimates

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

The Department accounts for all of its TARP and non-TARP credit program receivables in accordance with credit reform accounting (refer to the accounting policy above entitled "Credit Program Receivables," and Notes 7 and 11). These receivables are derived using credit reform modeling which is subject to the use of estimates. The Department recognizes the sensitivity of credit reform modeling to slight changes in certain model assumptions, and uses regular review of model factors, statistical modeling, and annual reestimates to reflect the most accurate cost of the credit programs to the U.S. Government. The purpose of reestimates is to update original program subsidy cost estimates to reflect actual cash flow experience as well as changes in forecasts of future cash flows. Forecasts of future cash flows are updated based on actual program performance to date, additional information about the portfolio, additional publicly available relevant historical market data on securities performance, revised expectations for future economic conditions, and enhancements to cash flow projection methods.

The forecasted cash flows used to determine these credit program amounts are sensitive to slight changes in model assumptions, such as general economic conditions, specific stock price volatility of the entities in which the Department has an equity interest, estimates of expected default, and prepayment rates. Forecasts of financial results have inherent uncertainty. The TARP Credit Program Receivables, Net line item on the Consolidated Balance Sheets is reflective of relatively illiquid, troubled assets whose values are particularly sensitive to future economic conditions and other assumptions. Additional discussion related to sensitivity analysis can be found in the Management's Discussion and Analysis section of this AFR.

The liabilities to the GSEs related to the SPSPA is a contingent liquidity commitment, predicated on the future occurrence of an excess of liabilities and minimum capital reserve amounts, as defined, over the assets of either GSE at the end of any reporting quarter, and are probable liabilities of the Department. The Department performs annual valuations, as of September 30, on the preferred stock and warrants in an attempt to provide a "sufficiently reliable" estimate of the outstanding commitments in order for the Department to record the remaining liability in accordance with SFFAS No. 5.

The valuations incorporate various forecasts, projections and cash flow analyses to develop an estimate of probable liability. Any changes in valuation, including impairment, are recorded and disclosed in accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*. Since the valuation is an annual process, the change in valuation of the preferred stock and warrants are deemed usual and recurring. The GSEs contingent liability is assessed annually and recorded at the gross estimated amount, without considering the increase in preferred stock liquidity preference, future dividend payments, or future commitment fees, due to the uncertainties involved. Note 8 includes a detailed discussion of the results of the valuation and the liability recorded.

Estimation of such complex and long-duration contingencies is subject to uncertainty, and it is possible that new developments will adversely impact ultimate amounts required to be funded by the Department under agreements between the Department and each GSE (Note 8). Specifically, the occurrence of future shareholder deficits, which ultimately determines the Department's liabilities to the GSEs, is most sensitive to future changes in the housing price index.

W. Other-Than-Temporary Impairments

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

X. Credit, Market and Foreign Currency Risk

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

Except for the Terrorism Risk Insurance Program, the Department's activities focus on the underlying problems in the credit markets, and the ongoing instability in those markets exposes the Department to potential costs and losses. The extent of the risk assumed by the Department is described in more detail in the notes to the financial statements and, where applicable, is factored into credit reform models and reflected in fair value measurements (Notes 7, 8, and 11). Given the history of the Department with respect to such exposure and the financial policies in place in the U.S. Government and other institutions in which the United States participates, the Department's expectation of credit losses is nominal.

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

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

Y. Earmarked Funds

The Department accounts for revenues and other financing sources for earmarked funds separately from other funds. Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities or purposes. SFFAS No. 27, *Identifying and Reporting Earmarked Funds*, defines the following three criteria for determining an earmarked fund: *(i)* a statute committing the U.S. Government to use specifically identified revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; (*ii*) explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and (*iii*) a requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguished the earmarked fund from the U.S. Government's general revenues.

Z. ALLOCATION TRANSFERS

The Department is a party to allocation transfers with other federal agencies as both a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent. Parent federal agencies report both the proprietary and budgetary activity and the child agency does not report any financial activity related to budget authority allocated from the parent federal agency to the child federal agency.

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

OMB allows certain exceptions to allocation reporting for certain funds. Accordingly, the Department has reported certain funds, including the Agency for International Development and Executive Office of the President funds, for which the Department is the child in the allocation transfer but, in compliance with OMB guidance (Circular No. A-136, II.4.2, question 5, for three exceptions), will report all activities relative to these allocation transfers in the Department's financial statements.

AA. FIDUCIARY ACTIVITIES

Fiduciary activities are the collection or receipt, and the management, protection, accounting, investment, and disposition by the U.S. Government of cash or other assets in which non-Federal individuals or entities have an ownership interest that the U.S. Government must uphold. Fiduciary cash and other assets are not assets of the U.S. Government. These activities are not reported in the Department's consolidated financial statements, but instead are reported in Note 27.

AB. RELATED PARTIES AND OTHER ENTITIES

The primary "related parties" with whom the Department conducts business are other federal agencies, mainly through the normal lending activities of the BPD and the FFB. These activities are disclosed in the consolidated financial statements. Additionally, the Secretary serves on the FHFA Oversight Board, and consults with the Director of FHFA on matters involving Fannie Mae and Freddie Mac. This provides the Department a voice in the FHFA's actions as the conservator for Fannie Mae and Freddie Mac. The Department has no transactions with FHFA, but rather transacts directly with the GSEs. The Department also utilizes the services of the FRBs to execute a variety of transactions on behalf of the BPD and the ESF. Because of the magnitude and variety of services provided, the following provides an overview of the FRBs' purpose, governance, and the various services provided on behalf of the Department.

Federal Reserve System

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

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

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

The Department also consults with the FR System on matters affecting the economy and certain financial stability activities (Notes 7, 11 and 26). The above financial activities involving the Department are accounted for and disclosed in the Department's consolidated financial statements. In accordance with SFFAC No. 2, *Entity and Display,* the FR Systems' assets, liabilities, and operations are not consolidated into the Department's financial statements.

Federal Reserve System Structure

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

The FOMC is comprised of the seven Board members and five of the 12 FRB presidents, and is charged with formulating and conducting monetary policy primarily through open market operations (the purchase and sale of certain securities in the open market), the principal tool of national monetary policy. These operations affect the amount of reserve balances available to depository institutions, thereby influencing overall monetary and credit conditions. The 12 FRBs are chartered under the Federal Reserve Act, which requires each member bank to own the capital stock of its FRB. Supervision and control of each FRB is exercised by a board of directors, of which three are appointed by the Board of Governors of the FR System, and six are elected by their member banks.

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

Federal Reserve System Assets and Liabilities

The FRBs hold Treasury and other securities in the SOMA for the purpose of conducting monetary policy. Treasury securities held by the FRBs totaled $1.6 trillion and $1.7 trillion at September 30, 2012 and 2011, respectively (Note 16). These assets are generally subject to the same market (principally interest-rate) and credit risks as other financial instruments. In the open market, the FR System purchases and sells Treasury securities as a mechanism for controlling the money supply.

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

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

FRB Residual Earnings Transferred to the Department

FRBs generate income, from interest earned on securities, reimbursable services provided to federal agencies, and the provision of priced services to depository institutions as specified by the Monetary Control Act of 1980. Although the FRBs generate earnings from carrying out open market operations (via the earnings on securities held in the SOMA account), their execution of these operations is for the purpose of accomplishing monetary policy rather than generating earnings. Each FRB is required by Board policy to transfer to the Department its residual (or excess) earnings, after providing for the cost of operations, payment of dividends, and reservation of an amount necessary to equate surplus with paid-in capital. These residual earnings may vary due to, among other things, changes in the SOMA balance levels that may occur in conducting monetary policy. In the event of losses, or a substantial increase in capital, an FRB will suspend its payments to the U.S. Treasury until such losses or increases in capital are recovered through subsequent earnings. The FRB residual earnings of $82.0 billion and $82.5 billion for fiscal years ended September 30, 2012 and 2011, respectively, are reported as custodial revenues on the Department's Statements of Custodial Activity. They constituted three percent of the Department's total custodial revenues collected in fiscal years 2012 and 2011. "Taxes, Interest and Other Receivables, Net" includes a receivable for FRB's residual earnings which represents the earnings due to the U.S. Treasury as of September 30, but not collected by the U.S. Treasury until after the end of the month (Note 13).

2. FUND BALANCE

As of September 30, 2012 and 2011, fund balance consisted of the following (in millions):

	2012	2011
Appropriated Funds	**$ 315,690**	$ 344,913
Revolving Funds	**26,698**	35,464
Special Funds	**976**	721
Clearing Funds	**681**	392
Deposit Funds	**163**	170
Other Funds (principally Receipt, Trust, and Suspense Funds)	**138**	124
Total Fund Balance	**$ 344,346**	$ 381,784

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

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

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

STATUS OF FUND BALANCE

As of September 30, 2012 and 2011, the status of the fund balance consisted of the following (in millions):

		2012		2011
Unobligated Balance – Available	**$**	**255,227**	$	270,786
Unobligated Balance - Not Available		**84,371**		98,168
Unpaid Obligations		**252,169**		270,983
Subtotal		**591,767**		639,937
Adjustment for Borrowing Authority		**(109,930)**		(123,844)
Adjustment for ESF		**(103,763)**		(105,026)
Adjustment for IMF		**(32,093)**		(27,065)
Adjustment for Intra-Treasury Investments		**(7,251)**		(7,024)
Adjustment for Non-Budgetary Funds		**973**		674
Adjustment for Authority Unavailable for Obligations		**3,706**		3,721
Other Adjustments		**937**		411
Total Status of Fund Balance	**$**	**344,346**	$	381,784

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

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

- Adjustments for Borrowing Authority – Borrowing authority is in budgetary status but not in the Fund Balance
- Adjustments for ESF – ESF investments and related balances that meet the criteria for reporting as part of budgetary resources are reported on the Statement of Budgetary Resources; however, they are not a component of the Fund Balance as they represent invested funds
- Adjustments for IMF – IMF related balances that meet the criteria for reporting as part of budgetary resources; however, they are not a component of the Fund Balance as they represent other monetary assets
- Adjustments for Intra-Treasury Investments – Budgetary resources include investments, however, the money has been moved from the Fund Balance asset account to Investments

- Adjustments for Non-Budgetary Funds – Include receipt, clearing, and deposit funds that represent amounts on deposit with Treasury that have no budgetary status
- Adjustment for Authority Unavailable for Obligations – Resources unavailable for obligations reduced the budgetary resources, however, they did not impact the Fund Balance

As of September 30, 2012 and 2011, the Department did not have any budgetary authority in the Fund Balance that was specifically withheld from apportionment by the OMB. The balances in non-entity funds, such as certain deposit funds (e.g., seized cash), are being held by the Department for the public or for another federal entity, such as the General Fund. Such funds have an offsetting liability equal to the Fund Balance. See Note 12 regarding restrictions related to the line of credit held on the U.S. quota in the IMF.

3. LOANS AND INTEREST RECEIVABLE – INTRA-GOVERNMENTAL

ENTITY INTRA-GOVERNMENTAL

The Department, through FFB, issues loans to federal agencies for the agencies' own use or for the agencies to loan to private sector borrowers whose loans are guaranteed by the federal agencies. When a federal agency has to honor its guarantee because a private sector borrower defaults, the federal agency that guaranteed the loan must obtain an appropriation or use other resources to repay the FFB. All principal and interest on loans to federal agencies and private sector borrowers are, or have a commitment to be, backed by the full faith and credit of the U.S. Government. The Department has not recognized any credit-related losses on its loans, nor has the Department recorded an allowance for uncollectible intra-governmental loans.

As of September 30, 2012 and 2011, entity intra-governmental loans (issued by the FFB) and interest receivable consisted of the following (in millions):

	Loans Receivable	**Interest Receivable**	**2012 Total**	Loans Receivable	Interest Receivable	2011 Total
Department of Agriculture	**$ 37,750**	**$ 343**	**$ 38,093**	$ 34,178	$ 48	$ 34,226
United States Postal Service[1]	**15,000**	**48**	**15,048**	13,000	47	13,047
Department of Energy	**12,171**	**35**	**12,206**	6,929	15	6,944
General Services Administration	**1,819**	**32**	**1,851**	1,898	33	1,931
Other Agencies	**1,123**	**7**	**1,130**	1,083	8	1,091
Total Entity Intra-governmental	**$ 67,863**	**$ 465**	**$ 68,328**	$ 57,088	$ 151	$ 57,239

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

NON-ENTITY INTRA-GOVERNMENTAL

The Department, through BPD, accounts for and reports on the principal borrowings from and repayments to the General Fund for 93 funds managed by other federal agencies, as well as the related interest due to the General Fund. These agencies are statutorily authorized to borrow from the General Fund, through BPD, to make loans for a broad range of purposes, such as education, housing, farming, and small business support.

As of September 30, 2012 and 2011, non-entity intra-governmental loans (issued by BPD) and interest receivable due to the General Fund consisted of the following (in millions):

	Loans Receivable	**Interest Receivable**	**2012 Total**	Loans Receivable	Interest Receivable	2011 Total
Department of Education	**$ 714,368**	**$ -**	**$ 714,368**	$ 546,321	$ -	$ 546,321
Department of Agriculture	**55,787**	**-**	**55,787**	55,356	-	55,356
Department of Homeland Security	**18,073**	**-**	**18,073**	17,754	-	17,754
Department of Housing and Urban Development	**11,567**	**-**	**11,567**	6,090	-	6,090
Export-Import Bank of the U.S.	**11,301**	**-**	**11,301**	8,279	-	8,279
Small Business Administration	**7,920**	**-**	**7,920**	11,190	-	11,190
Department of Labor	**6,065**	**-**	**6,065**	6,163	-	6,163
Department of Transportation	**5,193**	**-**	**5,193**	4,342	1	4,343
Department of Energy	**3,616**	**20**	**3,636**	3,104	20	3,124
Railroad Retirement Board	**3,402**	**44**	**3,446**	3,484	52	3,536
National Credit Union Administration	**3,200**	**2**	**3,202**	3,500	2	3,502
Overseas Private Investment Corporation	**2,241**	**-**	**2,241**	1,828	-	1,828
Department of Veterans Affairs	**838**	**-**	**838**	1,675	-	1,675
Other Agencies	**2,339**	**-**	**2,339**	2,250	-	2,250
Total Non-Entity Intra-governmental	**$ 845,910**	**$ 66**	**$ 845,976**	$ 671,336	$ 75	$ 671,411
Total Intra-governmental Loans and Interest Receivable (Entity and Non-Entity)	**$ 913,773**	**$ 531**	**$ 914,304**	$ 728,424	$ 226	$ 728,650

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

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

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

General Fund liabilities, primarily federal debt, are obligations of the U.S. Government that have accumulated since the U.S. Government's inception. These Department-managed liabilities are separately reported on the Consolidated Balance Sheets, with a corresponding amount reported as Due from the General Fund. Due from the General Fund represents a receivable, or future funds required of the General Fund to repay borrowings from the public and other federal agencies.

As of September 30, 2012 and 2011, the General Fund assets and liabilities had a negative net position of $14.9 trillion and $13.7 trillion, respectively. This negative net position represents the amount needed by the U.S. Government, through a combination of future tax collections and/or continued borrowing from the public and federal agencies to meet its obligations.

As of September 30, 2012 and 2011, Due from and Due to the General Fund included the following non-entity assets and liabilities (in millions):

Liabilities Requiring Funding from the General Fund	**2012**	2011
Federal Debt and Interest Payable (Note 16)	**$ 11,307,583**	$ 10,148,963
Federal Debt and Interest Payable - Intra-governmental (Note 16)	**4,861,005**	4,719,668
Refunds Payable (Note 23)	**3,255**	3,983
Adjustment for Eliminated Liabilities	**30,336**	30,103
Total Due from the General Fund	**$ 16,202,179**	$ 14,902,717

Assets to be Distributed to the General Fund	**2012**	2011
Fund Balance	**$ 406**	$ 358
Loans and Interest Receivable - Intra-governmental (Note 3)	**845,976**	671,411
Advances to the Unemployment Trust Fund	**32,932**	42,773
Cash Due to the General Fund (Held by the Department) (Note 5)	**79,245**	49,949
Accounts Receivable - Intra-governmental	**455**	388
Foreign Currency	**64**	73
Custodial Gold without certificates and Silver held by the U.S. Mint	**25**	25
Investments in Government Sponsored Enterprises (Note 8)	**109,342**	133,043
Non-TARP Investments in American International Group, Inc. (Note 26)	**2,611**	10,862
Credit Reform Downward Subsidy Reestimates	**10,444**	13,022
Loans and Interest Receivable	**94**	99
Taxes and Other Non-Entity Receivables Due to General Fund	**41,421**	36,615
Miscellaneous Assets	**-**	2
Adjustment for Eliminated Assets	**134,737**	267,855
Total Due to the General Fund	**$ 1,257,752**	$ 1,226,475

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

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

Advances have been issued to the DOL's Unemployment Trust Fund from the General Fund to states for unemployment benefits.

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

The Adjustment for Eliminated Liabilities principally represents investments in U.S. Government securities held by the Department's reporting entities that were eliminated against Federal Debt and Interest Payable Intra-governmental. The Adjustment for Eliminated Assets principally represents loans and interest payable owed by the Treasury reporting entities, which were eliminated against Loans and Interest Receivable Intra-governmental held by the BPD.

5. CASH, FOREIGN CURRENCY, AND OTHER MONETARY ASSETS

Cash, foreign currency, and other monetary assets held as of September 30, 2012 and 2011 were as follows (in millions):

	2012	2011
Entity:		
Cash	**$ 75**	$ 74
Foreign Currency and Foreign Currency Denominated Assets	**10,524**	10,767
Other Monetary Assets:		
Special Drawing Right Holdings	**55,240**	55,911
U.S. Dollars Held in Cash by the IMF	**137**	153
Total Entity	**65,976**	66,905
Non-Entity:		
Operating Cash of the U.S. Government	**79,195**	49,812
Foreign Currency	**64**	73
Miscellaneous Cash Held by All Treasury Reporting Entities	**316**	331
Total Non-Entity	**79,575**	50,216
Total Cash, Foreign Currency, and Other Monetary Assets	**$ 145,551**	$ 117,121

Non-entity operating and other miscellaneous cash due to the General Fund which was held by the Department consisted of the following as of September 30, 2012 and 2011 (in millions):

	2012	2011
Operating Cash - FRB Account	**$ 85,446**	$ 56,284
Operating Cash – Other	**-**	1,805
Subtotal	**85,446**	58,089
Outstanding Checks	**(6,251)**	(8,277)
Total Operating Cash of the U.S. Government	**79,195**	49,812
Miscellaneous Cash	**128**	230
Subtotal	**79,323**	50,042
Amounts Due to the Public	**(78)**	(93)
Total Cash Due to the General Fund (Note 4)	**$ 79,245**	$ 49,949

ENTITY

Cash, Foreign Currency, and Other Monetary Assets

Entity cash, foreign currency, and other monetary assets principally include foreign currency, foreign currency denominated assets (FCDA), SDRs and forfeited cash. Foreign currency, FCDAs, and SDRs are valued as of September 30, 2012 and 2011 using current exchange rates plus accrued interest. Also included are U.S. dollars restricted for use by the IMF which are maintained in two accounts at the FRBNY. FCDA holdings are normally invested in interest-bearing securities issued by or held through foreign governments or monetary authorities. FCDAs with original maturities of three months or less, including securities purchased under agreement to resell, were valued at $10.5 billion and $10.8 billion as of September 30, 2012 and 2011, respectively.

Special Drawing Rights

The SDR is an international reserve asset created by the IMF to supplement existing reserve assets. The IMF has allocated new SDRs on several occasions to members participating in the IMF's SDR department. The SDR derives its value as a reserve asset essentially from the commitments of participants to hold and accept SDRs and to honor various obligations connected with their proper functioning as a reserve asset. Pursuant to the *Special Drawing Rights Act of 1968*, as amended, the Department issued certificates to the Federal Reserve, valued at $5.2 billion as of September 30, 2012 and 2011, to finance its acquisition of SDRs from other countries or to provide U.S. dollar resources for financing other ESF operations.

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

Pursuant to the IMF Articles of Agreement, SDRs allocated to or otherwise acquired by the United States are permanent resources unless:

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

Except for the payment of interest and charges on SDR allocations to the United States, the payment of the Department's commitment related to SDR allocations is conditional on events listed above, in which the United States has a substantial or controlling voice. Allocations of SDRs were made in 1970, 1971, 1972, 1979, 1980, 1981, and 2009. The United States has received no SDR allocations since 2009.

As of September 30, 2012 and 2011, the total amount of SDR holdings of the United States was the equivalent of $55.2 billion and $55.9 billion, respectively. As of September 30, 2012 and 2011, the total value of SDR allocations to the United States was the equivalent of $54.5 billion and $55.1 billion, respectively.

Securities Purchased Under Agreement to Resell

The FRBNY, on behalf of the ESF, enters into transactions to purchase foreign-currency-denominated government-debt securities under agreements to resell for which the accepted collateral is the debt instruments, denominated in Euros, and issued or guaranteed in full by European governments. These agreements are subject to daily margining requirements.

NON-ENTITY

Cash, Foreign Currency, and Other Monetary Assets

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

The Operating Cash of the U.S. Government represents balances from tax collections, other revenues, federal debt receipts, and other receipts, net of checks outstanding, which are held in the FRBs and in foreign and domestic financial institutions.

Operating Cash of the U.S. Government is either insured by the FDIC (for balances up to $250,000 as of September 30, 2012 and 2011), or collateralized by securities pledged by the depository institutions and held by the FRB.

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

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

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

The gold and silver bullion reserve (deep storage and working stock) are reported on the consolidated financial statements at the values stated in 31 USC § 5116 – 5117 (statutory rates) which are $42.2222 per FTO of gold and no less than $1.292929292 per FTO of silver. Accordingly, the silver is valued at $1.292929292 per FTO. The market values of the gold and silver reserves disclosed below are based on the London Gold Fixing. As of September 30, 2012 and 2011, the values of gold and silver reserves consisted of the following (in millions):

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

	FTOs	Statutory Rate	2011 Statutory Carrying Value	Market Rate Per FTO	2011 Market Value
Gold	248,046,116	$ 42.2222	$ 10,473	$ 1,620.00	$ 401,835
Gold Held by Federal Reserve Banks	13,452,784	$ 42.2222	568	$ 1,620.00	21,794
Total Gold	261,498,900		11,041		423,629
Silver	16,000,000	$ 1.2929	21	$ 30.45	487
Total Gold and Silver Reserves			$ 11,062		$ 424,116

7. TROUBLED ASSET RELIEF PROGRAM – CREDIT PROGRAM RECEIVABLES, NET

The Department administers a number of programs designed to help stabilize the financial system and restore the flow of credit to consumers and businesses. Through TARP, the Department made direct loans, equity investments, and entered into other credit programs. On October 3, 2010, TARP's authority to make new commitments to purchase or guarantee troubled assets expired. The table below displays the assets held as of September 30, 2012 and 2011, by the observability of inputs significant to the measurement of each value (in millions):

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

[1] Measurement is based on direct market quotes for the specific asset, e.g. quoted prices of common stock.
[2] Measurement is primarily derived from market observable data, other than a direct market quote, for the asset. This data could be market quotes for similar assets for the same entity.
[3] Measurement is primarily derived from inputs representing management's best estimate of how a market participant would assess the risk inherent in the asset. These unobservable inputs are used because there is little to no direct market activity.
[4] Of the combined TARP Program totaling $41.2 billion at September 30, 2012, $967 million represented other intra-governmental assets and $40.2 billion represented assets with the public as reported on the Consolidated Balance Sheets.

Program	Quoted Prices for Identical Assets[1]	Significant Observable Inputs[2]	Significant Unobservable Inputs[3]	2011 Total
Capital Purchase Program	$ 202	$ -	$ 12,240	$ 12,442
American International Group, Inc. Investment Program	21,076	9,294	-	30,370
Automotive Industry Financing Program	10,091	-	7,747	17,838
Public-Private Investment Program	-	-	18,377	18,377
Other Programs, which include TALF, SBA 7 (a) securities and CDCI	-	126	951	1,077
Asset Guarantee Program[4]	-	739	-	739
Total TARP Programs	$ 31,369	$ 10,159	$ 39,315	$ 80,843

See table above for explanations to (1), (2), and (3).
[4] Of the combined TARP Program totaling $80.8 billion at September 30, 2011, $739 million represented other intra-governmental assets and $80.1 billion represented assets with the public as reported on the Consolidated Balance Sheets.

DIRECT LOAN AND EQUITY INVESTMENT PROGRAMS

Capital Purchase Program

TARP began implementing programs in fiscal year 2009, commencing with the Capital Purchase Program (CPP) which was designed to help stabilize the financial system by assisting in building the capital base of certain viable U.S. financial institutions to increase the capacity of those institutions to lend to businesses and consumers and support the economy. Under this program, the Department invested a total of $204.9 billion and purchased senior perpetual preferred stock and subordinate debentures from qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies (Qualified Financial Institution or QFI). Additionally, the Department exercised warrants received from non-public QFIs resulting in additional holdings of senior preferred stock (or subordinated debentures as appropriate). The senior preferred stock has a stated dividend rate ranging from 5.0 percent to 9.0 percent. The dividends are cumulative for bank holding companies and subsidiaries of bank holding companies, and non-cumulative for others, and payable when and if declared by the institution's board of directors. QFIs that are Sub-chapter S corporations (public and non-public) issued subordinated debentures that have a maturity of 30 years, and interest rates ranging from 7.7 percent to 13.8 percent. QFIs, subject to regulatory approval, may repay the Department's investment at any time. For fiscal years 2012 and 2011, repayments and sales of CPP investments totaled $8.2 billion and $30.2 billion, respectively.

In addition to the senior preferred stock, the Department received warrants from public QFIs to purchase a number of shares of common stock. The warrants have a ten-year term, and the Department may exercise any warrants held in whole or in part at any time.

As part of the management of the investments in CPP, the Department entered into certain agreements to exchange and/or convert existing investments. In fiscal year 2009, the Department entered into an exchange agreement with Citigroup under which the Department exchanged $25.0 billion of its investment in Citigroup senior preferred stock for 7.7 billion shares of Citigroup common stock, at $3.25 per share. Between April 2010 and January 2011, the Department had sold all of its Citigroup common stock held, generating cash proceeds of $31.9 billion, resulting in proceeds in excess of cost of $6.9 billion (cash proceeds from sales of Citigroup common stock and warrants in fiscal year 2011 were $15.8 billion, which exceeded cost by $3.9 billion).

The Department entered into other transactions with various financial institutions which generally are in poor financial condition with a high likelihood of failure. The changes in cost associated with these transactions are considered workouts rather than modifications, in accordance with SFFAS No. 2, and are captured in the year-end reestimates.

Of the $8.2 billion in CPP investment repayments and sales during fiscal year 2012, net proceeds of $1.3 billion resulted from auction sales which stemmed from the Department's decision in fiscal year 2012 to sell certain CPP investments to the public in auction sales. Total repayments and sales resulted in net proceeds less than cost of $285 million in fiscal year 2012. Because these auction sales were not considered in the formulation estimate for the CPP program, a modification was recorded, increasing the cost of the program by $973 million. During fiscal year 2011, certain financial institutions participating in CPP became eligible to exchange their TARP-held stock investments to preferred stock in the SBLF program (Note 11). Because this refinance was not considered in the formulation estimate for the CPP program, a modification was recorded in fiscal year 2011, resulting in a subsidy cost reduction of $1.0 billion.

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

American International Group, Inc. Investment Program

The Department provided assistance to systemically significant financial institutions on a case by case basis in order to help provide stability to those institutions that were critical to a functioning financial system and were at substantial risk of failure, as well as to help prevent broader disruption to financial markets. In fiscal year 2009, the Department invested in AIG which (after being restructured in the same fiscal year) consisted of $41.6 billion of AIG's non-cumulative 10.0 percent Series E preferred stock. Additionally, the Department made available to AIG a $29.8 billion equity capital facility and received AIG's non-cumulative 10.0 percent Series F preferred stock under which AIG drew $27.8 billion. In January 2011, the Department (in combination with AIG and the FRBNY) restructured the AIG investments in which it converted the $41.6 billion of Series E preferred stock and $27.8 billion of the Series F equity capital facility into a $20.3 billion interest in AIG SPVs, and 1.1 billion shares of AIG common stock. The remaining $2.0 billion of undrawn Series F capital facility was converted to a new equity capital facility that was subsequently cancelled in fiscal year 2011. Additionally, the credit facility between FRBNY and AIG was terminated, and the Department (not TARP) on behalf of the General Fund separately received 563 million shares of AIG common stock (Note 26). Upon completion of the restructuring, the Department (including TARP) held a combined total of 1.7 billion shares of AIG common stock, or 92.1 percent of AIG's common stock equity.

Since the January 2011 restructuring, the Department (including TARP) has sold shares of the AIG common stock in the open market. During fiscal year 2012, the Department (including TARP) sold 1.2 billion shares of AIG common stock for $38.2 billion, of which the General Fund and TARP received $13.0 billion and $25.2 billion, respectively. In fiscal year 2011, the Department (including TARP) sold 200 million shares of AIG common stock for $5.8 billion, of which the General Fund and TARP received $2.0 billion and $3.8 billion, respectively. For the TARP shares sold, the proceeds were less than the Department's cost by $9.9 billion and $1.9 billion for fiscal years 2012 and 2011, respectively. AIG common shares sold by the General Fund were provided at no cost to the Department. At September 30, 2012 and 2011, the Department owned 234 million shares and 1.5 billion shares of AIG common stock, respectively, with a fair value totaling approximately $7.7 billion and $31.9 billion, or 15.9 percent and 76.9 percent of AIG's outstanding common stock, respectively. Of this total, TARP owned 154 million shares and 960 million shares, at September 30, 2012 and 2011, respectively, or 10.5 percent ($5.1 billion fair value) and 50.8 percent ($21.1 billion fair value) of AIG's outstanding common stock, respectively. The fair value of the AIG common stock was based on the New York Stock Exchange (NYSE) quoted market price as of September 30, 2012 and 2011.

In fiscal year 2012, the Department received $9.6 billion in distributions from the AIG SPVs, which fully repaid the remaining investment balance of $9.3 billion. The Department recorded proceeds in excess of cost of $127 million plus investment income of $191 million. In fiscal year 2011, the Department received $11.5 billion in distributions from the AIG SPVs, reduced its AIG SPV outstanding balance by $11.2 billion to $9.3 billion, and received investment income of $246 million, and recorded capitalized dividend income of $204 million. The SPVs were valued at their liquidation preference since the value of the underlying assets within the SPVs greatly exceeded the liquidation preference.

Automotive Industry Financing Program

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

General Motors Company and General Motors Corporation

In fiscal year 2009, the Department provided $49.5 billion to General Motors Corporation (Old GM) through various loan agreements including the initial loan for general and working capital purposes and the final loan for debtor in possession (DIP) financing while Old GM was in bankruptcy. During fiscal year 2009, the Department and a newly created General Motors Company (New GM) extinguished substantially all but $7.1 billion of these initial financing arrangements, and the Department received $2.1 billion in 9.0 percent cumulative perpetual preferred stock and 60.8 percent of the common equity interest in New GM. Additionally, New GM assumed $7.1 billion of the original DIP loan which it fully repaid to the Department by the end of fiscal year 2010.

During fiscal year 2011, New GM repurchased its preferred stock for 102.0 percent of its liquidation amount, or $2.1 billion. As part of an initial public offering by New GM in fiscal year 2011, the Department sold approximately 412 million shares of its common stock for $13.5 billion. The sale resulted in net proceeds less than cost of $4.4 billion. At September 30, 2012 and 2011, the Department held 500 million shares of the common stock of New GM, which represented approximately 32.0 percent of New GM's common stock outstanding. The fair value of the New GM common shares held as of September 30, 2012 and 2011 was $11.4 billion and $10.1 billion, respectively, based on the NYSE quoted market price.

Chrysler Group LLC and Chrysler Holding LLC

In fiscal year 2009, the Department invested $5.9 billion in Chrysler Holding LLC (Old Chrysler), consisting of $4.0 billion for general and working capital purposes (the general purpose loan) and $1.9 billion in DIP financing while Old Chrysler was in bankruptcy. Upon entering bankruptcy, a portion of Old Chrysler was sold to a newly created entity, Chrysler Group LLC (New Chrysler). In fiscal year 2010, under the terms of a bankruptcy agreement, the initial financing to Old Chrysler was replaced by financing to New Chrysler in which the Department funded a $4.6 billion loan to New Chrysler, with a commitment to fund it an additional $2.1 billion. Also, New Chrysler assumed $500 million of the Old Chrysler general purpose loan. In fiscal year 2011, New Chrysler repaid the $5.1 billion loan principal ($4.6 billion funded and $500 million assumed from Old Chrysler) and interest due on the loan, and the Department terminated New Chrysler's ability to draw on the remaining available $2.1 billion loan commitment. Total net proceeds received relating to the fiscal year 2011 transactions were $896 million less than the Department's cost. As a result of these transactions, the Department had no remaining interest in New Chrysler as of September 30, 2012 and 2011. The Department continues to hold a right to receive proceeds from a bankruptcy liquidation trust, but no significant cash flows are expected.

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

The Department invested a total of $16.3 billion in GMAC Inc. between December 2008 and December 2009 to help support its ability to originate new loans to GM and Chrysler dealers and consumers, and to help address GMAC's capital needs. In May 2010, GMAC changed its corporate name to Ally Financial, Inc. (Ally). As a result of original investments, exchanges, conversions and warrant exercises, as of September 30, 2012 and 2011, the Department held 981,971 shares of Ally common stock, representing 73.8 percent of Ally's outstanding common stock. The Department also held 119 million shares of Ally Series F-2 Mandatorily Convertible Preferred Securities, with a $50 per share liquidation preference and a stated dividend rate of 9.0 percent, and are convertible into at least 513,000 shares of Ally common stock at Ally's option subject to approval of the FRB and consent by the Department, or pursuant to an order by the FRB compelling such conversion. The Series F-2 security is also convertible at the option of the Department upon certain specified corporate events. Absent any optional conversion, any Series F-2 remaining preferred shares will automatically convert to Ally common stock after seven years from the issuance date. When combined with the Ally common stock currently owned, conversion of the Series F-2 preferred stock into common stock would represent 81.0 percent ownership of Ally common stock held by the Department. In fiscal years 2012 and 2011, the Department received $534 million and $839 million in dividends from Ally, respectively.

Prior to September 30, 2011, the Department held 2.7 million shares of 8.0 percent cumulative Trust Preferred Securities (TruPS) with a $1,000 per share liquidation preference. During fiscal year 2011, the agreement between Ally and the Department regarding its TruPS was amended to facilitate the Department's sale of these securities on the open market. Because this amendment to agreement terms was not considered in the formulation subsidy cost estimate for the program, the Department recorded a modification resulting in a subsidy cost reduction of $174 million. In March 2011, the Department sold its TruPS for $2.7 billion, resulting in proceeds in excess of cost of $127 million.

As of September 30, 2012 and 2011, for investments in Ally's common equity and mandatorily convertible preferred stock, which are valued on an "if-converted" basis, the Department used certain valuation multiples such as price-to-earnings, price-to-tangible book value, and asset manager valuations to estimate the value of the shares. The multiples were based on those of comparable publicly-traded entities. The adjustment for market risk is incorporated in the data points the Department uses to determine the measurement for Ally as all points rely on market data.

Public-Private Investment Program

The Public-Private Investment Program (PPIP) is part of the Department's efforts to help restart the financial securities market and provide liquidity for legacy securities. Under this program, the Department (as a limited partner) made equity investments in and loans to nine investment vehicles (referred to as Public-Private Investment Funds or "PPIFs") established by private investment managers between September and December 2009. The equity investments were used to match private capital and equal 49.9 percent of the total equity invested. The loans bear interest at 1-Month LIBOR, plus 1.0 percent, payable monthly. The maturity date of each loan is the earlier of ten years or the termination of the PPIF. Each PPIF terminates in eight years from its commencement, if not previously terminated, or extended with two one-year extensions subject to the Department's approval. The loan agreements are subject to certain financial covenants and require cash flows from purchased securities received by the PPIFs to be distributed in accordance with a priority of payments schedule (waterfall) designed to help protect the interests of secured parties. As a condition of its investment, the Department also received a warrant from each of the PPIFs entitling the Department to 2.5 percent of investment proceeds otherwise allocable to the non-Department partners after the PPIFs return 100.0 percent of the non-Department partners' capital contributions. Additionally, the PPIFs pay a management fee to the fund manager from the Department's share of investment proceeds.

The PPIFs may invest, under certain conditions, in commercial mortgage-backed securities (CMBS) and non-agency residential mortgage-backed securities (RMBS) issued prior to January 1, 2009, for a term of three years. The three-year investment period for the remaining PPIFs ends December 2012. The PPIFs are also permitted to invest in certain temporary securities, including bank deposits, U.S. Treasury securities, and certain money market mutual funds. As of September 30, 2012, the PPIFs' portfolios were comprised of approximately 74.0 percent RMBS and 26.0 percent CMBS, compared to 79.0 percent and 21.0 percent, respectively, as of September 30, 2011.

At September 30, 2012 and 2011, the Department had equity investments in PPIFs outstanding of $4.1 billion and $5.5 billion, and loans outstanding of $5.7 billion and $10.4 billion, for an aggregate total of $9.8 billion and $15.9 billion, respectively. As of September 30, 2012 and 2011, the Department had legal commitments to disburse up to $3.1 billion and $4.3 billion, respectively, for additional investments and loans to the remaining PPIFs. During fiscal year 2012, the Department disbursed $245 million as an equity investment and $803 million as loans to PPIFs, as compared to $1.1 billion of equity investments and $2.3 billion as loans in fiscal year 2011. In addition, the Department received $5.7 billion and $1.0 billion in loan principal and interest repayments from the PPIFs in fiscal years 2012 and 2011, respectively. Also during fiscal year 2012, the Department received $3.2 billion in equity distributions, comprised of $1.3 billion of investment income, $223 million of proceeds in excess of cost, and a $1.7 billion reduction of the gross investment outstanding. In fiscal year 2011, the Department received $735 million in equity distributions, comprised of $306 million of investment income, $91 million of proceeds in excess of cost, and a $338 million reduction of the gross investment outstanding.

The Department estimates cash flows to the PPIFs by simulating the performance of the collateral supporting the assets held by the PPIF. Inputs used to simulate the cash flows, which consider market risks, include unemployment forecasts, home price appreciation/depreciation forecasts, the current term structure of interest rates, historical pool performance, and estimates of the net income and value of commercial real estate supporting the CMBS. The simulated cash flows are then run through a financial model that defines distributions of the RMBS/CMBS to determine the estimated cash flows to the PPIF. Once determined, these cash flows are run through the waterfall of the PPIF to determine the expected cash flows to the Department through both the equity investments and loans.

Other Direct Loan and Equity Investment Programs

The Department initiated other programs intended to help unlock the flow of credit to consumers and small businesses. Three programs were established to help accomplish this: the Term Asset-Backed Securities Loan Facility (TALF); the Small Business Administration (SBA) 7(a) Securities Purchase Program, and the Community Development Capital Initiative (CDCI). Each program is discussed in more detail below and included in the "Other Programs" column of the table within this note.

Term Asset-Backed Securities Loan Facility

The TALF was created by the FRB to provide low-cost funding to investors in certain classes of Asset Backed Securities (ABS). The Department agreed to participate in the program by providing liquidity and credit protection to the FRB.

Under the TALF, the FRBNY, as implementer of the TALF program, originated loans on a non-recourse basis to purchasers of certain AAA rated ABS secured by consumer and commercial loans and CMBS. The FRBNY ceased issuing new loans on June 30, 2010. Approximately $1.5 billion and $11.3 billion of loans due to the FRBNY remained outstanding as of September 30, 2012 and 2011, respectively.

As part of the program, the FRBNY created the TALF, LLC, an SPV that agreed to purchase from the FRBNY any collateral it has seized due to borrower default. The TALF, LLC would fund purchases from the accumulation of monthly fees paid by FRBNY as compensation for the agreement. Only if the TALF, LLC had insufficient funds to purchase the collateral did the Department commit to invest up to $20.0 billion in non-recourse subordinated notes issued by the TALF, LLC. This commitment was reduced to $4.3 billion in fiscal year 2010, and further reduced in fiscal year 2012 to $1.4 billion, in consultation with the FRBNY.

The Department disbursed $100 million upon creation of the TALF, LLC, and the remainder can be drawn to purchase collateral in the event the fees are not sufficient to cover purchases. The subordinated notes bear interest at 1-Month LIBOR plus 3.0 percent, and mature ten years from the closing date, subject to extension. As of September 30, 2012 and 2011, no TALF loans were in default and consequently no collateral was purchased by the TALF, LLC.

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

SBA 7(a) Securities Purchase Program

In March 2010, the Department began purchasing securities backed by SBA 7(a) loans (7(a) Securities) as part of the Unlocking Credit for Small Business Initiative. The program was created to provide additional liquidity to the market so that banks are able to make more small business loans. Under this program, the Department had purchased 7(a) securities collateralized with 7(a) loans that are guaranteed by the full faith and credit of the U.S. Government. In May 2011, the Department began selling its securities to investors; sales were completed and the program closed in January 2012. Over the course of the program, the Department had invested a total of $367 million (excluding purchased accrued interest), and received $376 million in sales proceeds and in principal and interest payments. As of September 30, 2012, the Department held no investment in SBA 7(a) securities, and held $128 million of these securities at September 30, 2011. During fiscal year 2012 and 2011, the Department had received $127 million and $247 million, respectively, in sales proceeds, and in principal and interest payments on the securities. The valuation of SBA 7(a) securities was based on the discounted estimated cash-flows of the securities.

Community Development Capital Initiative

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

CDFIs participating in the CPP, subject to certain criteria, were eligible to exchange, through September 30, 2010, their CPP preferred shares (subordinated debt) then held by the Department for CDCI preferred shares (subordinated debt). These exchanges were treated as disbursements from CDCI and repayments to CPP. The Department had invested a total of $570 million ($363 million as a result of exchanges from CPP) in 84 institutions under the CDCI. In fiscal year 2012, the Department received $3 million in repayments. No repayments were received in fiscal year 2011. The Department received $11 million in dividends and interest from its CDCI investments during both fiscal years 2012 and 2011. The Department valued the CDCI preferred stock investments in a manner broadly analogous to the methodology used to value the preferred stock securities within the CPP program.

OTHER CREDIT PROGRAMS

Asset Guarantee Program

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

In January 2009, the Department entered into a guarantee agreement with Citigroup under which the Department, the Federal Deposit Insurance Corporation (FDIC), and the FRBNY (collectively the USG Parties) provided protection against the possibility of large losses on an asset pool of approximately $301.0 billion of loans and securities backed by residential and commercial real estate and other such assets, which remained on Citigroup's balance sheet. The Department's portion of the guarantee was limited to $5.0 billion. As a premium for the guarantee, Citigroup issued $7.0 billion of cumulative perpetual preferred stock (subsequently converted to Trust Preferred Securities with similar terms) with an 8.0 percent stated dividend rate and a warrant for the purchase of Citigroup common stock, of which $4.0 billion of the preferred stock and the warrant were issued to the Department, and $3.0 billion of the preferred stock was issued to the FDIC.

In fiscal year 2010, the USG Parties and Citigroup agreed to terminate the guarantee agreement; accordingly, Citigroup cancelled $1.8 billion of the preferred stock previously issued to the Department. In fiscal year 2011, the Department sold its remaining Citigroup TruPS it held for $2.2 billion, and sold the warrants for $67 million. In connection with the termination of the guarantee agreement, FDIC agreed to transfer to the Department $800 million of TruPS holdings plus dividends, subject to Citigroup's payment of certain debt guaranteed by the FDIC. This TruPS related receivable from the FDIC was valued at $967 million and $739 million at September 30, 2012 and 2011, respectively. The Department expects to receive a cash transfer of dividends and interest, along with the TruPS from FDIC, as scheduled, on December 31, 2012. The Department valued the AGP preferred stock investments in a manner broadly analogous to the methodology used to value the preferred stock securities within the CPP program.

FHA-Refinance Program

In fiscal year 2010, the Department entered into a loss-sharing agreement with the FHA to support a program in which FHA guarantees refinancing of borrowers whose homes are worth less than the remaining amounts owed under their mortgage loans. In fiscal year 2011, the Department established a $50 million account, held by a commercial bank as its agent, from which any required reimbursements for losses will be paid to third-party claimants, including banks or other investors. FHA disbursed $234 million and $73 million of loans during fiscal year 2012 and 2011, respectively. At September 30, 2012 and 2011, 1,774 and 334 loans that FHA had guaranteed with a total value of $307 million and $73 million, respectively, had been refinanced under the program. At September 30, 2012 and 2011, the Department's maximum exposure related to the FHA guarantee totaled $41 million and $6 million, respectively. The Department's guarantee resulted in the Department incurring a $7 million and $1 million liability as of September 30, 2012 and 2011, respectively.

Based on credit reform accounting, the liability was derived as the present value of the future cash outflows for the Department's share of losses incurred on any defaults of the disbursed loans. The budget subsidy rates for the program, entirely for defaults, excluding modifications and reestimates, were set at 4.0 percent and 1.26 percent for loans guaranteed in fiscal years 2012 and 2011, respectively. As of September 30, 2012 and 2011, the Department recorded subsidy cost of $9 million and $1 million, respectively, for projected losses due to defaults. The program recorded a $3 million downward reestimate for the year ended September 30, 2012, due to a reduction in market risks and lower than projected defaults. As of September 30, 2012, no claims were paid under the program.

Subsidy Cost

During fiscal year 2012, a modification occurred in the CPP. During fiscal year 2011, modifications occurred within AIFP (see Ally Financial Inc.) and CPP. See the detailed discussion above for modifications related to each program. Modification cost (income) for the fiscal years ended September 30, 2012 and 2011, totaled $973 million and $1.2 billion, respectively.

Changes in subsidy cost due to reestimates from year to year are mainly due to improved market conditions. Net downward reestimates for the fiscal years ended September 30, 2012 and 2011, totaled $11.9 billion and $11.6 billion, respectively.

During fiscal year 2012, there were significant AIG sales of common stock which impacted the subsidy cost. The AIG Investment Program had a decrease in subsidy cost resulting from a downward reestimate of $9.2 billion. The Department calculated a $9.2 billion downward reestimate relating primarily to sales in fiscal year 2012 of 806 million shares of AIG common stock at prices higher than September 30, 2011, and increase in revaluing the remaining portfolio.

SUMMARY TABLES

The following tables provide the net composition, subsidy cost, modifications and reestimates, a reconciliation of subsidy cost allowances, and subsidy by component for each TARP direct loan, equity investment or other credit programs for the fiscal years ended September 30, 2012 and 2011. There were no budget subsidy rates for fiscal year 2012 and 2011, except for the FHA- Refinance Program as previously disclosed in this note. All of the disbursements were from loans or investments obligated in prior years.

Troubled Asset Relief Program Direct Loans and Equity Investments

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

As of September 30, 2011 (in millions)	CPP	AIG	AIFP	PPIP	Other Programs	2011
Direct Loans and Equity Investment Programs:						
Direct Loans and Equity Investment Outstanding, Gross	$ 17,299	$ 51,087	$ 37,278	$ 15,943	$ 798	$ 122,405
Subsidy Cost Allowance	(4,857)	(20,717)	(19,440)	2,434	279	(42,301)
Direct Loans and Equity Investments Outstanding, Net	$ 12,442	$ 30,370	$ 17,838	$ 18,377	$ 1,077	$ 80,104
New Loans or Investments Disbursed	$ -	$ 20,292	$ -	$ 3,421	$ 126	$ 23,839
Obligations for Loans and Investments Not Yet Disbursed	$ -	$ -	$ -	$ 4,279	$ 4,200	$ 8,479
Reconciliation of Subsidy Cost Allowance:						
Balance, Beginning of Period	$ 1,546	$ 21,405	$ 14,529	$ (676)	$ (59)	$ 36,745
Subsidy Cost for Disbursements and Modifications	(1,010)	20,085	(174)	(15)	1	18,887
Interest and Dividend Revenue	1,283	450	1,280	428	20	3,461
Fee Income	-	165	-	-	-	165
Net Proceeds from Sales and Repurchases of Assets in Excess of (Less than) Cost	4,540	(1,918)	(5,165)	91	190	(2,262)
Net Interest Income (Expense) on Borrowings from BPD and Financing Account Balance	(686)	(938)	(945)	(418)	(29)	(3,016)
Balance, End of Period, Before Reestimates	5,673	39,249	9,525	(590)	123	53,980
Subsidy Reestimates	(816)	(18,532)	9,915	(1,844)	(402)	(11,679)
Balance, End of Period	$ 4,857	$ 20,717	$ 19,440	$ (2,434)	$ (279)	$ 42,301
Reconciliation of Subsidy Cost:						
Subsidy Cost for Disbursements	$ -	$ 20,085	$ -	$ (15)	$ 1	$ 20,071
Subsidy Cost for Modifications	(1,010)	-	(174)	-	-	(1,184)
Subsidy Reestimates	(816)	(18,532)	9,915	(1,844)	(402)	(11,679)
Total Direct Loans and Equity Investment Programs Subsidy Cost (Income)	$ (1,826)	$ 1,553	$ 9,741	$ (1,859)	$ (401)	$ 7,208

Troubled Asset Relief Program Asset Guarantee Program
As of September 30, 2012 and 2011
(In Millions)

		2012		2011
Asset Guarantee Program	**$**	**967**	$	739
Reconciliation of Asset Guarantee Program:				
Balance, Beginning of Period	**$**	**(739)**	$	(3,055)
Dividend Revenue		**-**		15
Net Proceeds from Sale of Assets in Excess of cost		**-**		2,301
Net Interest Expense on Borrowings from BPD		**(21)**		(30)
Balance, End of Period, Before Reestimate		**(760)**		(769)
Subsidy Reestimate		**(207)**		30
Balance, End of Period	**$**	**(967)**	$	(739)

Housing Programs Under TARP

The following housing programs under TARP are designed to provide stability for both the housing market and homeowners. These programs assist homeowners who are experiencing financial hardships to remain in their homes until their financial position improves or they relocate to a more sustainable living situation. These programs fall within three initiatives:

1. Making Home Affordable Program (MHA)
2. HFA Hardest-Hit Fund
3. Federal Housing Administration (FHA)-Refinance Program

The MHA includes various programs that provide an array of incentives to servicers, borrowers, and investors for: *(i)* modifying first liens, *(ii)* extinguishing second liens on first lien loans, *(iii)* helping investors to partially offset losses due to home price declines, *(iv)* offering incentives to encourage mortgage principal reduction for eligible homeowners whose homes are worth significantly less than their outstanding first-lien mortgage balances, *(v)* offering assistance to unemployed homeowners, and *(vi)* assisting eligible borrowers unable to retain their homes by simplifying and streamlining the short sale and deed in lieu of foreclosure processes. All MHA disbursements are made to servicers either for themselves or for the benefit of borrowers and investors, and all payments are contingent on borrowers remaining in good standing. To be considered for MHA programs, borrowers must apply by December 31, 2013.

Implemented in fiscal year 2010, the HFA Hardest-Hit Fund provides targeted aid to families in the states hit hardest by the housing market downturn and unemployment. Approved states meeting the criteria for this program develop and roll out their own programs with timing and types of programs offered targeted to address the specific needs and economic conditions of their state. States have until December 31, 2017 to enter into agreements with borrowers.

As discussed above under "Other Credit Programs," the FHA-Refinance Program is a joint initiative with the HUD which is intended to encourage refinancing of existing underwater (i.e. the borrower owes more than the home is worth) mortgage loans not currently insured by FHA into FHA-insured mortgages. HUD will pay a portion of the amount refinanced to the investor and the Department will pay incentives to encourage the extinguishment of second liens associated with the refinanced mortgages. The Department established a letter of credit that obligated the Department's portion of any claims associated with the FHA-guaranteed mortgages. Homeowners can refinance into FHA-guaranteed mortgages through December 31, 2014, and the Department will honor its share of claims against the letter of credit through 2020.

As of September 30, 2012 and 2011, the Department had committed up to $45.6 billion for these programs. For fiscal year 2012 and 2011, payments made from the Housing Programs under TARP totaled $3.1 billion and $1.9 billion, respectively.

8. INVESTMENTS IN GOVERNMENT SPONSORED ENTERPRISES

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

Leading up to the financial crisis, increasingly difficult conditions in the housing market challenged the soundness and profitability of the GSEs, thereby undermining the entire housing market. This led Congress to pass the Housing and Economic Recovery Act (HERA) (P.L. 110-289). This Act created the new FHFA, with enhanced regulatory authority over the GSEs, and provided the Secretary with certain authorities intended to ensure the financial stability of the GSEs, if necessary. On September 7, 2008, FHFA placed the GSEs under conservatorship, and the Department entered into a Senior Preferred Stock Purchase Agreement (SPSPA) with each GSE. These actions were taken to preserve the GSEs' assets, ensure a sound and solvent financial condition, and mitigate systemic risks that contributed to current market instability. The SPSPAs were amended in August 2012 (the amended SPSPAs) which changed, among other things, the basis by which quarterly dividends are paid by the GSEs to the U.S. Government. The dividend change in the amended SPSPAs is effective commencing with the quarter ending March 31, 2013.

The actions taken by the Department thus far are temporary, as defined by section 1117 of HERA, and are intended to provide financial stability. The purpose of the Department's actions is to maintain the solvency of the GSEs so they can continue to fulfill their vital roles in the home mortgage market while the Administration and Congress determine what structural changes should be made. The FHFA director may terminate the conservatorship if safe and solvent conditions can be established. Draws under the SPSPAs are designed to ensure that the GSEs maintain positive net worth as a result of any net losses from operations, and also meet taxpayer dividend requirements under the SPSPAs. The SPSPAs were structured to ensure any draws result in an increased nominal investment as further discussed below.

Under the SPSPAs, the Department initially received from each GSE: *(i)* 1,000,000 shares of non-voting variable liquidation preference senior preferred stock with a liquidation preference value of $1,000 per share, and *(ii)* a non-transferrable warrant for the purchase, at a nominal cost, of 79.9 percent of common stock on a fully-diluted basis. The warrants expire on September 7, 2028. Through December 31, 2012, the senior preferred stock accrues dividends at 10.0 percent per year, payable quarterly. Under the amended SPSPAs, the quarterly dividend payment will change from a 10.0 percent per annum fixed rate dividend to an amount equivalent to the GSE's positive net worth above a capital reserve amount. The capital reserve amount is initially set at $3.0 billion for calendar year 2013, and declines by $600 million at the beginning of each calendar year thereafter until it reaches zero by calendar year 2018. The GSEs will not pay a quarterly dividend if their positive net worth is not above the required capital reserve threshold; in such cases, the Department may be required to provide funding pursuant to the amended SPSPAs.

Cash dividends of $18.4 billion and $15.6 billion were received during fiscal years ended September 30, 2012 and 2011, respectively. In addition, beginning in fiscal year 2011, the GSEs were scheduled to begin paying the Department a "Periodic Commitment Fee" (PCF) on a quarterly basis, payable in cash or via an increase to the liquidation preference. This fee may be waived by the Department for up to one year at a time if warranted by adverse mortgage market conditions. The Department waived the PCF payments for calendar years 2012 and 2011 given that the imposition of the PCF at that time would not fulfill its intended purpose of generating increased compensation to the American taxpayer. Commencing January 1, 2013, the PCF will no longer be required pursuant to the amended SPSPAs.

The SPSPAs, which have no expiration date, provide for the Department to disburse funds to the GSEs if, at the end of any quarter, the FHFA determines that the liabilities of either GSE exceed its assets. The maximum amount available to each GSE under this agreement was originally $100.0 billion in fiscal year 2008, raised to $200.0 billion in fiscal year 2009, and replaced in fiscal year 2010 with a formulaic cap. This formulaic cap allows for continued draws for a three-year period ending December 2012 at amounts that will automatically adjust upwards quarterly by the cumulative amount of any net deficits realized by either GSE and downward by the GSE's positive net worth, if any, as of December 31, 2012, but not below $200.0 billion, and will become fixed at the end of the three-year period. At the conclusion of this period, the remaining commitment will then be fully available to be drawn per the terms of the agreements (referred to hereafter as the "Adjusted Caps"). Draws against the funding commitment of the SPSPAs do not result in the issuance of additional shares of senior preferred stock; instead, the liquidation preference of the initial 1,000,000 shares is increased by the amount of the draw.

Actual payments to the GSEs for fiscal years ended September 30, 2012 and 2011 were $18.5 billion and $20.8 billion, respectively. Additionally, $9.0 billion and $316.2 billion were accrued as a contingent liability as of September 30, 2012 and 2011, respectively. This accrued contingent liability is based on the projected future draws under the SPSPAs. It is undiscounted and does not take into account any of the offsetting dividends which may be received, as the dividends are owed directly to the General Fund.

ACCOUNTING TREATMENT

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

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

INVESTMENTS IN GSEs

As of September 30, 2012 and 2011, the Department's investments in the GSEs consisted of the following (in millions):

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

GSEs Investments		Gross Investments As of 9/30/11		Cumulative Valuation Loss		9/30/11 Fair Value
Fannie Mae Senior Preferred Stock	$	104,627	$	(26,718)	$	77,909
Freddie Mac Senior Preferred Stock		66,004		(12,380)		53,624
Fannie Mae Warrants Common Stock		3,104		(2,137)		967
Freddie Mac Warrants Common Stock		2,264		(1,721)		543
Total GSEs Investments	$	175,999	$	(42,956)	$	133,043

SENIOR PREFERRED STOCK AND WARRANTS FOR COMMON STOCK

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

The fair value of the senior preferred stock considers the amount of forecasted dividend payments. The fair valuations assume that a hypothetical buyer would acquire the discounted dividend stream as of the transaction date. The significant decline in the fair value of the senior preferred stock at September 30, 2012 compared to 2011 is primarily due to a decrease in expected dividend payments and an increase in the discount rate used in the current year's valuation to reflect more of the variable nature of the future cash flows anticipated as a result of the amended SPSPAs compared to the prior fiscal year.

The fair value of the warrants are impacted by the nominal exercise price and the large number of potential exercise shares, the market trading of the common stock that underlies the warrants as of September 30, the principal market, and the market participants. Other discounting factors are the holding period risk related directly to the amount of time that it will take to sell the exercised shares without depressing the market and the other activity under the SPSPA.

CONTINGENT LIABILITIES TO GSES

As part of the fair valuation exercise, the Department prepared a series of long-range forecasts through 2025 to determine what the implied amount of the total contingent liability to the GSEs under the SPSPAs would be as of September 30. Since future payments under the SPSPAs are deemed to be probable, the Department estimated a contingent liability of $9.0 billion as of September 30, 2012. This estimate reflects the projected equity deficits of the GSEs stemming from credit losses and contractual dividend requirements until December 31, 2012. The estimated contingent liability as of September 30, 2012 included several case scenarios which resulted in total SPSPA estimates ranging from $3.5 billion (based on an "optimistic" case scenario) to $22.4 billion (based on an "extreme" case scenario). The $9.0 billion contingent liability reported as of September 30, 2012 reflects the Department's best estimate. This compares to the $316.2 billion contingent liability reported as of September 30, 2011 which was based on a range of $309.6 billion to $376.1 billion. At September 30, 2012, the maximum remaining potential commitment to the GSEs for the remaining life of the SPSPAs under the Adjusted Caps was estimated at $282.3 billion, which was based upon case scenario estimates ranging from $274.0 billion to $291.5 billion. The recorded contingent liability of $316.2 billion at September 30, 2011 constituted the maximum commitment payable under the Adjusted Caps, minus actual payments made through the end of that fiscal year. Such accruals are adjusted as new information develops or circumstances change.

Based on the annual valuation of the Department's estimated future contingent liability, the Department reduced its estimated liability by $288.7 billion and $22.9 billion at the end of fiscal years 2012 and 2011, respectively, via a reduction in expense. The significant reduction in this estimated liability at September 30, 2012 compared to 2011 is primarily due to a forecasted reduction in the amount of future draws needed by the GSEs which, in part, reflects lower quarterly dividend payments anticipated as a result of the amended provisions of the SPSPAs. The Department reported this expense reduction as a reduction to entity costs within the Economic Program section of the Department's Consolidated Statements of Net Cost.

In determining the contingent liability estimates, the Department relied on the GSEs' public filings and press releases concerning its audited and unaudited financial statements, monthly summaries, quarterly credit supplements, September 2012 forecast for the years 2012 through 2015 (as provided by FHFA), and discussions with the GSEs' forecasting team and FHFA. The forecasted draws under the SPSPAs after December 31, 2015 were based on general guidance provided by the GSE managers as to the key assumptions that were used for subsequent periods. Absent longer-term financial forecasts from the GSEs and FHFA, the forecasts after 2015 generally assume similar operating assumptions on the guarantee business and assume a gradual wind-down of the retained portfolios (and corresponding net interest income) through 2025, as directed under the amended SPSPAs for each GSE to reduce the maximum balance of its retained mortgage portfolio by 15.0 percent per annum beginning December 31, 2013 (a change from the 10.0 percent per annum prior to the amended SPSPAs). The maximum balance of the GSEs' retained mortgage portfolio is initially set at $650 billion as of December 31, 2012, and is required under the amended SPSPAs to be reduced to $250.0 billion by December 31, 2018. The Department also relied upon economic and demographic data from the 2012 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds and the FHFA's House Price Index.

As of September 30, 2012 and 2011, the summarized unaudited aggregated financial condition of the GSEs was as follows (in millions):

		2012		2011
Combined Assets				
Investment Securities	**$**	**338,974**	$	422,741
Mortgage Loans		**4,641,231**		4,715,057
Other		**262,548**		248,415
Total Combined Assets		**5,242,753**		5,386,213
Combined Liabilities				
Long-Term Debt		**4,963,297**		4,974,759
Other		**272,137**		425,236
Total Combined Liabilities		**5,235,434**		5,399,995
Combined Net Equity (Deficit)	**$**	**7,319**	$	(13,782)
For the Nine Months Ended September 30				
Combined Net Interest Income	**$**	**29,097**	$	28,832
Combined Provisions for Loan Losses		**(3,628)**		(28,672)
Combined Net Interest Income After Provision for Loan Losses	**$**	**25,469**	$	160
Combined Regulatory Capital - Minimum Capital Deficit as of September 30	**$**	**(231,949)**	$	(231,531)

Excludes financial guarantees not consolidated on GSE balance sheets.

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

Both GSEs reported significantly lower early delinquencies on additions to their credit books on loans originated after 2008. This favorable early delinquency experience is an improvement compared with the loans originated in 2005 through 2008. Incremental draws under the SPSPAs through December 31, 2012 are projected in order to meet the 10.0 percent per annum dividend payment requirement. Under the amended SPSPAs, both GSEs may require additional draws should they report a net deficit in any quarter commencing with the quarter ending March 31, 2013.

Under the amended SPSPAs, the Department's forecasts indicate that each GSE will not fully utilize the amount of funding available under the Adjusted Cap. The Department's forecasts of future liquidity payments may differ from actual experience. Future actual liquidity payment levels will depend on numerous factors that are difficult to predict, including, but not limited to, changes in government policy with respect to the GSEs, the business cycle, inflation, home prices, unemployment rates, interest rates, changes in housing preferences, home financing alternatives, availability of debt financing, market rates of guarantee fees, outcomes of loan refinancings and modifications, new housing programs, and other applicable factors.

GSEs Non-Entity Cost (Revenue)

For the fiscal years ended September 30, 2012 and 2011, GSEs Non-Entity Cost (Revenue) consisted of the following (in millions):

Summary of GSEs Non-Entity Cost (Revenue)		**2012**		2011
General Fund Revenue from Increase in Liquidity Preference of GSEs Preferred Stock	**$**	**(18,519)**	$	(20,766)
Fair Value (Gain)/Loss on GSEs Warrants/Preferred Stock		**42,220**		(3,061)
GSEs Preferred Stock Dividends		**(18,379)**		(15,588)
Total GSEs Non-Entity Cost (Revenue)	**$**	**5,322**	$	(39,415)

Regulatory Environment

Pursuant to a provision within the Dodd Frank Act, the Secretary conducted a study and developed recommendations regarding the options for ending the conservatorship. In February 2011, the President delivered to Congress a report from the Secretary that provided recommendations regarding the options for ending the conservatorship and plans to wind down the GSEs. To date, Congress has not approved a plan to address the future of the GSEs, thus the GSEs continue to operate under the direction of their conservator, the FHFA, who's stated planned objectives are to build a revitalized infrastructure for the secondary mortgage market and a continued gradual contraction of the GSEs presence in the secondary mortgage market.

In December 2011, Congress passed the Temporary Payroll Tax Cut Continuation Act of 2011 (TPTCCA), which was funded by an increase of ten basis points in the GSEs' guarantee fees beginning April 1, 2012, and is effective through October 1, 2021. The increased fees are to be remitted to the Department and not retained by the GSEs. On September 28, 2012, the GSEs remitted to the Department an amount of $35 million as the first payment of these increased fees covering the period of April 1, 2012 through June 30, 2012. This increase in guarantee fees did not affect the profitability of the GSEs during that time period.

9. INVESTMENTS IN INTERNATIONAL FINANCIAL INSTITUTIONS

Investments in international financial institutions (or Multilateral Development Banks) consist of investments in the World Bank Group (International Bank for Reconstruction and Development, International Finance Corporation, and Multilateral Investment Guarantee Agency), and five regional development banks (the Inter-American, European, Asian, North American, and African institutions), as enumerated in the table below.

As of September 30, 2012 and 2011, investments in international financial institutions consisted of the following (in millions):

		2012		2011
International Bank for Reconstruction and Development	**$**	**2,103**	$	1,985
Inter-American Development Bank (1)		**1,587**		1,508
European Bank for Reconstruction and Development		**636**		636
International Finance Corporation		**569**		569
Asian Development Bank		**671**		565
North American Development Bank		**225**		225
African Development Bank		**207**		174
Multilateral Investment Guarantee Agency		**45**		45
Total	**$**	**6,043**	$	5,707

Refer to Note 28 for a description of the additional commitments related to these institutions.
(1) Includes Inter-American Investment Corporation

10. OTHER INVESTMENTS AND RELATED INTEREST

Other investments and related interest include foreign currency holdings that are typically invested in interest-bearing securities issued or held through foreign governments or monetary authorities (See Note 5). ESF holds most of the Department's foreign currency investments. Other foreign currency-denominated assets and investment securities are considered available-for-sale securities and recorded at fair value. These holdings are normally invested in interest-bearing securities issued or held through foreign governments or monetary authorities.

As of September 30, 2012 and 2011, other investments and related interest consisted of the following (in millions):

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

Type of Investment		Cost/ Acquisition Value		Unamortized (Premium)/ Discount		Interest Receivable		9/30/11 Net Investment		Unrealized Gain/(Loss)		9/30/11 Fair Value
Foreign Investments:												
Euro Bonds & Notes	$	4,498	$	85	$	98	$	4,681	$	149	$	4,830
Japanese Government Bonds		8,037		28		7		8,072		20		8,092
Other FCDAs		2,851		-		-		2,851		4		2,855
Other Investments		30		(2)		-		28		(7)		21
Total Non-Federal	$	15,416	$	111	$	105	$	15,632	$	166	$	15,798

11. Other Credit Program Receivables, Net

The Department administers a number of programs, in addition to the TARP programs, designed to stabilize the nation's financial system and restore the flow of credit to consumers, businesses, and homeowners. For fiscal years ended September 30, 2012 and 2011, other credit program receivables, net consisted of the following (in millions):

		2012		2011
Government Sponsored Enterprise Programs:				
GSEs Mortgage-Backed Securities Purchase Program	**$**	**-**	$	72,417
State and Local Housing Finance Agency Program		**12,556**		14,328
Small Business Lending Fund Program		**3,930**		4,108
International Monetary Fund Programs:				
Reserve Position in the IMF Quota Program (FCRA portion)		**1,858**		1,931
New Arrangements to Borrow Program (FCRA portion)		**1,511**		-
Community Development Financial Institutions Direct Loans Program		**33**		36
Total	**$**	**19,888**	$	92,820

GSEs Mortgage-Backed Securities Purchase Program

HERA authorized the Department to purchase GSE MBS consisting of mortgage pass-through securities issued by Fannie Mae and Freddie Mac. The Department, using private sector asset managers, purchased MBS on the open market. By purchasing these credit-guaranteed securities, the Department sought to broaden access to mortgage funding for current and prospective homeowners and to promote stability in the mortgage market. The authority granted by Congress to purchase MBS expired on December 31, 2009, at which point the purchase of new securities ended.

The Department originally planned to hold the MBS securities to maturity. However, in fiscal year 2011, the Department decided its goals had been achieved and began an orderly sale of its MBS portfolio. Sales were completed during fiscal year 2012.

As of September 30, 2011, the $72.4 billion MBS net credit program receivable included a negative subsidy allowance of $1.8 billion. The subsidy allowance was negative in that the Department expected to generate earnings in excess of costs on its portfolio. Because the Department originally planned to hold all MBS securities to maturity, the sale of the GSE MBS portfolio was not considered in the formulation estimate for the GSE MBS program. Accordingly, the Department recorded a modification in fiscal year 2011, resulting in an upward reestimate or increase in the cost of the program by $9.7 billion. Subsequently, at September 30, 2011, the Department performed a financial statement reestimate of the program's cost that resulted in a downward reestimate, or a decrease in the cost of the program, by $7.9 billion. The decrease in program costs was the result of higher than projected sales proceeds when compared to projected sales proceeds in the modification. The effects of the modification and financial statement reestimate, when combined with other reconciling items, resulted in the $1.8 billion negative subsidy allowance at September 30, 2011 (see the fiscal year 2011 table below). At September 30, 2012, the Department performed a financial statement reestimate of the program's cost that identified excess sales proceeds of $705 million for fiscal year 2012. A closing reestimate will be performed in early fiscal year 2013.

State and Local Housing Finance Agency (HFA) Initiative

Under HERA, the Department, together with the Federal Housing Finance Agency (FHFA), Fannie Mae, and Freddie Mac, created an initiative in October 2009 to provide support to HFAs. This initiative was designed to support low mortgage rates and expand resources for low and middle income borrowers to purchase or rent homes, making them more affordable over the long term. The HFA initiative is comprised of two separate programs: *(i)* the New Issue Bond Program (NIBP) and *(ii)* the Temporary Credit and Liquidity Program (TCLP), with modified conversion authority expiration dates of December 31, 2012 and December 31, 2015, respectively. As of September 30, 2012 and 2011, the

HFA net credit program receivable of $12.6 billion and $14.3 billion, respectively, included a positive subsidy allowance of $1.1 billion and $815 million, respectively, which reflects the Department's projection that the HFA program will result in a net cost to the Department after accounting for repayments, interest, and fees.

Under the terms of the NIBP, the Department purchased securities of Fannie Mae and Freddie Mac backed by new mortgage revenue bonds issued by HFAs. As of September 30, 2012 and 2011, the NIBP gross credit program receivable was $13.7 billion and $15.1 billion, respectively. The Department performed a financial statement reestimate of the NIBP program's cost as of September 30, 2012. This reestimate increased the cost of the program by $588 million. The upward reestimate in fiscal year 2012 was primarily driven by lower projected prepayment rates and lower than expected market interest rates which reduced coupon rates for the HFA bonds converted from escrow in fiscal year 2012. The drop in prepayment rates increases the cost of the program since the HFA bonds carry a lower weighted average coupon than the funding cost of the program. The reestimate performed at September 30, 2011 increased the cost of the program by $9 million. This upward reestimate was driven by lower market interest rates used to calculate the coupon rates on the expected release of escrowed NIBP funds between September 30, 2011 and December 31, 2011.

Under the terms of the TCLP, the Department entered into participation interests with Fannie Mae and Freddie Mac, supporting credit and liquidity facilities that the GSEs are providing to eight states as part of the program. Fannie Mae and Freddie Mac provided replacement credit and liquidity facilities to HFAs to help reduce the costs of maintaining existing financing and relieve financial strains on the HFAs. The Department agreed to support the GSE replacement credit and liquidity facilities by purchasing GSE securities backed by HFA bonds tendered to the GSEs. As of September 30, 2012 and 2011, the liquidity facilities covered $3.9 billion and $6.6 billion, respectively, of single-family and multi-family variable-rate demand obligations (VRDOs). As of September 30, 2012 and 2011, none of these bonds had been tendered to the GSEs and, accordingly, the Department had not disbursed any funds. As such, the Department did not perform September 30, 2012 or 2011 subsidy reestimates for TCLP.

Small Business Lending Fund

On September 27, 2010, the *Small Business Jobs Act of 2010* (P.L. 111-240) was enacted and, in part, created the SBLF program. Pursuant to the Act, the Department provided capital to qualified community banks to encourage lending to small businesses. As an incentive to participating banks to increase lending to small businesses, the dividend rate a bank pays to the Department for SBLF funding will be reduced as the bank's small business lending increases. The initial dividend rate of 5.0 percent may be reduced to as low as 1.0 percent. If lending does not increase by the end of the first two years, the rate will increase to 7.0 percent. The program provides an incentive for banks to repay loans within 4 ½ years. At that time, the rate will increase to 9.0 percent for all banks remaining in the program. The Department treats these purchases of capital as direct loans in accordance with the requirements of FCRA. The Department's authority to provide new capital to SBLF participants expired on September 27, 2011, and accordingly, there were no new capital disbursements in fiscal year 2012.

As of September 30, 2012 and 2011, SBLF net credit program receivable was $3.9 billion and $4.1 billion, respectively. These amounts include a positive subsidy allowance of $50 million at September 30, 2012, indicating an increase in program costs, and a negative subsidy allowance of $80 million at September 30, 2011, indicating expected earnings in excess of costs.

The Department performed a financial statement reestimate of the program's cost as of September 30, 2012 and 2011. These reestimates resulted in an upward reestimate, or an increase in the cost of the program, of $105 million as of September 30, 2012, and resulted in a downward reestimate, or a decrease in the cost of the program, of $372 million as of September 30, 2011. Both the 2012 and 2011 reestimates were driven by changes in performance assumptions, actual performance to-date, and actual program funding costs. The 2012 performance assumptions anticipate an increased cost due to lower dividend rates, both actual and projected, paid by participating institutions relative to the dividend rates projected as of September 30, 2011. These lower dividend rates are the result of continuing success by participating banks in increasing small business lending.

INTERNATIONAL MONETARY FUND

In 2009, Congress passed the *Supplemental Appropriations Act of 2009* which authorized an increase in the U.S. quota in the IMF, as well as an increase in U.S. participation in the New Arrangements to Borrow (NAB), one of the IMF's supplemental borrowing arrangements (Note 12). For the first time, Congress subjected both program increases to FCRA. Under FCRA, both program increases are treated as direct loans to the IMF. For U.S. budget and accounting purposes, there are effectively two portions of the IMF quota and NAB programs. The IMF quota program comprises a FCRA portion of $7.7 billion and a non-FCRA portion of $57.3 billion. The IMF NAB program comprises a FCRA portion of $96.3 billion and a non-FCRA portion of $10.2 billion. The U.S. commitments to the IMF are denominated in SDRs and, thus, the dollar amounts of these commitments fluctuate with the SDR valuation rate. These designations only affect the manner in which the Department accounts for the use and repayment of these funds. The following is a discussion of the FCRA portions of both the U.S. quota and NAB programs.

United States Quota

On March 25, 2011, the Department disbursed $2.0 billion (SDR 1.2 billion) to increase the reserve asset portion of the U.S. quota. The undisbursed FCRA portion is reported as a letter of credit (Note 12). At September 30, 2012 and 2011, the IMF program had a net credit program receivable of $1.9 billion, which included a positive subsidy allowance of $137 million and $64 million, respectively, which reflects the Department's projection that the program will result in a net cost to the Department after accounting for repayments, interest, and fees. The Department performed a financial statement reestimate of the program's cost as of September 30, 2012 and 2011. The reestimate resulted in an increase in program costs (an upward reestimate) of $67 million and $15 million for fiscal years 2012 and 2011, respectively, primarily due to a fluctuation in the valuation of the SDR rate since the calculation of the fiscal year 2011 reestimate.

New Arrangements To Borrow

On April 12, 2012, the Department made its initial FCRA disbursement to the NAB of $629 million. As of September 30, 2012, disbursements for fiscal year 2012 totaled $1.5 billion. The program had a negative subsidy allowance of $21 million as of September 30, 2012.

The Department performed a financial statement reestimate of the program's cost as of September 30, 2012. This reestimate resulted in a decrease in the cost of the program (a downward reestimate) of $25 million primarily due to a fluctuation in the valuation of the SDR rate since the timing of the disbursements in April and August 2012.

SUMMARY TABLES

The following tables provide the net composition of the Department's portfolio, subsidy cost, modifications and reestimates, a reconciliation of subsidy cost allowances, budget subsidy rates, and the components of the subsidy for each credit program for the fiscal years ended September 30, 2012 and 2011.

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

2011						
(in millions)	GSE MBS	HFA	SBLF	IMF[2]	Other	TOTAL
Credit Program Receivables, Net:						
Credit Program Receivables, Gross	$ 70,586	$ 15,143	$ 4,028	$ 1,995	$ 53	$ 91,805
Subsidy Cost Allowance	1,831	(815)	80	(64)	(17)	1,015
Credit Program Receivables, Net	$ 72,417	$ 14,328	$ 4,108	$ 1,931	$ 36	$ 92,820
New Credit Program Loans Disbursed	$ -	$ -	$ 4,028	$ 1,995	$ -	$ 6,023
Obligations for Loans Not Yet Disbursed [1]	$ -	$ -	$ -	$ 6,026	$ -	$ 6,026

(1) *Excludes $97.5 billion of obligated but undisbursed IMF-NAB loans which are accounted for pursuant to FCRA. The obligation is based on the SDR exchange rate as of September 30, 2011 and has a 0.34 percent subsidy rate.*
(2) *All credit program receivable and loan disbursement balances under this program relate to the IMF Quota. The balance of obligations for loans not yet disbursed relate to the IMF-NAB.*

	GSE MBS	HFA	SBLF	IMF	Other	TOTAL
Budget Subsidy Rate, Excluding Modifications and Reestimates:						
Interest Differential	-	-	(26.54%)	1.69%	-	
Defaults	-	-	19.88%	0.02%	-	
Other	-	-	13.90%	0.63%	-	
Total Budget Subsidy Rate	-	-	7.24%	2.34%	-	
Subsidy Cost by Component:						
Interest Differential	$ -	$ -	$ (1,069)	$ 34	$ -	$ (1,035)
Defaults	-	-	801	-	-	801
Other	-	-	560	13	-	573
Total Subsidy Cost, Excluding Modifications and Reestimates	$ -	$ -	$ 292	$ 47	$ -	$ 339
Reconciliation of Subsidy Cost Allowance:						
Balance, Beginning	$ (7,894)	$ 1,186	$ -	$ -	$ 15	$ (6,693)
Subsidy Cost for Disbursements	-	-	292	47	-	339
Subsidy Cost for Modifications	9,738	-	-	-	-	9,738
Fees Received	-	30	-	-	-	30
Subsidy Allowance Amortized	2,885	(410)	-	2	-	2,477
Other	1,364	-	-	-	-	1,364
Balance, Ending, Before Reestimates	6,093	806	292	49	15	7,255
Subsidy Reestimates	(7,924)	9	(372)	15	2	(8,270)
Balance, Ending	$ (1,831)	$ 815	$ (80)	$ 64	$ 17	$ (1,015)
Reestimates:						
Interest Rate Reestimate	$ -	$ -	$ (58)	$ -	$ -	$ (58)
Technical/Default Reestimate	(7,924)	9	(314)	15	2	(8,212)
Total Reestimates - Increase (Decrease) in Subsidy Cost	$ (7,924)	$ 9	$ (372)	$ 15	$ 2	$ (8,270)
Reconciliation of Subsidy Costs:						
Subsidy Cost for Disbursements	$ -	$ -	$ 292	$ 47	$ -	$ 339
Subsidy Cost for Modifications	9,738	-	-	-	-	9,738
Subsidy Reestimates	(7,924)	9	(372)	15	2	(8,270)
Total Credit Program Receivables Subsidy Costs	$ 1,814	$ 9	$ (80)	$ 62	$ 2	$ 1,807
Administrative Expense	$ 21	$ -	$ -	$ -	$ -	$ 21

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

The United States participates in the IMF through a quota subscription and certain borrowing arrangements that supplement IMF resources. The U.S. Congress enacted the *Supplemental Appropriations Act of 2009* (P.L. 111-32) which provided for an increase of approximately SDR 5.0 billion (approximately $8.0 billion) in the U.S. quota in the IMF effective in March 2011. P.L. 111-32 also provided for an increase in the United States' participation in the NAB up to the dollar equivalent of SDR 75 billion, activated in April 2011. Unlike all prior U.S. funding for the IMF, P.L. 111-32 subjects the increases in both the U.S. quota and the NAB to the requirements of FCRA. The existing portions of the U.S. quota and NAB funding, referred to as "non-FCRA funds," are accounted for in the same manner as they previously had been, and do not result in net budgetary outlays. The new portions of this funding provided under P.L. 111-32 are accounted for in accordance with credit reform accounting guidelines (Note 11). For the FCRA portions of the U.S. quota and NAB, subsidy costs of the programs are treated as net budgetary outlays and a credit program receivable is established for the amount disbursed. The net budgetary outlay, under FCRA, constitutes the shortfall or excess between program disbursements and the net present value of expected future repayments.

Reserve Position in the International Monetary Fund

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

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

As of September 30, 2012 and 2011, the U.S. quota in the IMF was SDR 42.1 billion. The U.S. dollar value of the U.S. quota consisted of the following (in millions):

	Non-FCRA	**FCRA(3)**	**Total 2012**	Non-FCRA	FCRA(3)	Total 2011
Letter of Credit(1)	**$ 35,718**	**$ 5,747**	**$ 41,465**	$ 37,331	$ 5,792	$ 43,123
Reserve Position(2)	**21,573**	**1,923**	**23,496**	20,682	1,974	22,656
Total U.S. Quota in the IMF	**$ 57,291**	**$ 7,670**	**$ 64,961**	$ 58,013	$ 7,766	$ 65,779

(1) This amount is included as part of the Fund Balance as reported on the Consolidated Balance Sheets and "Appropriated Funds" as disclosed in Note 2. Amount also includes approximately 0.25 percent of the U.S. quota that is held in cash in an IMF account at the FRBNY.
(2) The amounts shown in the non-FCRA columns are included in the Reserve Position in the IMF on the Consolidated Balance Sheets, while the amount in the FCRA columns represents SDR 1.2 billion at the current exchange rate.
(3) Represents the FCRA portion of the U.S. quota in the IMF which is included in Other Credit Program Receivables, Net on the Consolidated Balance Sheets.

The U.S. quota is denominated in SDRs. Consequently, fluctuations in the value of the U.S. dollar with respect to the SDR result in valuation changes in dollar terms for the U.S. quota. The Department periodically adjusts this balance to maintain the SDR value of the U.S. quota. As of September 30, 2012 and 2011, the net downward adjustment amounted to $818 million and $548 million, respectively, to reflect the appreciation of the U.S. dollar against the SDR.

LOANS AND INTEREST RECEIVABLE

In addition to quota subscriptions, the IMF maintains borrowing arrangements to supplement its resources in order to forestall or cope with an impairment of the international monetary system when IMF liquidity is low. The United States currently participates in two such arrangements – the NAB and the General Arrangements to Borrow (GAB). In accordance with P.L. 111-32, which provided for an increase in the United States' participation in the NAB of up to the dollar equivalent of SDR 75 billion, the United States increased its NAB participation from SDR 6.6 billion to SDR 69.1 billion, which was equivalent to $106.5 billion and $107.9 billion as of September 30, 2012 and 2011, respectively. As of September 30, 2012, under the U.S. NAB arrangement with the IMF, there was $10.2 billion (reflecting the entire U.S. non-FCRA commitment to the NAB) and $1.5 billion of FCRA (Note 11) U.S. loans outstanding under the NAB arrangement, respectively. As of September 30, 2011, there was $6.1 billion of non-FCRA U.S. loans outstanding under this arrangement. These amounts are liquid and interest bearing claims on the IMF, and the non-FCRA portions are reported as Loans and Interest Receivable on the Consolidated Balance Sheets. As of September 30, 2012, the IMF had not utilized the GAB.

13. TAXES, INTEREST, AND OTHER RECEIVABLES, NET

As of September 30, 2012 and 2011, Taxes, Interest and Other Receivables, Net consisted of the following (in millions):

	2012	2011
Non-Entity		
Federal Taxes Receivable, Gross	**$ 152,060**	$ 147,025
Less: Allowance on Taxes Receivable	**(113,046)**	(112,017)
Interest Receivable on FRB Deposits of Earnings	**2,282**	1,599
Other Receivables	**148**	23
Less: Allowance on Other Receivables	**(17)**	(10)
Total Non-Entity (Note 15)	**41,427**	36,620
Entity		
Miscellaneous Entity Receivables and Related Interest	**36**	70
Total Taxes, Interest and Other Receivables, Net	**$ 41,463**	$ 36,690

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

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

14. PROPERTY, PLANT, AND EQUIPMENT, NET

As of September 30, 2012 and 2011, property, plant and equipment consisted of the following (in millions):

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

	Depreciation Method	Service Life	Cost	Accumulated Depreciation	2011 Book Net Value
Buildings, structures, and facilities	S/L	3-50 years	$ 703	$ (360)	$ 343
Furniture, fixtures, and equipment	S/L	2-20 years	3,097	(2,259)	838
Construction in progress	N/A	N/A	153	-	153
Land and land improvements	N/A	N/A	15	-	15
Internal-use software in use	S/L	2-15 years	1,529	(1,151)	378
Internal-use software in development	N/A	N/A	320	-	320
Assets under capital lease	S/L	2-25 years	7	(1)	6
Leasehold improvements	S/L	2-25 years	510	(297)	213
Total			$ 6,334	$ (4,068)	$ 2,266

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

HERITAGE ASSETS

The Department has a total of fifteen multi-use heritage assets for fiscal years 2012 and 2011. The Treasury Complex (Main Treasury Building and Annex), declared a national historical landmark in 1972, is treated as a multi-use heritage asset and is expected to be preserved indefinitely. The buildings that house the Mint in Denver, San Francisco, Fort Knox, and West Point are also considered multi-use heritage assets and included on the National Register of Historic Places. Additionally, the Mint maintains heritage assets consisting of four coin collections and six historical artifacts. The condition of the multi-use heritage assets is disclosed within the Required Supplemental Information (Unaudited) section of this report.

15. NON-ENTITY VS. ENTITY ASSETS

Non-entity assets are those that are held by the Department but are not available for use by the Department. For example, the non-entity Fund Balance represents unused balances of appropriations received by various Treasury entities to conduct custodial operations such as the payment of interest on the federal debt and refunds of taxes and fees (Note 2). Non-entity intra-governmental loans and interest receivable represents loans managed by the Department on behalf of the General Fund. These loans are provided to federal agencies, and the Department is responsible for collecting these loans and transferring the proceeds to the General Fund (Note 3). The Department also manages the non-entity advances to the DOL's Unemployment Trust Fund that are issued from the General Fund to states for unemployment benefits. The Department transfers repayment of these advances to the General Fund (Note 4).

Non-entity cash, foreign currency, and other monetary assets include the operating cash of the U.S. Government, managed by the Department. It also includes foreign currency maintained by various U.S. and military disbursing offices, as well as seized monetary instruments (Note 5). Non-entity investments in GSEs include the GSEs' senior preferred stock and warrants held by the Department on behalf of the General Fund. As the stock and warrants are liquidated, all proceeds are returned to the General Fund (Note 8). Non-entity investments in AIG include AIG common stock held by the Department on behalf of the General Fund. Proceeds from the sale of the AIG common stock are returned to the General Fund (Note 26).

As of September 30, 2012 and 2011, the Department's total assets, segregated between non-entity and entity, are shown below (in millions):

	2012		
	Non-Entity	**Entity**	**Total**
Intra-governmental Assets:			
Fund balance [(a)]	**$ 1,879**	**$ 342,467**	**$ 344,346**
Loans and Interest Receivable (Note 3)	**845,976**	**68,328**	**914,304**
Advances to the Unemployment Trust Fund (Note 4)	**32,932**	**-**	**32,932**
Due from the General Fund (Note 4)	**16,202,179**	**-**	**16,202,179**
Other Intra-governmental Assets	**456**	**1,039**	**1,495**
Total Intra-governmental Assets	**17,083,422**	**411,834**	**17,495,256**
Cash, Foreign Currency, and Other Monetary Assets (Note 5)[(b)]	**79,575**	**65,976**	**145,551**
Gold and Silver Reserves (Note 6)[(c)]	**11,062**	**-**	**11,062**
Investments in GSEs (Note 8)	**109,342**	**-**	**109,342**
Taxes, Interest and Other Receivables, Net (Note 13)	**41,427**	**36**	**41,463**
Non-TARP Investments in American International Group, Inc. (Note 26)	**2,611**	**-**	**2,611**
Other Assets [(d)]	**95**	**116,482**	**116,577**
Total Assets	**$ 17,327,534**	**$ 594,328**	**$ 17,921,862**

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

	2011		
	Non-Entity	Entity	Total
Intra-governmental Assets:			
Fund Balance [(e)]	$ 1,465	$ 380,319	$ 381,784
Loans and Interest Receivable (Note 3)	671,411	57,239	728,650
Advances to the Unemployment Trust Fund (Note 4)	42,773	-	42,773
Due from the General Fund (Note 4)	14,902,717	-	14,902,717
Other Intra-governmental Assets	388	760	1,148
Total Intra-governmental Assets	15,618,754	438,318	16,057,072
Cash, Foreign Currency, and Other Monetary Assets (Note 5)[(f)]	50,216	66,905	117,121
Gold and Silver Reserves (Note 6)[(g)]	11,062	-	11,062
Investments in GSEs (Note 8)	133,043	-	133,043
Taxes, Interest and Other Receivables, Net (Note 13)	36,620	70	36,690
Non-TARP Investments in American International Group, Inc. (Note 26)	10,862	-	10,862
Other Assets [(h)]	102	224,274	224,376
Total Assets	$ 15,860,659	$ 729,567	$ 16,590,226

[(e)] $358 million of the non-entity balance represents assets held on behalf of the General Fund (Note 4).
[(f)] $49.9 billion of the non-entity balance represents assets held on behalf of the General Fund (Note 4).
[(g)] $25 million of the non-entity balance represents assets held on behalf of the General Fund (Note 4).
[(h)] Other Assets (Entity) include TARP and non-TARP credit program receivables, net, totaling $80.1 billion and $92.8 billion, respectively, a reserve position in the IMF of $20.7 billion, and other various assets on the Consolidated Balance Sheets not separately presented in this table.

16. FEDERAL DEBT AND INTEREST PAYABLE

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

The federal debt as of September 30, 2012 and 2011 was as follows (in millions):

Intra-governmental	**2012**	2011
Beginning Balance	**$ 4,625,038**	$ 4,501,028
New Borrowings/Repayments	**134,494**	124,010
Subtotal at Par Value	**4,759,532**	4,625,038
Premium/(Discount)	**55,964**	47,386
Debt Principal Not Covered by Budgetary Resources (Note 19)	**4,815,496**	4,672,424
Interest Payable Covered by Budgetary Resources	**45,509**	47,741
Total	**$ 4,861,005**	$ 4,720,165

Held by the Public	**2012**	2011
Beginning Balance	**$ 10,127,031**	$ 9,022,808
New Borrowings/Repayments	**1,142,555**	1,104,223
Subtotal at Par Value	**11,269,586**	10,127,031
Premium/(Discount)	**(19,225)**	(29,538)
Debt Principal Not Covered by Budgetary Resources (Note 19)	**11,250,361**	10,097,493
Interest Payable Covered by Budgetary Resources	**57,222**	51,470
Total	**$ 11,307,583**	$ 10,148,963

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

FEDERAL DEBT HELD BY OTHER FEDERAL AGENCIES

Certain federal agencies are allowed to invest excess funds in debt securities issued by the Department on behalf of the U.S. Government. The terms and the conditions of debt securities issued are designed to meet the cash needs of the U.S. Government. The vast majority of debt securities are non-marketable securities issued at par value, but others are issued at market prices and interest rates that reflect market terms. The average intra-governmental interest rate for debt held by the federal entities, excluding TIPS, for fiscal years 2012 and 2011 was 3.7 percent and 4.1 percent, respectively. The average intra-governmental interest rate on TIPS for fiscal years 2012 and 2011 was 1.5 percent and 1.8 percent, respectively. The average interest rate represents the original issue weighted effective yield on securities outstanding at the end of the fiscal year.

The federal debt also includes intra-governmental marketable debt securities that certain agencies are permitted to buy and sell on the open market. The debt held by federal agencies at par value (not including premium/discount or interest payable) as of September 30, 2012 and 2011 was as follows (in millions):

	2012	2011
Social Security Administration	**$ 2,719,042**	$ 2,654,497
Office of Personnel Management	**927,302**	897,951
Department of Defense Agencies	**562,657**	497,391
Department of Health and Human Services	**302,932**	321,615
All Other Federal Agencies - Consolidated	**247,599**	253,584
Total Federal Debt Held by Other Federal Agencies	**$ 4,759,532**	$ 4,625,038

FEDERAL DEBT HELD BY THE PUBLIC

Federal debt held by the public at par value (not including premium/discount or interest payable) as of September 30, 2012 and 2011 consisted of the following (in millions):

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

(at par value)	Term	Average Interest Rates		2011
Marketable:				
Treasury Bills	1 Year or Less	0.1%	$	1,475,557
Treasury Notes	Over 1 Year - 10 Years	2.3%		6,406,983
Treasury Bonds	Over 10 Years	5.8%		1,016,407
Treasury Inflation-Protected Security (TIPS)	5 Years or More	1.9%		705,352
Total Marketable				9,604,299
Non-Marketable	On Demand to Over 10 Years	2.8%		522,732
Total Federal Debt Held by the Public			$	10,127,031

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

The Department issues marketable notes and bonds as long-term securities that pay semi-annual interest based on the securities' stated interest rates. These securities are issued at either par value or at an amount that reflects a discount or a premium. The average interest rate on marketable notes and bonds represents the stated interest rate adjusted by any discount or premium on securities outstanding at year-end. Treasury notes are issued with a term of over one year to ten years, and Treasury bonds are issued with a term of more than ten years. The Department also issues TIPS that have interest and redemption payments tied to the Consumer Price Index for all Urban Consumers, a widely used measurement of inflation. TIPS are issued with a term of five years or more. At maturity, TIPS are redeemed at the inflation-adjusted principal amount, or the original par value, whichever is greater. TIPS pay a semi-annual fixed rate of interest applied to the inflation-adjusted principal. The average interest rate on TIPS represents the stated interest rate on principal plus inflation, adjusted by any discount or premium on securities outstanding as of the end of the fiscal year. The inflation-adjusted TIPS principal balance of federal debt held by the public included inflation of $77.9 billion and $76.1 billion as of September 30, 2012 and 2011, respectively.

During fiscal year 2012, the Department issued bills, notes, bonds, and TIPS to meet the borrowing needs of the U.S. Government. Treasury bills outstanding increased by $ 137.5 billion; whereas, Treasury notes, bonds, and TIPS outstanding increased by $708.0 billion, $178.3 billion, and $102.1 billion, respectively, in fiscal year 2012.

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

Federal Debt Held by the Public includes federal debt held outside of the U.S. Government by individuals, corporations, FRBs, state and local governments, foreign governments, and central banks. As of September 30, 2012 and 2011, the FRBs had total holdings of $1.6 trillion and $1.7 trillion, respectively, which included a net of $1.5 billion and $759 million in Treasury securities held by the FRBs as collateral for securities lending activities, respectively. These securities are held in the FRB System Open Market Account (SOMA) for the purpose of conducting monetary policy.

From May 16, 2011 to August 2, 2011, the Department was forced to depart from its normal debt management procedures and invoke legal authorities to avoid exceeding the statutory debt limit. Congress raised the statutory debt limit on August 2, 2011. During the period of delay in raising the debt limit, actions taken by Treasury included: *(i)* suspending investment of receipts and reinvestments of maturities (including interest earnings) of the Government Securities Investment Fund (G-Fund) of the Federal Employees' Retirement System, the ESF, the Civil Service Retirement and Disability Fund (Civil Service Fund), and the Postal Service Retiree Health Benefit Fund (Postal Benefits Fund); *(ii)* redeeming a Civil Service fund security early to make benefit payments; and *(iii)* suspending the sales of State and Local Government Series securities.

Subsequent to the August 2, 2011 increase to the statutory debt limit, the Department took steps to restore foregone principal and interest to the four funds. Principal for the four funds of nearly $240 billion was restored on August 2, 2011. During fiscal years 2012 and 2011, the Department paid and/or accrued foregone interest owed to the funds totaling $59 million and $875 million, respectively, as reported on the Department's Consolidated Statements of Net Cost.

17. OTHER DEBT AND INTEREST PAYABLE

The Department, through FFB, has outstanding borrowings and related accrued interest with the Civil Service Retirement and Disability Fund which is administered by the OPM. At September 30, 2012 and 2011, FFB had borrowings of $7.2 billion and $8.5 billion, inclusive of $83 million and $98 million of accrued interest payable, respectively. During fiscal years 2012 and 2011, the Department paid $1.3 billion and $1.8 billion in principal, respectively. The outstanding borrowings at September 30, 2012 and 2011 had a stated interest rate of 4.63 percent and an effective interest rate of 4.63 percent. Maturity dates ranged from June 30, 2013 to June 30, 2019 for outstanding borrowings at September 30, 2012, and from June 30, 2012 to June 30, 2019 for outstanding borrowings at September 30, 2011.

18. D.C. PENSIONS AND JUDICIAL RETIREMENT ACTUARIAL LIABILITY

Pursuant to Title XI of the *Balanced Budget Act of 1997*, as amended (the Act), on October 1, 1997, the Department became responsible for certain District of Columbia (D.C.) retirement plans. The Act was intended to relieve the D.C. government of the burden of unfunded pension liabilities transferred to the District by the U.S. Government in 1979. To fulfill its responsibility, the Department manages two funds – the D.C. Teachers', Police Officers', and Firefighters' Federal Pension Fund (the D.C. Federal Pension Fund) and the District of Columbia Judicial Retirement and Survivors' Annuity Fund (the Judicial Retirement Fund). The Department is required to make annual amortized payments from the General Fund to the D.C. Federal Pension Fund and the Judicial Retirement Fund. The D.C. Federal Pension Fund benefit payments are related to creditable service performed on or before June 30, 1997, while the Judicial Retirement Fund benefit payments are related to all creditable service. The actuarial cost method used to determine costs for the retirement plans is the Aggregate Entry Age Normal Actuarial Cost Method. The actuarial liability is based upon long-term economic assumptions. The pension benefit costs incurred by the plans are included on the Consolidated Statements of Net Cost.

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

A reconciliation of the pension actuarial liability as of September 30, 2012 and 2011 is as follows (in millions):

	2012	2011
Beginning Liability Balance	**$ 9,671**	$ 9,743
Pension Expense:		
Normal cost	**4**	5
Interest on Pension Liability During the Year	**215**	266
Actuarial (Gains) Losses During the Year:		
From Experience	**23**	(123)
From Discount Rate Assumption Change	**532**	472
From Other Assumption Changes	**158**	(154)
Total Pension Expense	**932**	466
Less Amounts Paid	**(544)**	(538)
Ending Liability Balance	**$ 10,059**	$ 9,671

Additional Information ($ in millions):

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

		D.C. Federal Pension Fund		Judicial Retirement Fund		2011 Total
Pensions and Other Actuarial Liability	$	9,481	$	190	$	9,671
Unobligated Budgetary Resources		(3,591)		(131)		(3,722)
Unfunded Liability	$	5,890	$	59	$	5,949
Amount Received from the General Fund	$	492	$	9	$	501
Annual Rate of Investment Return Assumption		2.28% - 4.97%		2.28% - 4.97%		
Future Annual Rate of Inflation and Cost-of-Living Adjustment		2.39%		2.43%		
Future Annual Rate of Salary Increases:						
Police Officers & Firefighters		4.26%		N/A		
Teachers		4.26%		N/A		
Judicial		N/A		1.84%		

19. LIABILITIES

LIABILITIES NOT COVERED BY BUDGETARY AND OTHER RESOURCES

As of September 30, 2012 and 2011, liabilities not covered by budgetary and other resources consisted of the following (in millions):

	2012	2011
Intra-governmental Liabilities Not Covered by Budgetary and Other Resources		
Federal Debt Principal, Premium/Discount (Note 16)	$ 4,815,496	$ 4,672,424
Other Intra-governmental Liabilities	124	124
Total Intra-governmental Liabilities Not Covered by Budgetary and Other Resources	4,815,620	4,672,548
Federal Debt Principal, Premium/Discount (Note 16)	11,250,361	10,097,493
Gold and Silver Reserves	11,062	11,062
D.C. Pensions and Judicial Retirement - Unfunded Liability (Note 18)	6,354	5,949
Liabilities to GSEs (Note 8)	9,003	316,230
Other Liabilities	2,866	2,017
Total Liabilities Not Covered by Budgetary and Other Resources	16,095,266	15,105,299
Total Liabilities Covered by Budgetary and Other Resources	1,437,200	1,404,789
Total Liabilities	$ 17,532,466	$ 16,510,088

OTHER LIABILITIES

Total "Other Liabilities" displayed on the Consolidated Balance Sheets consists of both liabilities that are covered and not covered by budgetary resources. Other liabilities at September 30, 2012 and 2011 consisted of the following (in millions):

	Current	Non-Current	2012 Total	Current	Non-Current	2011 Total
Intra-governmental						
Accounts Payable	$ 203	$ -	$ 203	$ 124	$ -	$ 124
Unfunded Federal Workers Compensation Program Liability (FECA)	47	58	105	45	58	103
Other Accrued Liabilities	233	-	233	226	-	226
Total Intra-governmental	$ 483	$ 58	$ 541	$ 395	$ 58	$ 453
With the Public						
Liability for Deposit Funds (Held by the U.S. Government for Others) and Suspense Accounts	$ 275	$ -	$ 275	$ 861	$ -	$ 861
Actuarial Federal Workers Compensation Program Liability (FECA)	-	576	576	-	553	553
Accrued Funded Payroll and Benefits	558	-	558	557	-	557
Accounts Payable and Other Accrued Liabilities	3,905	60	3,965	2,186	65	2,251
Total with the Public	$ 4,738	$ 636	$ 5,374	$ 3,604	$ 618	$ 4,222

20. Net Position

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

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

Appropriations Received

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

Transfers to the General Fund and Other

The amount reported as "Transfers to the General Fund and Other" on the Consolidated Statement of Changes in Net Position under "Other Financing Sources" includes the following as of September 30, 2012 and 2011 (in millions):

		2012		2011
Categories of Transfers to the General Fund and Other				
Interest Revenue	$	**38,874**	$	37,758
Increase in Liquidity Preference of GSEs Preferred Stock, GSEs Preferred Stock Dividends and Valuation Changes (Note 8)		**(5,322)**		39,415
Downward Reestimates of Credit Reform Subsidies (Notes 7 and 11)		**11,648**		49,744
Other		**1,141**		1,021
TOTAL	**$**	**46,341**	$	127,938

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

The "Other" line mainly represents collections from other federal agencies as reimbursement of costs incurred by the Department for its administration of trust funds established within the Social Security Act. The Department is directed by statute to execute these administrative services. Seigniorage and numismatic profits also are included in the "Other" line. Seigniorage is the face value of newly minted circulating coins less the cost of production. Numismatic profit is any profit on the sale of proof coins, uncirculated coins, commemorative coins, and related products and accessories. The United States Mint is required to distribute seigniorage and numismatic profits in excess of operating expenses to the General Fund. In any given year, the amount recognized as seigniorage may differ from the amount distributed to the General Fund by an insignificant amount due to timing differences.

21. CONSOLIDATED STATEMENTS OF NET COST AND NET COSTS OF TREASURY SUB-ORGANIZATIONS

The Department's Consolidated Statements of Net Cost display information on a consolidated basis. The complexity of the Department's organizational structure and operations requires that supporting schedules for Net Cost be included in the notes to the financial statements. These supporting schedules provide consolidating information, which fully displays the costs of each sub-organization (DO and each operating bureau).

REPORTING ENTITY

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

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

INTRA-DEPARTMENTAL COSTS/REVENUES

Intra-departmental costs/revenues resulting from the provision of goods and/or services on a reimbursable basis among Departmental sub-organizations are reported as costs by providing sub-organizations and as revenues by receiving sub-organizations. The Department recognized intra-departmental imputed costs on the Consolidated Statements of Net Cost of $518 million and $415 million during fiscal years 2012 and 2011, respectively. Accordingly, such costs or revenues are eliminated in the consolidation process.

INTRA-GOVERNMENTAL COSTS

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

In certain cases, other federal agencies incur costs that are directly identifiable to the Department's operations. In accordance with SFFAS No. 30, *Inter-Entity Cost Implementation Amending* SFFAS No. 4, *Managerial Cost Accounting Standards and Concepts*, the Department recognizes identified costs paid on behalf of the Department by other agencies as an expense of the Department. The material imputed inter-departmental financing sources currently recognized by the Department include the actual cost of future benefits for the federal pension plans that are paid by other federal entities, the Federal Employees Health Benefits Program (FEHB), and any un-reimbursed contract dispute payments made from the Treasury Judgment Fund on behalf of the Department. The funding for these costs is reflected as costs on the Consolidated Statements of Net Cost, and as imputed financing sources on the Statements of Changes in Net Position. Costs paid by other agencies on behalf of the Department were $812 million and $925 million for the fiscal years ended September 30, 2012 and 2011, respectively.

CONSOLIDATED STATEMENTS OF NET COST PRESENTATION

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

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

Non-entity other federal costs shown on the Consolidated Statements of Net Cost for the years ended September 30, 2012 and 2011 consisted of the following (in millions):

	2012	2011
Credit Reform Interest on Uninvested Fund (Intra-governmental)	$ **8,745**	$ 8,015
Judgment Claims and Contract Disputes	**3,480**	2,290
Resolution Funding Corporation	**2,628**	2,239
Corporation for Public Broadcasting	**444**	435
Legal Services Corporation	**356**	408
All Other Payments	**637**	356
Total	**$ 16,290**	$ 13,743

21. CONSOLIDATED STATEMENT OF NET COST AND NET COSTS OF TREASURY SUB-ORGANIZATIONS (IN MILLIONS)

For Fiscal Year Ended September 30, 2012

Program Costs	Bureau of Engraving & Printing	Bureau of the Public Debt[b]	Depart-mental Office[a]	Fin. Crimes Enforcement Network	Financial Management Service[b]	Internal Revenue Service	U.S. Mint
FINANCIAL PROGRAM							
Intra-governmental Gross Costs	$ -	$ 191	$ 2,412	$ -	$ 227	$ 4,225	$ -
Less: Earned Revenue	-	(287)	(2,762)	-	(142)	(47)	-
Intra-governmental Net Costs	-	(96)	(350)	-	85	4,178	-
Gross Costs with the Public	-	375	587	-	1,224	8,329	-
Less: Earned Revenue	-	(2)	(1)	-	-	(433)	-
Net Costs with the Public	-	373	586	-	1,224	7,896	-
Net Cost: Financial Program	-	277	236	-	1,309	12,074	-
ECONOMIC PROGRAM							
Intra-governmental Gross Costs	88	-	4,216	-	-	-	76
Less: Earned Revenue	(2)	-	(1,220)	-	-	-	(3)
Intra-governmental Net Costs	86	-	2,996	-	-	-	73
Gross Costs with the Public	594	-	(285,280)	-	-	-	3,194
Less: Earned Revenue	(726)	-	(3,707)	-		-	(3,303)
Net Costs with the Public	(132)	-	(288,987)	-	-	-	(109)
Net Cost (Revenue): Economic Program	(46)	-	(285,991)	-	-	-	(36)
SECURITY PROGRAM							
Intra-governmental Gross Costs	-	-	150	59	-	169	-
Less: Earned Revenue	-	-	(29)	6	-	(2)	-
Intra-governmental Net Costs	-	-	121	65	-	167	-
Gross Costs with the Public	-	-	154	60	-	526	-
Less: Earned Revenue	-	-	-	-	-	-	-
Net Costs with the Public	-	-	154	60	-	526	-
Net Cost: Security Program	-	-	275	125	-	693	-
Total Net Program Cost Before Changes in Actuarial Assumptions	(46)	277	(285,480)	125	1,309	12,767	(36)
Loss on Pension, ORB, or OPEB Assumption Changes	-	-	690	-	-	-	-
Total Net Cost of (Revenue From) Treasury Operations	$ (46)	$ 277	$ (284,790)	$ 125	$ 1,309	$ 12,767	$ (36)

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

(b) Effective in October 2012, the BPD and FMS operating bureaus were consolidated to form one new operating bureau, the Bureau of the Fiscal Service. Funding of salaries and expenses related to the new bureau through a single appropriation is pending Congressional legislation.

21. CONSOLIDATED STATEMENT OF NET COST AND NET COSTS OF TREASURY SUB-ORGANIZATIONS (IN MILLIONS) (CON'T):

For Fiscal Year Ended September 30, 2012

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

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

For Fiscal Year Ended September 30, 2011

Program Costs	Bureau of Engraving & Printing	Bureau of the Public Debt(c)	Depart-mental Office(c)(d)	Fin. Crimes Enforcement Network	Financial Management Service	Internal Revenue Service	U.S. Mint
FINANCIAL PROGRAM(c)							
Intra-governmental Gross Costs	$ -	$ 177	$ 2,145	$ -	$ 197	$ 4,405	$ -
Less: Earned Revenue	-	(214)	(2,393)	-	(170)	(70)	-
Intra-governmental Net Costs	-	(37)	(248)	-	27	4,335	-
Gross Costs with the Public	-	339	860	-	1,222	9,059	-
Less: Earned Revenue	-	(4)	(1)	-	-	(408)	-
Net Costs with the Public	-	335	859	-	1,222	8,651	-
Net Cost: Financial Program	-	298	611	-	1,249	12,986	-
ECONOMIC PROGRAM							
Intra-governmental Gross Costs	89	-	9,618	-	-	-	76
Less: Earned Revenue	(3)	-	(2,496)	-	-	-	(10)
Intra-governmental Net Costs	86	-	7,122	-	-	-	66
Gross Costs with the Public	459	-	(1,467)	-	-	-	4,408
Less: Earned Revenue	(539)	-	(8,479)	-		-	(4,601)
Net Costs with the Public	(80)	-	(9,946)	-	-	-	(193)
Net Cost (Revenue): Economic Program	6	-	(2,824)	-	-	-	(127)
SECURITY PROGRAM							
Intra-governmental Gross Costs	-	-	160	67	-	-	-
Less: Earned Revenue	-	-	(23)	(3)	-	-	-
Intra-governmental Net Costs	-	-	137	64	-	-	-
Gross Costs with the Public	-	-	155	55	-	-	-
Less: Earned Revenue	-	-	-	-	-	-	-
Net Costs with the Public	-	-	155	55	-	-	-
Net Cost: Security Program	-	-	292	119	-	-	-
Total Net Program Cost Before Changes in Actuarial Assumptions	6	298	(1,921)	119	1,249	12,986	(127)
Loss on Pension, ORB, or OPEB Assumption Changes	-	-	195	-	-	-	-
Total Net Cost of (Revenue From) Treasury Operations	$ 6	$ 298	$ (1,726)	$ 119	$ 1,249	$ 12,986	$ (127)

(c) Of the total $2.8 billion of net revenue reported by Departmental Offices for the Economic Program, GSE and ESF contributed $21.1 billion and $1 billion of net income, respectively, partially offset by OFS, DO policy offices, and OAS net cost of $9.5 billion, $7.1 billion, and $2.5 billion, respectively

(d) Certain fiscal year 2011 activity on the Consolidated Statements of Net Cost have been reclassified to conform to the presentation in the current fiscal year, the effects of which are immaterial. BPD and DO management program net costs (income) totaling ($5) million and $303 million, respectively, have been reclassified to the financial program.

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

For Fiscal Year Ended September 30, 2011

Program Costs	Office of the Comptroller of the Currency	Office of Thrift Supervision(e)	Alcohol and Tobacco Tax and Trade Bureau	Combined Total	Eliminations	2011 Consolidated
FINANCIAL PROGRAM						
Intra-governmental Gross Costs	$ -	$ -	$ 15	$ 6,939	$ 2,215	$ 4,724
Less: Earned Revenue	-	-	-	(2,847)	(573)	(2,274)
Intra-governmental Net Costs	-	-	15	4,092	1,642	2,450
Gross Costs with the Public	-	-	40	11,520	-	11,520
Less: Earned Revenue	-	-	(3)	(416)	-	(416)
Net Costs with the Public	-	-	37	11,104	-	11,104
Net Cost: Financial Program	-	-	52	15,196	1,642	13,554
ECONOMIC PROGRAM						
Intra-governmental Gross Costs	122	31	15	9,951	9,561	390
Less: Earned Revenue	(26)	(15)	-	(2,550)	(2,514)	(36)
Intra-governmental Net Costs	96	16	15	7,401	7,047	354
Gross Costs with the Public	715	161	38	4,314	-	4,314
Less: Earned Revenue	(817)	(169)	-	(14,605)	-	(14,605)
Net Costs with the Public	(102)	(8)	38	(10,291)	-	(10,291)
Net Cost (Revenue): Economic Program	(6)	8	53	(2,890)	7,047	(9,937)
SECURITY PROGRAM						
Intra-governmental Gross Costs	-	-	-	227	77	150
Less: Earned Revenue	-	-	-	(26)	(21)	(5)
Intra-governmental Net Costs	-	-	-	201	56	145
Gross Costs with the Public	-	-	-	210	-	210
Less: Earned Revenue	-	-	-	-	-	-
Net Costs with the Public	-	-	-	210	-	210
Net Cost: Security Program	-	-	-	411	56	355
Total Net Program Cost Before Changes in Actuarial Assumptions	(6)	8	105	12,717	8,745	3,972
Loss on Pension, ORB, or OPEB Assumption Changes	-	-	-	195	-	195
Total Net Cost of (Revenue From) Treasury Operations	$ (6)	$ 8	$ 105	$ 12,912	$ 8,745	$ 4,167

(e) On July 21, 2011, OTS merged into OCC. Accordingly, OTS's operating results through July 20, 2011 are reported separately herein, and its operating results subsequent to July 20, 2011 have been combined with OCC's operating results.

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

Federal agencies are required to disclose additional information related to the Combined Statements of Budgetary Resources. In accordance with SFFAS No. 7, *Accounting for Revenue and Other Financing Sources*, the Department must report the value of goods and services ordered and obligated which have not been received. This amount includes any orders for which advance payment has been made but for which delivery or performance has not yet occurred. The information for the fiscal years ended September 30, 2012 and 2011 was as follows (in millions):

Undelivered Orders

	2012	2011
Undelivered Orders		
Paid	**$ 107**	$ 114
Unpaid	**190,252**	208,868
Undelivered orders at the end of the year	**$ 190,359**	$ 208,982

Contributed Capital

Contributed capital represents the current year authority and prior year balances of amounts actually transferred through non-expenditure transfers to miscellaneous receipt accounts of the General Fund of the Treasury to repay a portion of a capital investment.

	2012	2011
Contributed Capital	**$ 78**	$ 58

Apportionment Categories of Obligations Incurred

Apportionment categories are determined in accordance with the guidance provided in OMB Circular No. A-11, *Preparation, Submission and Execution of the Budget*. Apportionment Category A represents resources apportioned for calendar quarters. Apportionment Category B represents resources apportioned for other time periods for activities, projects or objectives, or for any combination thereof (in millions).

Direct vs. Reimbursable Obligations Incurred

	2012	2011
Direct - Category A	**$ 17,958**	$ 3,203
Direct - Category B	**83,093**	247,733
Direct - Exempt from Apportionment	**369,596**	461,985
Total Direct	**470,647**	712,921
Reimbursable - Category B	**4,490**	5,872
Reimbursable - Exempt from Apportionment	**1,326**	1,254
Total Reimbursable	**5,816**	7,126
Total Direct and Reimbursable	**$ 476,463**	$ 720,047

Terms of Borrowing Authority Used

Several Departmental programs have authority to borrow under the FCRA, as amended. The FCRA provides indefinite borrowing authority to financing accounts to fund the unsubsidized portion of direct loans and to satisfy obligations in the event the financing account's resources are insufficient. Repayment requirements are defined by OMB Circular No. A-11. Interest expense due is calculated based on the beginning balance of borrowings outstanding and the borrowings/repayments activity that occurred during the fiscal year. Undisbursed Departmental borrowings earn interest at the same rate as the financing account pays on its debt owed to BPD. In the event that principal and interest collections exceed the interest expense due, the excess will be repaid to the Department. If principal and interest do not exceed interest expense due, the Department will borrow the difference. The Department makes periodic principal repayments based on the analysis of cash balances and future disbursement needs. All interest on borrowings were due on September 30, 2012. Interest rates on FCRA borrowings range from 0.07 percent to 7.59 percent.

AVAILABLE BORROWING

(in millions)		**2012**		2011
Beginning Balance	**$**	**123,844**	$	23,477
Current Authority		**11,019**		157,060
Borrowing Authority Withdrawn		**(10,038)**		(2,307)
Borrowing Authority Converted to Cash		**(14,895)**		(54,386)
Ending Balance	**$**	**109,930**	$	123,844

RECONCILIATION OF THE PRESIDENT'S BUDGET

The Budget of the United States (also known as the President's Budget), with actual numbers for fiscal year 2012, was not published at the time that these financial statements were issued. The President's Budget is expected to be published in February 2013, and can be located at the OMB website http://www.whitehouse.gov/omb and will be available from the U.S. Government Printing Office. The following chart displays the differences between the Combined Statement of Budgetary Resources (SBR) in the fiscal year 2011 Agency Financial Report and the actual fiscal year 2011 balances included in the fiscal year 2013 President's Budget.

Reconciliation of Fiscal Year 2011 Combined Statement of Budgetary Resources to the Fiscal Year 2013 President's Budget

(in millions)	Budgetary Resources	Outlays (net of offsetting collections)	Offsetting Receipts	Net Outlays	Obligations Incurred
Statement of Budgetary Resources (SBR) Amounts	$ 1,089,001	$ 433,312	$ (119,958)	$ 313,354	$ 720,047
Included in the Treasury Department Chapter of the President's Budget (PB) but not in the SBR					
IRS non-entity tax credit payments (1)	110,136	109,871	-	109,871	110,141
Tax and Trade Bureau (TTB) non-entity collections for Puerto Rico	452	452	-	452	452
Continued dumping subsidy - U.S. Customs and Border Patrol	92	126	-	126	126
Other	-	-	(19)	(19)	(3)
Subtotal	110,680	110,449	(19)	110,430	110,716
Included in the SBR but not in the Treasury Department chapter of the PB					
Treasury resources shown in non-Treasury chapters of the PB (2)	(156,955)	(6,747)	-	(6,747)	(111,759)
Offsetting collections net of collections shown in PB	(11,620)	-	(128)	(128)	4
Treasury offsetting receipts shown in other chapters of PB	-	-	542	542	-
Unobligated balance carried forward, recoveries of prior year funds and expired accounts	(269,462)	-	-	-	-
ESF resources not shown in PB (3)	(44,840)	-	-	-	-
Treasury Financing Accounts (CDFI, GSE, OFS and SBLF)	(104,685)	119,294	-	119,294	(76,114)
Enacted reduction, 50% Transfer Accounts, and Capital Transfers to General Fund not included in PB	(39)	-	-	-	-
Unobligated balance transfers	(245)				
Other	(1)	(1)	(2)	(3)	(6)
Subtotal	(587,847)	112,546	412	112,958	(187,875)
Trust Funds (4)	(89)	74	(76)	(2)	(805)
President's Budget Amounts(5)	**$ 611,745**	**$ 656,381**	**$ (119,641)**	**$ 536,740**	**$ 642,083**

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

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

(3) *The ESF is a self-sustaining component that finances its operations with the buying and selling of foreign currencies to regulate the fluctuations of the dollar. Because of the nature of the activities of the component, it does not receive appropriations, and therefore is excluded from the PB.*

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

(5) *Per the President's Budget for fiscal year 2013 – Budgetary Resources and Outlays are from the Analytical Perspective. Offsetting Receipts and Obligations Incurred are from the Appendix.*

LEGAL ARRANGEMENTS AFFECTING USE OF UNOBLIGATED BALANCES

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

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

CHANGE IN BUDGETARY ACCOUNTING

Effective July 31, 2012, the Department changed the budgetary accounting for certain market-based Treasury debt securities purchased by the Department of Defense (DoD) Military Funds to recognize the budget activity for premiums and discounts at the time of purchase rather than when the premium/discount is amortized over the term of the security in accordance with guidance provided by the OMB. For those previously issued securities held by the DoD on July 31, 2012, the Department recorded the net unamortized premium totaling $75.1 billion as budget activity in the current fiscal year presented in accordance with guidance provided by the OMB. This change in accounting is reported as a decrease in both Obligations Incurred and Appropriations (discretionary and mandatory) on the Combined Statement of Budgetary Resources for the fiscal year ended September 30, 2012. On the Consolidated Statement of Changes in Net Position for the fiscal year ended September 30, 2012, this change in accounting is reported within the Cumulative Results of Operations section as a decrease in Appropriations Used and a corresponding increase in Accrued Interest and Discount on Debt, and within the Unexpended Appropriations section as a decrease in Appropriations Received and a corresponding decrease in Appropriations Used.

23. COLLECTION AND DISPOSITION OF CUSTODIAL REVENUE

The Department collects the majority of federal revenue from income and excise taxes. Collection activity, by revenue type and tax year, is presented for the fiscal years ended September 30, 2012 and 2011 (in millions):

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

	Tax Year				
	2011	2010	2009	Pre-2009	2011 Collections
Individual Income and FICA Taxes	$ 1,357,129	$ 703,856	$ 18,980	$ 22,065	$ 2,102,030
Corporate Income Taxes	165,768	62,650	1,855	12,575	242,848
Estate and Gift Taxes	23	6,367	691	1,998	9,079
Excise Taxes	53,429	19,023	87	255	72,794
Railroad Retirement Taxes	3,523	1,164	1	4	4,692
Unemployment Taxes	4,806	1,961	39	87	6,893
Fines, Penalties, Interest, & Other Revenue - Tax Related	284	9	-	-	293
Tax Related Revenue Received	1,584,962	795,030	21,653	36,984	2,438,629
Deposit of Earnings, Federal Reserve System	63,792	18,754	-	-	82,546
Fines, Penalties, Interest, & Other Revenue - Non-Tax Related	273	25	-	-	298
Non-Tax Related Revenue Received	64,065	18,779	-	-	82,844
Total Revenue Received	$ 1,649,027	$ 813,809	$ 21,653	$ 36,984	$ 2,521,473
Less Amounts Collected for Non-Federal Entities					462
Total					$ 2,521,011

AMOUNTS PROVIDED TO FUND THE U.S. GOVERNMENT

For the years ended September 30, 2012 and 2011, collections of custodial revenue transferred to other entities were as follows (in millions):

		2012		2011
Department of the Interior	$	511	$	344
General Fund (1)		2,268,311		2,106,419
Total	$	2,268,822	$	2,106,763

(1) The General Fund amount for fiscal years 2012 and 2011 includes cash proceeds from the sale of AIG common stock of $13.0 billion and $2.0 billion, respectively, as reported on the Statements of Custodial Activity.

FEDERAL TAX REFUNDS PAID

Refund activity, by revenue type and tax year, was as follows for the years ended September 30, 2012 and 2011 (in millions):

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

	Tax Year				
	2011	2010	2009	Pre-2009	2011 Refunds
Individual Income and FICA Taxes	$ 1,140	$ 302,832	$ 26,455	$ 13,957	$ 344,384
Corporate Income Taxes	6,342	16,623	6,451	38,361	67,777
Estate and Gift Taxes	-	11	401	1,366	1,778
Excise Taxes	799	1,047	159	184	2,189
Railroad Retirement Taxes	-	2	-	1	3
Unemployment Taxes	3	54	15	18	90
Total	$ 8,284	$ 320,569	$ 33,481	$ 53,887	$ 416,221

FEDERAL TAX REFUNDS PAYABLE

As of September 30, 2012 and September 30, 2011, refunds payable to taxpayers consisted of the following (in millions):

		2012		2011
Internal Revenue Service	$	3,252	$	3,981
Alcohol and Tobacco Tax and Trade Bureau		3		2
Total	$	3,255	$	3,983

24. Earmarked Funds

The majority of the Department's earmarked fund activities are attributed to the ESF and the pension and retirement funds managed by the Office of D.C. Pensions. In addition, earmarked funds managed by BEP, Mint, and OCC (the Department's non-appropriated bureaus) and certain funds managed by the IRS are public enterprise (or revolving) funds and receive no appropriations from the Congress. Other miscellaneous earmarked funds are managed by BPD, DO, FMS, FMD (a division of FMS), IRS, OFR, and TFF.

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

Bureau	Fund Code	Fund Title/Description
Exchange Stabilization Fund (ESF)		
ESF	20X4444	Exchange Stabilization Fund
D.C. Pensions		
DCP	20X1713	Federal payment - D.C. Judicial Retirement
DCP	20X1714	Federal payment - D.C. Federal Pension Fund
DCP	20X5511	D.C. Federal Pension Fund
DCP	20X8212	D.C. Judicial Retirement and Survivor's Annuity Fund
Public Enterprise/Revolving Funds		
BEP	20X4502	Bureau of Engraving and Printing Fund
MNT	20X4159	Public Enterprise Fund
OCC	20X8413	Assessment Funds
OCC	20X4264	Assessment Funds
IRS	20X4413	Federal Tax Lien Revolving Fund
Other Earmarked Funds		
BPD	20X5080	Gifts to Reduce Pubic Debt
DO	20X5816	Confiscated and Vested Iraqi Property and Assets
DO	20X8790	Gifts and Bequests Trust Fund
FMD	20X5081	Presidential Election Campaign
FMD	20X8902	Esther Cattell Schmitt Gift Fund
FMD	9515585	Travel Promotion Fund, Corp for Travel Promotion
FMD	9525585	Travel Promotion Fund, Corp for Travel Promotion
FMD	95X5585	Travel Promotion Fund, Corp for Travel Promotion
FMS	206/75445	Debt Collection Special Fund
FMS	207/85445	Debt Collection Special Fund
FMS	208/95445	Debt Collection Special Fund
FMS	209/05445	Debt Collection Special Fund
FMS	200/15445	Debt Collection Special Fund
FMS	201/25445	Debt Collection Special Fund
FMS	202/35445	Debt Collection Special Fund
IRS	20X5510	Private Collection Agency Program
IRS	20X5433	Informant Reimbursement
OFR	20X5590	Financial Research Fund
TFF	20X5697	Treasury Forfeiture Fund

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

D.C. Pension Funds provide annuity payments for retired D.C. teachers, police officers, judges, and firefighters. The sources of revenues are through intra-governmental flows including annual appropriations and interest earnings from investments, as well as inflows of resources to the government of employee contributions. All proceeds are earmarked. Note 18 provides detailed information on various funds managed by DCP.

The BEP, Mint, OCC, and IRS operate "public enterprise/revolving funds" to account for their respective revenues and expenses. 31 USC § 5142 established the revolving fund for BEP to account for revenue and expenses related to the currency printing activities. P.L. 104-52 (31 USC § 5136) established the Public Enterprise Fund for the Mint to account for all revenue and expenses related to the production and sale of numismatic products and circulating coinage. Revenues and other financing sources at the Mint are mainly from the sale of numismatic and bullion products, and the sale of circulating coins to the FRB system, and represent inflows of resources to the government. 12 USC § 481 established the Assessment Funds for OCC. Revenue and financing sources are from the bank examinations and assessments for the oversight of the national banks, savings associations, and savings and loan holding companies. These non-appropriated funds contribute to the inflows of resources to the government to specifically fund these entity's operations. 26 USC § 7810 established the Federal Tax Lien Revolving Fund to account for revenue and expenses from the sale of property foreclosed upon by a holder of a lien. There are minimal transactions with other government agencies.

There are other earmarked funds at several Treasury bureaus, such as donations to the Presidential Election Campaign Fund, funds related to the debt collection program, gifts to reduce the public debt, and other enforcement related activities. Public laws, the U.S. Code, and the *Debt Collection Improvement Act* established and authorized the use of these funds. Sources of revenues and other financing sources include contributions, cash and property forfeited in enforcement activities, public donations, and debt collection, representing inflows to the government.

INTRA-GOVERNMENTAL INVESTMENTS IN TREASURY SECURITIES

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

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

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

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

Summary Information for Earmarked Funds as of and for the Fiscal Year Ended September 30, 2012

(in millions)	Exchange Stabilization Fund	D.C. Pensions	Public Enterprise/ Revolving Funds	Other Earmarked Funds	Combined Earmarked Funds	Elimi-nations	2012 Total
ASSETS							
Fund Balance	$ -	$ 1	$ 1,093	$ 749	$ 1,843	$ -	$ 1,843
Investments and Related Interest – Intra-governmental	22,680	4,082	1,380	1,634	29,776	29,775	1
Cash, Foreign Currency and Other Monetary Assets	65,764	-	-	18	65,782	-	65,782
Investments and Related Interest	15,416	-	-	-	15,416	-	15,416
Other Assets	-	9	1,350	139	1,498	8	1,490
Total Assets	$ 103,860	$ 4,092	$ 3,823	$ 2,540	$ 114,315	$ 29,783	$ 84,532
LIABILITIES							
Intra-governmental Liabilities	$ -	$ -	$ 37	$ 395	$ 432	$ 28	$ 404
Certificates Issued to Federal Reserve Banks	5,200	-	-	-	5,200	-	5,200
Allocation of Special Drawing Rights	54,463	-	-	-	54,463	-	54,463
DC Pension Liability	-	10,059	-	-	10,059	-	10,059
Other Liabilities	7	57	621	253	938	-	938
Total Liabilities	59,670	10,116	658	648	71,092	28	71,064
Net Position							
Unexpended Appropriations	200	-	-	-	200	-	200
Cumulative Results of Operations	43,990	(6,024)	3,165	1,892	43,023	-	43,023
Total Liabilities and Net Position	$ 103,860	$ 4,092	$ 3,823	$ 2,540	$ 114,315	$ 28	$ 114,287
Statement of Net Cost							
Gross Cost	$ 1,557	$ 256	$ 5,001	$ 406	$ 7,220	$ 64	$ 7,156
Less: Earned Revenue	(956)	(99)	(5,033)	-	(6,088)	(133)	(5,955)
Gains/Losses on Pension, ORB, or OPEB Assumption Changes	-	690	5	-	695	-	695
Total Net Cost of (Revenue From Operations	$ 601	$ 847	$ (27)	$ 406	$ 1,827	$ (69)	$ 1,896
Statement of Changes in Net Position							
Cumulative Results of Operations:							
Beginning Balance	$ 44,591	$ (5,669)	$ 3,024	$ 1,665	$ 43,611	$ (2)	$ 43,613
Budgetary Financing Sources	-	492	(77)	572	987	(126)	1,113
Other Financing Sources	-	-	191	61	252	(40)	292
Total Financing Sources	-	492	114	633	1,239	(166)	1,405
Net Cost of (Revenue From) Operations	(601)	(847)	27	(406)	(1,827)	69	(1,896)
Change in Net Position	(601)	(355)	141	227	(588)	(97)	(491)
Ending Balance	$ 43,990	$ (6,024)	$ 3,165	$ 1,892	$ 43,023	$ (99)	$ 43,122

** The eliminations reported above include both inter and intra eliminations for the Earmarked Funds. The total eliminations amount will not agree with the eliminations reported in the Statement of Changes in Net Position, which include eliminations for Other Funds.*

Summary Information for Earmarked Funds as of and for the Fiscal Year ended September 30, 2011

(in millions)	Exchange Stabilization Fund	D.C. Pensions	Public Enterprise/ Revolving Funds	Other Earmarked Funds	Combined Earmarked Funds	Elimi-nations	2011 Total
ASSETS							
Fund Balance	$ -	$ 7	$ 1,123	$ 493	$ 1,623	$ -	$ 1,623
Investments and Related Interest - Intra-governmental	22,721	4,048	1,188	1,587	29,544	29,544	-
Cash, Foreign Currency and Other Monetary Assets	66,678	-	-	20	66,698	-	66,698
Investments and Related Interest	15,777	-	-	-	15,777	-	15,777
Other Assets	-	2	1,422	110	1,534	6	1,528
Total Assets	$ 105,176	$ 4,057	$ 3,733	$ 2,210	$ 115,176	$ 29,550	$ 85,626
LIABILITIES							
Intra-governmental Liabilities	$ -	$ -	$ 48	$ 369	$ 417	$ 58	$ 359
Certificates Issued to Federal Reserve Banks	5,200	-	-	-	5,200	-	5,200
Allocation of Special Drawing Rights	55,150	-	-	-	55,150	-	55,150
DC Pension Liabilities	-	9,671	-	-	9,671	-	9,671
Other Liabilities	35	55	661	176	927	-	927
Total Liabilities	60,385	9,726	709	545	71,365	58	71,307
Net Position							
Unexpended Appropriations	200	-	-	-	200	-	200
Cumulative Results of Operations	44,591	(5,669)	3,024	1,665	43,611	-	43,611
Total Liabilities and Net Position	$ 105,176	$ 4,057	$ 3,733	$ 2,210	$ 115,176	$ 58	$ 115,118
Statement of Net Cost							
Gross Cost	$ 438	$ 287	$ 6,062	$ 306	$ 7,093	$ 81	$ 7,012
Less: Earned Revenue	(1,484)	(117)	(6,181)	-	(7,782)	(165)	(7,617)
Gains/Losses on Pension, ORB, or OPEB Assumption Changes	-	195	-	-	195	-	195
Total Net Cost of Operations	$ (1,046)	$ 365	$ (119)	$ 306	$ (494)	$ (84)	$ (410)
Statement of Changes in Net Position							
Cumulative Results of Operations							
Beginning Balance	$ 43,545	$ (5,805)	$ 2,528	$ 1,158	$ 41,426	$ -	$ 41,426
Budgetary Financing Sources	-	501	(51)	851	1,301	(50)	1,351
Other Financing Sources	-	-	428	(38)	390	(36)	426
Total Financing Sources	-	501	377	813	1,691	(86)	1,777
Net Cost of Operations	1,046	(365)	119	(306)	494	84	410
Change in the Net Position	1,046	136	496	507	2,185	(2)	2,187
Ending Balance	$ 44,591	$ (5,669)	$ 3,024	$ 1,665	$ 43,611	$ (2)	$ 43,613

** The eliminations reported above include both inter and intra eliminations for the Earmarked Funds. The total eliminations amount will not agree with the eliminations reported in the Statement of Changes in Net Position, which include eliminations for Other Funds.*

25. RECONCILIATION OF NET COST OF TREASURY OPERATIONS AND NON-ENTITY COSTS TO BUDGET

The Reconciliation of Net Cost of Operations to Budget explains the difference between the budgetary net obligations and the proprietary net cost of Treasury operations and non-entity costs. For the fiscal years ended September 30, 2012 and 2011, the Reconciliation of Net Cost of Operations to Budget consisted of the following (in millions):

	2012	2011
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated:		
Obligations Incurred (Note 22)	**$ 476,463**	$ 720,047
Less: Spending Authority from Offsetting Collections and Recoveries	**(180,078)**	(223,941)
Obligations Net of Offsetting Collections and Recoveries	**296,385**	496,106
Less: Offsetting Receipts	**(73,881)**	(119,958)
Net Obligations	**222,504**	376,148
Other Resources:		
Donations and Forfeiture of Property	**174**	163
Financing Sources for Accrued Interest and Discount on the Debt (Note 22)	**95,877**	14,042
Transfers In/Out Without Reimbursement	**(47)**	(60)
Imputed Financing from Cost Absorbed by Others	**812**	925
Transfers to the General Fund and Other (Note 20)	**(46,341)**	(127,938)
Net Other Resources Used to Finance Activities	**50,475**	(112,868)
Total Resources Used to Finance Activities	**272,979**	263,280
RESOURCES USED TO FINANCE ITEMS NOT PART OF THE NET COST OF TREASURY OPERATIONS AND NON-ENTITY COSTS		
Change in Budgetary Resources Obligated for Goods, Services, and Benefits Ordered but not yet Provided	**(11,371)**	67,967
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowances for Subsidy	**(78,651)**	(23,549)
Adjustment to Accrued Interest and Discount on the Debt	**22,720**	15,277
Other (including Offset to Offsetting Receipts)	**183,385**	(164,856)
Total Resources Used to Finance Items Not Part of the Net Cost of Treasury Operations and Non-Entity Costs	**116,083**	(105,161)
Total Resources Used to Finance the Net Cost of Treasury Operations and Non-Entity Costs	**156,896**	368,441
Total Components of Net Cost of Treasury Operations and Non-Entity Costs That Will Require or Generate Resources in Future Periods	**(15,760)**	23,213
Total Components of Net Cost of Treasury Operations and Non-Entity Costs That Will Not Require or Generate Resources	**4,045**	12,501
Total Components of Net Cost of Treasury Operations and Non-Entity Costs That Will Not Require or Generate Resources in the Current Period	**(11,715)**	35,714
Net Cost of Treasury Operations and Non-Entity Costs	**$ 145,181**	$ 404,155

26. NON-TARP INVESTMENTS IN AMERICAN INTERNATIONAL GROUP, INC.

Under the initial terms of a capital facility agreement between the FRBNY and AIG, FRBNY established a trust (Trust) and AIG issued into the Trust Series C Convertible Participating Serial Preferred Stock that was convertible into approximately 77.9 percent of the issued and outstanding shares of AIG. Subsequent to this initial agreement, a reverse stock split of AIG's common stock increased this equity interest to 79.8 percent. The General Fund of the U.S. Government was the sole beneficiary of the Trust. In connection with the establishment of the Trust, the Department, as custodian of the General Fund, recorded a non-entity asset of $23.5 billion as of September 30, 2009, along with a corresponding entry to custodial revenue for the same amount, to reflect the value of the General Fund's beneficiary interest holding in the Trust.

On September 30, 2010, the Department, the FRBNY, and AIG entered into an AIG Recapitalization Agreement for the purpose of restructuring the U.S. Government's holding in AIG. This restructuring was executed on January 14, 2011, converting the Trust's AIG preferred stock into 563 million shares of AIG common stock, and the Trust was dissolved (refer to Note 7 for a discussion of the TARP-related transactions that occurred in connection with the January 14, 2011 restructuring). The Department intends to sell all of its General Fund and TARP holdings in AIG common stock together, on a pro rata basis, in the open market over time. The General Fund will be the ultimate recipient of any future dividends earned and proceeds realized from the liquidation of its holdings of AIG common stock. Accordingly, such dividends and proceeds are deposited into the accounts of the General Fund. The conversion of the Trust's preferred stock into AIG common stock reduced the non-entity portion of the outstanding common stock ownership in AIG from 79.8 percent to approximately 31 percent. In connection with the January 14, 2011 restructuring, the Department recorded a non-entity asset of $25.5 billion to reflect the value of the General Fund's 31 percent ownership in AIG's common stock. This transaction also included removing the previous asset, the General Fund's sole beneficiary interest in the Trust, which was dissolved as part of the recapitalization.

During fiscal year 2012, the Department sold 1.2 billion shares of AIG common stock held by the General Fund and TARP (415 million and 806 million shares, respectively). The sale of the AIG common stock resulted in total gross cash proceeds of $38.2 billion, of which the General Fund and the TARP received $13.0 billion and $25.2 billion, respectively, for the fiscal year ended September 30, 2012 (refer to Note 7).

During fiscal year 2011, the Department sold in the open market 200 million shares of AIG common stock held by the General Fund and TARP (68 million and 132 million shares, respectively). The sale of the AIG common stock resulted in total gross cash proceeds of $5.8 billion, of which the General Fund and the TARP received $2.0 billion and $3.8 billion, respectively, for the fiscal year ended September 30, 2011 (refer to Note 7).

After taking into consideration the sales of AIG common stock, the General Fund owned 80 million and 495 million shares of AIG outstanding common stock as of September 30, 2012 and 2011, respectively. The carrying value of the remaining non-entity investment held in AIG was $2.6 billion and $10.9 billion as of September 30, 2012 and 2011, respectively, which represented the fair value of the common stock as of that date. The fair value of the non-entity assets recorded as of September 30, 2012 and 2011 was based on the market value of AIG's common stock which is actively traded on the NYSE. The September 30, 2012 carrying value of the AIG investments held on behalf of the General Fund declined by $8.3 billion from the end of the prior fiscal year due to sales of $13.0 billion, partially offset by a fair value gain of $4.7 billion during fiscal year 2012. The September 30, 2011 carrying value declined by $9.9 billion from the end of fiscal year 2010 due to sales of $2.0 billion and a fair value loss of $7.9 billion during fiscal year 2011. Accordingly, the carrying value of the AIG common stock investment was adjusted by these amounts, and a corresponding amount was reported as custodial expense on the Statements of Custodial Activity.

The Department will re-value its non-entity AIG common stock holdings at least annually until all of these common shares are liquidated. Like any asset, future events may increase or decrease the value of the General Fund's interest in the AIG common stock.

27. SCHEDULE OF FIDUCIARY ACTIVITY

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

Bureau	Fund Code	Authority	Fund Title/Description
BEP	20X6513.013	31 USC 5119	Mutilated Currency Claims Funds
BPD	20X6008	31 USC 3513	Payment Principal & Interest Govt. Agencies
FMD	20X6045	31 USC 3328	Proceeds, Payments of Unpaid Checks
FMD	20X6048	31 USC 3329, 3330	Proceeds of Withheld Foreign Checks
FMD	2015X6078	50 APP. USC 2012	War Claims Fund, Foreign Claims Settlement Commission
FMD	20X6092	31 USC 1321	Debt Management Operations
FMD	20X6104	22 USC 1627	Albanian Claims Fund, Treasury
FMD	20X6133	31 USC 1322	Payment of Unclaimed Moneys
FMD	20X6309	22 USC 1627(a)	Libyan Claims Settlement Fund
FMD	20X6310	22 USC 1627(a)	Libyan Claims Settlement Fund
FMD	20X6311	98 Stat. 1876	Kennedy Center Revenue Bond
FMD	20X6312	22 USC 1627	Iranian Claims Settlement Fund
FMD	20X6314	22 USC 1644g	German Democrat Settlement Fund
FMD	20X6315	22 USC 1645h	Vietnam Claims Settlement Fund
FMD	20X6501.018	31 USC 3513	Small Escrow Amounts
FMD	20X6720	31 USC 3513	SM DIF Account for Dep. & Check Adj.
FMD	20X6830	104 Stat. 1061	Net Interest Payments to/from State
FMD	20X6999	31 USC 3513	Accounts Payable, Check Issue UNDDR
IRS	20X6737	90 Stat. 269-270	Internal Revenue Collections for Northern Mariana Island
IRS	20X6738	31 USC 3513	Coverover Withholdings-U.S. Virgin Islands
IRS	20X6740	31 USC 3515	Coverover Withholdings-Guam
IRS	20X6741	31 USC 3513	Coverover Withholdings-American Samoa
OAS	20X6317.001	22 USC 2431	Belize Escrow, Debt Reduction
OAS	20X6501.018	31 USC 3513	Small Escrow Amounts

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

Schedule of Fiduciary Activity

(in millions)	2012			2011		
	Unclaimed Monies - FMD	**All Other Fiduciary Funds**	**Total Fiduciary Funds**	Unclaimed Monies - FMD	All Other Fiduciary Funds	Total Fiduciary Funds
Fiduciary Net Assets, Beginning of the Year	**$ 451**	**$ 413**	**$ 864**	$ 420	$ 156	$ 576
Increases:						
Contributions to Fiduciary Net Assets	**59**	**243**	**302**	31	479	510
Investment Earnings	**-**	**1**	**1**	-	1	1
Total Increases	**59**	**244**	**303**	31	480	511
Decreases:						
Disbursements to and on behalf of beneficiaries	**(1)**	**(314)**	**(315)**	-	(223)	(223)
Total Decreases	**(1)**	**(314)**	**(315)**	-	(223)	(223)
Net Increase (Decrease) in Fiduciary Assets	**58**	**(70)**	**(12)**	31	257	288
Fiduciary Net Assets, End of Year	**$ 509**	**$ 343**	**$ 852**	$ 451	$ 413	$ 864

Schedule of Fiduciary Net Assets

(in millions)	2012			2011		
	Unclaimed Monies - FMD	**All Other Fiduciary Funds**	**Total Fiduciary Funds**	Unclaimed Monies - FMD	All Other Fiduciary Funds	Total Fiduciary Funds
Fiduciary Assets						
Cash and Cash Equivalents	**$ 509**	**$ 328**	**$ 837**	$ 451	$ 336	$ 787
Investments	**-**	**17**	**17**	-	77	77
Total Fiduciary Assets	**509**	**345**	**854**	451	413	864
Less: Fiduciary Liabilities	**-**	**(2)**	**(2)**	-	-	-
Total Fiduciary Net Assets	**$ 509**	**$ 343**	**$ 852**	$ 451	$ 413	$ 864

28. COMMITMENTS AND CONTINGENCIES

LEGAL CONTINGENCIES

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

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

The Department had one contingent liability in fiscal year 2012 related to legal action taken in the case of *Cobell v. Salazar* where losses are determined to be probable. In this case, the parties agreed to a total settlement of $3.4 billion. Specific details of this litigation case are provided below.

In the opinion of the Department's management and legal counsel, based on information currently available, the expected outcome of other legal actions, individually or in the aggregate, will not have a materially adverse effect on the

Department's consolidated financial statements, except for the pending legal actions described below which may have a materially adverse impact on the consolidated financial statements depending on the outcomes of the cases.

Pending Legal Actions

- *Cobell et al. v. Salazar et al. (formerly Cobell v. Kempthorne):* Native Americans allege that the Department of the Interior and the Department of the Treasury have breached trust obligations with respect to the management of the plaintiffs' individual Indian monies. In August 2008, the Federal District Court issued an opinion awarding $455 million to the plaintiffs. This decision was overturned in July 2009. The Appellate Court found that the U.S. Government owes a cost-effective accounting, in scale with available funds.

  In December 2009, the parties agreed to settle the plaintiff's claims, as well as claims for mismanagement of assets and land that were not asserted in the case, for $1.5 billion. The U.S. Government also agreed to pay an additional amount of up to $1.9 billion to purchase certain land interests owned by Native Americans. The Department of the Interior, jointly named in the case, accrued the entire $3.4 billion as a contingent liability in fiscal year 2011 upon President Obama's signing of legislation authorizing the settlement in December 2010. Accordingly, the Department of the Treasury will not accrue any portion of this liability. Several class members appealed the settlement however, in May 2012, the Appellate Court upheld the District Court's decision approving the settlement. Appellants filed petitions for certiorari to the Supreme Court. Final approval of the settlement will not occur until the appeals from individuals challenging the settlement have run their course.

- *Tribal Trust Fund Cases:* Numerous cases have been filed in the U.S. District Courts in which Native American Tribes seek a declaration that the United States has not provided the tribes with a full and complete accounting of their trust funds, and seek an order requiring the U.S. Government to provide such an accounting. In addition, there are a number of other related cases seeking damages in the U.S. Court of Federal Claims, which do not name the Department as a defendant. During fiscal year 2012, a number of tribal trust fund cases settled for an aggregate settlement amount totaling $754 million, which was paid from the Judgment Fund. The U.S. Government is currently in discussion with counsel representing most of the remaining plaintiff tribes with tribal trust fund cases pending against the United States about the feasibility of an out-of-court settlement. Plaintiff tribes in several of the pending cases have chosen to pursue active litigation, rather than settlement discussion, and the U.S. Government is vigorously litigating those cases. The Department is unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.
- *Amidax Trading Group v. S.W.I.F.T.*: Plaintiffs allege that the Department's Terrorist Finance Tracking Program has involved unlawful disclosure of information by the Society for Worldwide Interbank Financial Telecommunications (S.W.I.F.T.). Defendants include the Department of the Treasury as well as several Treasury officials. The case was dismissed by the District Court in February 2009, and the plaintiff subsequently appealed that ruling to the Court of Appeals for the Second Circuit. The parties completed the appellate briefing, and the oral argument occurred in July 2010. In December 2011, the Second Circuit ruled in favor of the defendants, affirming the District Court and, in July 2012, the Second Circuit denied the plaintiff's petition for rehearing. It is unclear whether the plaintiff will file a petition of certiorari with the Supreme Court, but the plaintiff has obtained an extension of the deadline, until December 24, 2012, to seek Supreme Court review. The Department is unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.
- *James X. Bormes v. United States of America:* The complaint alleges that the government willfully violated certain provisions of the Fair and Accurate Credit Transaction Act (FACTA) P.L. 108-159 in that the transaction confirmation received by the complainant from Pay.gov improperly included the expiration date of the credit card used for that transaction. The complaint does not state the amount of damages sought on behalf of the class beyond asserting that

each class member would be entitled to $100 to $1,000 in statutory damages. In a letter sent to the Department of Justice, the plaintiff proposed a fund of $30 million for just the Illinois class members.

In July 2009, the U.S. District Court for the Northern District of Illinois granted the U.S. Government's motion to dismiss this case for lack of an unequivocal waiver of sovereign immunity. In November 2010, the U.S. Court of Appeals for the Federal Circuit reversed the District Court's decision and directed that the case be remanded back to the District Court for further proceedings. The U.S. Government's petition for a rehearing of that decision was denied by the Federal Circuit in March 2011. In January 2012, the U.S. Supreme Court granted the U.S. Government a writ of certiorari concerning this decision. The case was argued on October 2, 2012, and a decision by the U.S. Supreme Court is pending. The Department is unable to determine the likelihood of an unfavorable outcome or an estimate of potential loss at this time.

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

OTHER COMMITMENTS AND CONTINGENCIES

Loan Commitments

The Department, through FFB, makes loan commitments with federal agencies, or private sector borrowers whose loans are guaranteed by federal agencies, to extend them credit for their own use (refer to Notes 1L and 3). As of September 30, 2012 and 2011, the Department had loan commitments totaling $86.2 billion and $95.5 billion, respectively.

Multilateral Development Banks

The Department, on behalf of the United States, has subscribed to capital for certain multilateral development banks (MDBs), portions of which are callable under certain limited circumstances to meet the obligations of the respective MDB. There has never been, nor is there anticipated, a call on the U.S. commitment for these subscriptions. As of September 30, 2012 and 2011, U.S. callable capital in MDBs was as follows (in millions):

	2012	2011
Inter-American Development Bank	**$ 32,786**	$ 28,687
International Bank for Reconstruction and Development	**31,805**	29,966
Asian Development Bank	**11,027**	8,469
European Bank for Reconstruction and Development	**3,055**	1,803
African Development Bank	**2,053**	1,545
North American Development Bank	**1,275**	1,275
Multilateral Investment Guarantee Agency(1)	**315**	293
Total	**$ 82,316**	$ 72,038

(1) Includes, for fiscal year 2012, commitments of $22 million for the undisbursed portion of the subscription to paid-in capital investments.

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

Terrorism Risk Insurance Program

The *Terrorism Risk Insurance Act* (TRIA), signed into law in November 2002, was enacted to address market disruptions resulting from terrorist attacks on September 11, 2001. TRIA helps to ensure available and affordable commercial property and casualty insurance for terrorism risk, and simultaneously allows private markets to stabilize. The authority to pay claims under the Terrorism Risk Insurance Program (TRIA Program) is activated upon the certification of an "act of terrorism" by the Secretary in concurrence with the Secretary of State and the Attorney General. If a certified act of terrorism occurs, insurers may be eligible to receive reimbursement from the U.S. Government for insured losses above a designated deductible amount. Insured losses above this amount will be shared between insurance companies and the U.S. Government. TRIA also gives the Department authority to recoup federal payments made under the TRIA Program through policyholder surcharges under certain circumstances, and contains provisions designed to manage litigation arising from or relating to a certified act of terrorism. There were no claims under TRIA as of September 30, 2012 or 2011.

Exchange Stabilization Agreement

In April 1994, the Department signed the North American Framework Agreement (NAFA), which includes the Exchange Stabilization Agreement (ESA) with Mexico. The Department, through the ESF, has a standing swap line for $3.0 billion with Mexico under the NAFA and its implementing ESA. The amounts and terms (including the assured source of repayment) of any borrowing under NAFA and ESA will have to be negotiated and agreed to before any actual drawing can occur. The ESA does provide sample clauses that state that transactions shall be exchange rate neutral for the ESF, and shall bear interest based on a then current rate tied to U.S. Treasury bills. There were no drawings outstanding on the ESF swap line as of September 30, 2012 and 2011. The Department renewed the ESA through December 14, 2012.

New Arrangements to Borrow

The Supplemental Appropriations Act of 2009 (P.L. 111-32) provided the authorization and appropriations for an increase in the United States' participation in the New Arrangements to Borrow (NAB). Because the U.S. financial participation in the IMF is denominated in SDRs, P.L. 111-32 authorized and appropriated up to the dollar equivalent of SDR 75 billion to implement this commitment. The United States agreed in May 2010 that its participation in the NAB would increase from SDR 6.6 billion to SDR 69.1 billion, pursuant to IMF Executive Board Decision No. 14577-(10/35). Total U.S. participation in the NAB of SDR 69.1 billion was equivalent to $106.5 billion and $107.9 billion as of September 30, 2012 and 2011, respectively. Refer to Notes 11 and 12 for more information on the NAB.

Contingent Liability to GSEs

The SPSPA agreements between the Department and each GSE, which have no expiration date, provide for the Department to disburse funds to the GSEs if, at the end of any quarter, the FHFA determines that the liabilities exceed its assets. At September 30, 2012, the Department recorded a contingent liability of $9.0 billion with a projected maximum remaining potential commitment to the GSEs of $282.3 billion. The recorded contingent liability of $316.2 billion at September 30, 2011 constituted the maximum commitment payable at the end of that year. Such accruals are adjusted as new information develops or circumstances change. Refer to Note 8 for a full description of the SPSPA agreements and related contingent liability.

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

Introduction

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

Other Claims for Refunds

The Department has estimated that $11.4 billion may be payable as other claims for tax refunds. This estimate represents amounts (principal and interest) that may be paid for claims pending judicial review by the federal courts or internally, by Appeals. The total estimated payout (including principal and interest) for claims pending judicial review by the federal courts is $6.1 billion and by appeals is $5.3 billion.

The Department made an administrative determination to accept the position that certain medical residents who received stipends be exempted from FICA taxes for periods before April 1, 2005. At September 30, 2012, the IRS estimated unpaid refund claims of approximately $2.4 billion. In accordance with federal accounting standards, the amounts of these claims have not been recorded as a liability in the consolidated financial statements because certain administrative processes have not been completed as of September 30, 2012.

IRS Federal Taxes Receivable, Net

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

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

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

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

The components of the total unpaid assessments at September 30, 2012 and 2011, were as follows (in millions):

		2012		2011
Total Unpaid Assessments	**$**	**364,000**	$	356,314
Less: Compliance Assessments		**(87,000)**		(102,693)
Write Offs		**(125,000)**		(106,519)
Gross Federal Taxes Receivable		**152,000**		147,102
Less: Allowance for Doubtful Accounts		**(113,000)**		(112,363)
Federal Taxes Receivables, Net	**$**	**39,000**	$	34,739

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

ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

As an agent of the U.S. Government and as authorized by 26 USC, the TTB collects excise taxes from alcohol, tobacco, firearms, and ammunition industries. In addition, special occupational taxes are collected from certain tobacco businesses. During fiscal years 2012 and 2011, TTB collected approximately $23.4 billion and $23.5 billion in taxes, interest, and other revenues, respectively. Federal excise taxes are also collected on certain articles produced in Puerto Rico and the Virgin Islands, and imported into the United States. In accordance with 26 USC 7652, such taxes collected on rum imported into the United States are "covered over" or paid into the treasuries of Puerto Rico and the Virgin Islands.

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

DEFERRED MAINTENANCE

In fiscal years 2012 and 2011, the Department had no material amounts of deferred maintenance costs to report on vehicles, buildings, and structures owned by the Department.

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

Logistic personnel use condition assessment surveys and/or the total life-cycle cost methods to determine deferred maintenance and acceptable operating condition of an asset. Periodic condition assessments, physical inspections, and review of manufacturing and engineering specifications, work orders, and building and other structure logistics reports can be used under these methodologies. Multi-use heritage assets held by the Department are generally in acceptable physical condition and are recognized and presented with general property, plant and equipment on the Consolidated Balance Sheets.

STATEMENT OF BUDGETARY RESOURCES DISAGGREGATED BY TREASURY REPORTING ENTITY

The following table provides the Statement of Budgetary Resources for the fiscal year ended September 30, 2012 disaggregated by Treasury reporting entity rather than by Treasury major budget account, since Treasury manages its budget at the reporting entity level.

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

(in millions):	Bureau of Engraving & Printing	Bureau of the Public Debt	Departmental Offices[1]	Fin. Crimes Enforcement Network	Financial Management Service	Internal Revenue Service
BUDGETARY RESOURCES						
Unobligated balance brought forward, October 1	$ 26	$ 95	$ 366,022	$ 34	$ 312	$ 885
Recoveries of prior year unpaid obligations	-	6	13,164	1	21	105
Other changes in unobligated balance	-	(2)	(40,845)	(1)	(5)	(96)
Unobligated balance from prior year budget authority, net	26	99	338,341	34	328	894
Appropriations (discretionary and mandatory)	-	360,402	37,903	111	18,844	12,175
Borrowing authority (discretionary and mandatory)	-	-	11,019	-	-	-
Spending authority from offsetting collections	730	284	28,422	8	221	144
Total Budgetary Resources	$ 756	$ 360,785	$ 415,685	$ 153	$ 19,393	$ 13,213
STATUS OF BUDGETARY RESOURCES						
Obligations incurred	$ 705	$ 360,692	$ 79,390	$ 119	$ 19,033	$ 12,233
Unobligated balance, end of year:						
Apportioned	22	84	229,800	32	325	602
Exempt from apportionment	-	-	22,593	-	6	6
Unapportioned	29	9	83,902	2	29	372
Total unobligated balance brought forward, end of year	51	93	336,295	34	360	980
Total Status of Budgetary Resources	$ 756	$ 360,785	$ 415,685	$ 153	$ 19,393	$ 13,213
CHANGE IN OBLIGATED BALANCE						
Unpaid obligations, gross, brought forward, October 1	$ 140	$ 87	$ 268,670	$ 27	$ 833	$ 1,776
Uncollected customer payments from Federal sources, brought forward, October 1	(40)	(19)	(1,010)	(9)	(24)	(52)
Obligated balance, net, start of year	100	68	267,660	18	809	1,724
Obligations incurred	705	360,692	79,390	119	19,033	12,233
Outlays, gross	(728)	(360,669)	(85,126)	(109)	(18,953)	(12,232)
Change in uncollected customer payments from Federal sources	(15)	12	158	2	(3)	11
Recoveries of prior year unpaid obligations	-	(6)	(13,164)	(1)	(21)	(105)
Obligated balance, end of year:						
Unpaid obligations, end of year (gross)	117	104	249,770	36	892	1,672
Uncollected customer payments from Federal sources, end of year	(55)	(7)	(852)	(7)	(27)	(41)
Obligated Balance, End of Year	$ 62	$ 97	$ 248,918	$ 29	$ 865	$ 1,631
BUDGET AUTHORITY AND OUTLAYS, NET						
Budget authority, gross (discretionary and mandatory)	$ 730	$ 360,686	$ 77,344	$ 119	$ 19,065	$ 12,319
Actual offsetting collections (discretionary and mandatory)	(715)	(295)	(161,078)	(10)	(219)	(156)
Change in uncollected customer payments from Federal sources (discretionary and mandatory)	(15)	12	158	2	(3)	11
Budget Authority, Net (Discretionary and Mandatory)	$ -	$ 360,403	$ (83,576)	$ 111	$ 18,843	12,174
Outlay, gross (discretionary and mandatory)	$ 728	$ 360,669	$ 85,126	$ 109	$ 18,953	12,232
Actual offsetting collections (discretionary and mandatory)	(715)	(295)	(161,078)	(10)	(219)	(156)
Outlays, net (discretionary and mandatory)	13	360,374	(75,952)	99	18,734	12,076
Distributed offsetting receipts	-	(39,420)	(33,243)	-	(474)	(744)
Agency Outlays, Net (Discretionary and Mandatory)	$ 13	$ 320,954	$ (109,195)	$ 99	$ 18,260	$ 11,332

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

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

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

PART 3:

Other Accompanying Information

(UNAUDITED)

SECTION A: SCHEDULE OF SPENDING

The following Schedule of Spending (SOS) presents an overview of the funds available for the Department to spend and how the Department spent these funds as of and for the fiscal year ended September 30, 2012. The financial data used to populate this schedule is the same underlying data used to populate the Department's Statement of Budgetary Resources (SBR). Accordingly, the budgetary financial information in this schedule is presented on a combined basis rather than on a consolidated basis. Specifically, the SOS presents "Total Resources" (or "Total Budgetary Resources" per the SBR), "Total Spending" (or "Outlays, Gross" per the SBR), and "Total Amounts Agreed to be Spent" (or "Obligations Incurred" per the SBR).

		2012
What Money is Available to Spend?		
Total Resources	$	816,061
Less: Amount Available, But Not Agreed to be Spent		(255,227)
Less: Amount Not Available to be Spent		(84,371)
Total Amounts Agreed to be Spent	**$**	**476,463**
How was the Money Spent?		
Interest and Dividends[i]	$	376,631
Grants, Subsidies, and Contributions[ii]		55,023
Investments and Loans[iii]		25,415
Personnel Compensation and Other Related Benefits		11,557
Other Contractual Services		4,183
Other		9,285
Total Spending		482,094
Amounts Remaining to be Spent		(5,631)
Total Amounts Agreed to be Spent	**$**	**476,463**

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

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

[iii] *Investments and Loans primarily include $18.5 billion of liquidity payments made to the Government Sponsored Enterprises under the Senior Preferred Stock Purchase Agreements (Note 8), along with other investments made in connection with loans issued for credit reform and non-credit reform activities.*

SECTION B: TAX GAP AND TAX BURDEN

TAX GAP

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

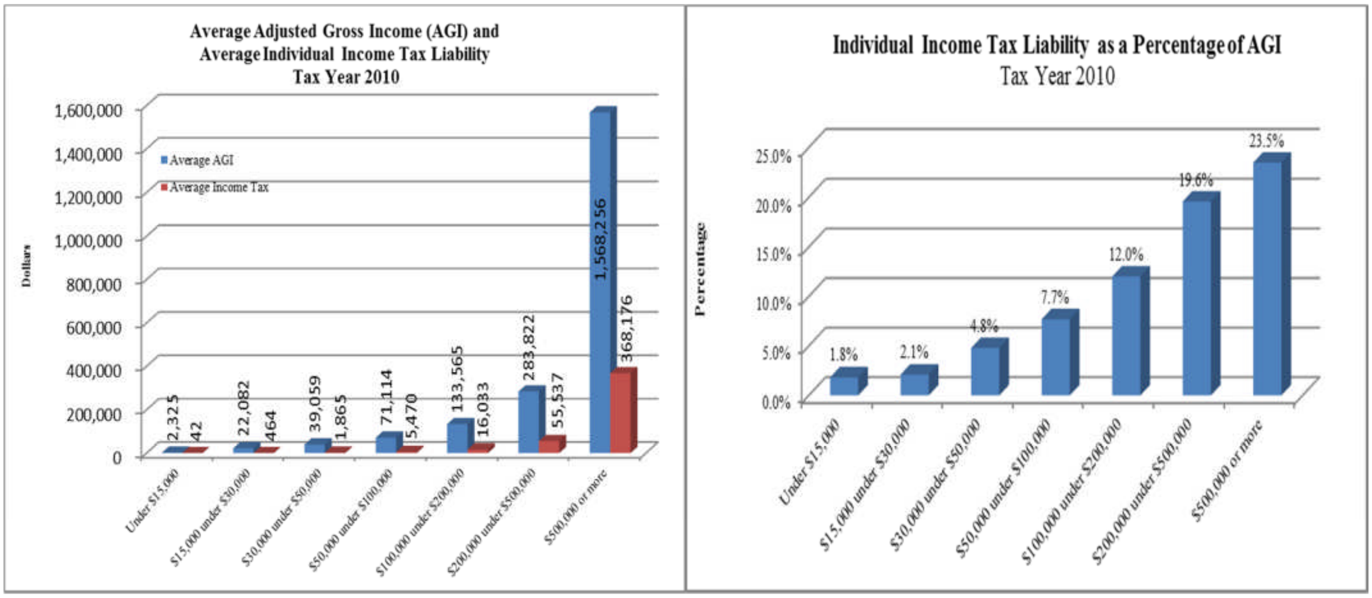
The underreporting gap accounts for 84 percent of the gross tax gap, with the remainder divided between the nonfiling gap (6 percent) and the underpayment of reported tax liability (10 percent). The IRS remains committed to finding ways to increase compliance and reduce the tax gap, while minimizing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

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

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

TAX BURDEN

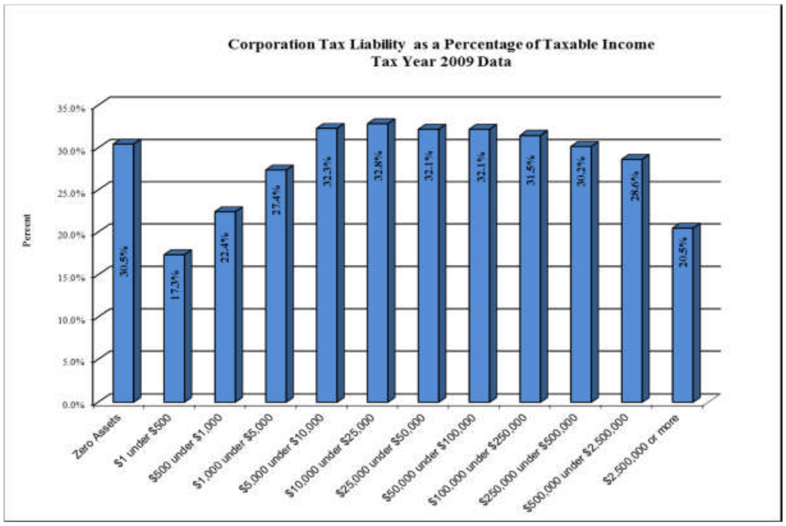
The Internal Revenue Code (IRC) provides for progressive definitions of taxable income and progressive rates of tax, whereby higher incomes are generally subject to higher rates of tax. The following graphs and charts present the latest available information on reported income tax and adjusted gross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



Individual Income Tax Liability

Tax Year 2010

Adjusted gross income (AGI)	Number of taxable returns (in thousands)		AGI (in millions)		Total income tax (in millions)		Average AGI per return (in whole dollars)		Average income tax per return (in whole dollars)	Income tax as a percentage of AGI
Under $15,000	37,602	$	87,421	$	1,587	$	2,325	$	42	1.8%
$15,000 under $30,000	30,858		681,419		14,314		22,082		464	2.1%
$30,000 under $50,000	25,605		1,000,098		47,754		39,059		1,865	4.8%
$50,000 under $100,000	30,533		2,171,323		167,026		71,114		5,470	7.7%
$100,000 under $200,000	13,998		1,869,639		224,423		133,565		16,033	12.0%
$200,000 under $500,000	3,472		985,431		192,826		283,822		55,537	19.6%
$500,000 or more	825		1,293,811		303,745		1,568,256		368,176	23.5%
Total	**142,893**	**$**	**8,089,142**	**$**	**951,675**		-		-	-



CORPORATION TAX LIABILITY

Tax Year 2009

Total Assets (in thousands)		Income subject to tax (in millions)		Total income tax after credits (in millions)	Percentage of income tax after credits to taxable income
Zero Assets	$	45,444	$	13,840	30.5%
$1 under $500		6,280		1,088	17.3%
$500 under $1,000		3,273		734	22.4%
$1,000 under $5,000		11,116		3,043	27.4%
$5,000 under $10,000		6,206		2,002	32.3%
$10,000 under $25,000		9,865		3,237	32.8%
$25,000 under $50,000		8,968		2,883	32.1%
$50,000 under $100,000		12,209		3,925	32.1%
$100,000 under $250,000		20,445		6,430	31.5%
$250,000 under $500,000		24,838		7,492	30.2%
$500,000 under $2,500,000		91,990		26,347	28.6%
$2,500,000 or more		654,215		133,974	20.5%
Total	**$**	**894,849**	**$**	**204,995**	-

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

In accordance with the *Reports Consolidation Act of 2000*, the Inspectors General issue Semiannual Reports to Congress that identify specific management and performance challenges facing the Department. At the end of each fiscal year, the Treasury Office of Inspector General (OIG) and Treasury Inspector General for Tax Administration (TIGTA) send an update of these management challenges to the Secretary and cite any new challenges for the upcoming fiscal year. SIGTARP does not provide the Secretary with a semiannual report or annual update on management and performance challenges. This section contains the incoming management and performance challenges letters from OIG and TIGTA and the Secretary's responses describing actions taken and planned to address the challenges.

OFFICE OF INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

October 25, 2012

INFORMATION MEMORANDUM FOR SECRETARY GEITHNER

FROM: Eric M. Thorson
Inspector General

SUBJECT: Management and Performance Challenges Facing the Department of the Treasury (OIG-CA-13-002)

In accordance with the Reports Consolidation Act of 2000, we are providing you with our perspective on the most serious management and performance challenges facing the Department of the Treasury.

In assessing the Department's most serious challenges, we are mindful of the fragile state of the economy. Despite the efforts of the Administration and the Congress, the economic recovery in the United States has been slow, in part, because of economic conditions in other parts of the world such as the European Union and China. Last year, we acknowledged that, in looking for ways to address this country's budget deficit, cuts to programs and operations were likely although the extent of and the specific nature of any cuts were unknown. That situation remains the same today. Very soon, the Administration and the Congress will need to address the "fiscal cliff" as it relates to the expiration of the Bush-era tax cuts, the payroll tax "holiday," and the automatic spending cuts from the sequestration agreement reached as part of the debt ceiling compromise last year. While the results of the upcoming national election may bring some clarity as to the direction the federal government will take to address these matters, that direction is expected to require significant sacrifices.

With that as a backdrop, Treasury has, in recent years, had to administer additional responsibilities intended to support and improve the country's economy. In order to do so, in nearly every case, the Department had to start up and administer these new responsibilities with very thin staffing and resources. In July of this year, the Department was given another new responsibility – the Gulf Coast Restoration Trust Fund – with no additional resources to administer it. I know that the Department's senior leadership is fully cognizant of these pressures and the need for strong management. That said, if the Department is faced with reduced funding, my office will monitor and examine the effect on Treasury's programs and operations. Like last year, we cannot emphasize enough to the Department's stakeholders the critical importance that Treasury is resourced sufficiently to maintain a strong control environment.

This year we are reporting four challenges, three of which are repeated from last year.

- Transformation of Financial Regulation (Repeat Challenge)
- Management of Treasury's Authorities Intended to Support and Improve the Economy (Repeat Challenge)
- Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement (Repeat Challenge)
- Gulf Coast Restoration Trust Fund Administration (New Challenge)

We removed one challenge from last year – Management of Capital Investments – as the Department demonstrated improved governance in the development of two major investments, Treasury Network (TNet) and the Financial Crimes Enforcement Network (FinCEN) Bank Secrecy Act Information Technology Modernization (BSA IT Mod) program. While the removal of this challenge is a major accomplishment, we caution that going forward, engaged senior management involvement is essential to any successful systems development effort.

In addition to the above challenges, we are reporting elevated concerns about three matters – cyber security, currency and coin production, and documenting key activities and decisions. We also note the actions Treasury is undertaking to consolidate and restructure the Bureau of the Public Debt (BPD) and the Financial Management Service (FMS) into the Bureau of the Fiscal Service (BFS).

2012 Management and Performance Challenges

Challenge 1: Transformation of Financial Regulation (Repeat Challenge)

In response to the need for financial reform, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) in July 2010. Dodd-Frank established new responsibilities for Treasury and created new offices tasked to fulfill those responsibilities.

Dodd-Frank established the Financial Stability Oversight Council (FSOC), which you chair as the Treasury Secretary. FSOC's mission is to identify risks to financial stability that could arise from the activities of large, interconnected financial companies; respond to any emerging threats to the financial system; and promote market discipline. FSOC accomplished a number of things over the last year.

<u>Annual reporting</u> - As required, FSOC issued its second annual report in July 2012. The report contained recommendations to (1) further reforms to address structural vulnerabilities in key markets, (2) heighten risk management and supervisory attention in specific areas, (3) take steps to address reform of the housing finance market, and (4) ensure implementation and coordination on financial regulatory reform.

<u>Designation of systemically significant financial market utilities</u>[4] - In July 2012, FSOC designated eight financial market utilities as systemically important. The financial market utilities are subject to (1) risk management standards governing the operations related to the payment, clearing, and settlement activities and (2) additional examinations and reporting requirements, as well as potential enforcement actions.

<u>Ruling for designating nonbank financial institutions for consolidated supervision</u> - Dodd-Frank calls for consolidated supervision and heightened prudential standards for large, interconnected nonbank financial companies. In this regard, the Board of Governors of the Federal Reserve System (FRB) is responsible for supervising these firms and adopting specific prudential rules. In April 2012, FSOC adopted a final rule and interpretative guidance related to designating nonbank financial companies for consolidated supervision.

[4] The term "financial market utility" means any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and that person. However, the term does not include entities such as national securities exchanges, national securities associations, and many others.

FSOC still has quite a bit of work ahead to meet all of its responsibilities. For example, it is still in the process of designating the first group of nonbank financial institutions for consolidated supervision. That said, FSOC continues its work monitoring the stability of U.S. and European markets. Additionally, we note that you as the Secretary of the Treasury recently released a letter on the urgent need for money market fund reform to be completed either by the Securities and Exchange Commission or FSOC.

The Council of Inspectors General on Financial Oversight (CIGFO), which I chair, was also established by Dodd-Frank. It facilitates the sharing of information among member inspectors general with a focus on reporting our concerns that may apply to the broader financial sector and ways to improve financial oversight. Accordingly, CIGFO is an important source of independent analysis to FSOC. As required, CIGFO met quarterly and issued its second annual report in July 2012. CIGFO also established its first working group in December 2011. This working group evaluated FSOC controls over non-public information and the manner in which FSOC, as a whole, safeguarded information from unauthorized sources. The working group issued its report in June 2012 which highlighted several areas for FSOC's consideration as it moves forward. In the future, CIGFO will continue reviewing FSOC's compliance with Dodd-Frank to ensure continued rigorous oversight of the U.S. financial system.

Dodd-Frank also established two new offices within Treasury: the Office of Financial Research (OFR) and the Federal Insurance Office (FIO).[5] OFR is the data collection, research and analysis arm of FSOC. In December 2011, the President nominated Mr. Richard Berner to serve as Director. The Director position currently remains vacant while Mr. Berner's confirmation is under consideration in the Senate. Among other duties, the OFR Director is to report to Congress annually on the office's activities and its assessments of systemic risk, with the first report due in July 2012. Despite not having a confirmed Director, OFR issued its annual report. Furthermore, in June 2012, we completed a review of the stand-up of OFR and reported that in the 21 months since OFR was created, efforts to establish the office were still in progress. The officials responsible for establishing OFR initially engaged in high-level strategic and organizational planning and sought to hire key personnel. They also focused their attention on developing and facilitating the global acceptance of a universal Legal Entity Identifier (LEI).[6] In the summer of 2011, after key operational personnel were brought on board, we noted that progress toward establishing a comprehensive implementation planning and project management process accelerated. This culminated in the approval of a methodology in January 2012, a strategic framework in March 2012, and a strategic "roadmap" in April 2012. While well over a year had passed since OFR was established, we concluded that these documents and methodology, taken together, finally provide OFR with a comprehensive implementation plan. This plan lays out the expected evolution of OFR's capabilities, reaching a mature state by fiscal year 2016. Concurrent with the development of its comprehensive implementation plan, OFR also began to develop its analytic and data support for FSOC, and its Research and Analysis Center has sponsored seminars and published two working papers on risk assessment topics.

[5] It should be noted that Dodd-Frank also established two other new offices within Treasury – the Offices of Minority and Women Inclusion at Departmental Offices and at the Office of the Comptroller of the Currency. Our future work plan includes reviews of these new offices.
[6] LEI is being developed as the universal standard for identifying all parties to financial contracts. It is a key element in OFR's efforts to understand and monitor risks to financial stability and meet its statutory mandate to develop and promote data standards.

The FIO is charged with monitoring the insurance industry, including identifying gaps or issues in the regulation of insurance that could contribute to a systemic crisis in the insurance industry or financial system. The FIO Director, whom you appointed in March 2011, is to advise FSOC on insurance matters. We are currently reviewing the stand-up of FIO.

The other regulatory challenges that we discussed last year still remain. Specifically, since September 2007, 126 financial institutions supervised by the Office of the Comptroller of the Currency (OCC) or the former Office of Thrift Supervision (OTS) have failed, with estimated losses to the Deposit Insurance Fund of approximately $35.3 billion. This is an increase of 13 financial institutions since my last challenges memorandum. With more than 450 banks on the Federal Deposit Insurance Corporation's troubled bank list, we anticipate bank failures to continue into the foreseeable future but at a lower rate than in recent years.

Although many factors contributed to the turmoil in the financial markets, our failed bank reviews generally found that OCC and the former OTS did not identify early or force timely correction of unsafe and unsound practices by numerous failed institutions under their respective supervision. Furthermore, in 2010, the unprecedented speed at which servicers foreclosed on defaulted mortgages revealed flaws in the processing of those foreclosures. In response, the federal banking regulators completed a review of foreclosure practices at major mortgage servicers. The review found deficiencies in the servicers' foreclosure processes including weak management oversight, foreclosure document deficiencies, poor oversight of third parties involved in the foreclosure process, and inadequate risk control systems. As a result, the federal banking regulators issued formal enforcement actions against 14 mortgage servicers and 2 third party providers subject to the review. We are currently reviewing OCC's oversight of the servicers' efforts to comply with the enforcement actions. While it is too soon to tell whether these servicing deficiencies have been addressed, at the time, the foreclosure crisis did not help an already stressed housing market.

In my last memorandum, I noted that Treasury was successful in standing up the Bureau of Consumer Financial Protection (CFPB). CFPB is an independent bureau of FRB but Treasury has a unique role in its operations. Specifically, until a Director is confirmed by the Senate, you are charged with exercising some, but not all, of the Director's authorities. In January 2012, the President made a recess appointment of Mr. Richard Cordray as Director. However, recess appointments expire at the end of the Senate's next session – accordingly Mr. Cordray's appointment will end in late 2013, or when formally confirmed by the Senate, or when another individual is nominated, confirmed, and permanently appointed to the position. Legislation has also been proposed to change the form of governance over CFPB. The FRB Inspector General is designated by Dodd-Frank to provide oversight of CFPB. However, given Treasury's statutory role, our office will coordinate with the FRB Office of Inspector General when necessary on CFPB oversight matters.

Clearly, as we have said in the past, the intention of Dodd-Frank is most notably to prevent, or at least minimize, the impact of a future financial sector crisis on the U.S. economy. To accomplish this, Dodd-Frank has placed great responsibility within Treasury and with the Treasury Secretary. This management challenge from our perspective is to maintain an effective FSOC process supported by OFR and FIO within Treasury and build a streamlined banking regulatory structure that timely identifies and strongly responds to emerging risks. This is especially important in times of economic growth and financial institution profitability, when such government action is generally unpopular.

Challenge 2: Management of Treasury's Authorities Intended to Support and Improve the Economy (Repeat Challenge)

Congress provided Treasury with broad authorities to address the recent financial crisis under the Housing and Economic Recovery Act (HERA) and the Emergency Economic Stabilization Act (EESA) enacted in 2008, the American Recovery and Reinvestment Act of 2009 (Recovery Act), and the Small Business Jobs Act of 2010. Certain authorities in HERA and EESA have now expired but challenges remain in managing Treasury's outstanding investments. To a large extent, Treasury's program administration under these acts has matured. However, the long-term impact on small business lending resulting from investment decisions under the Small Business Jobs Act programs are still not clear. Our discussion of this challenge will begin with this act and then address the others for which Treasury is responsible.

Management of the Small Business Lending Fund and State Small Business Credit Initiative

Enacted in September 2010, the Small Business Jobs Act created a $30 billion Small Business Lending Fund (SBLF) within Treasury and provided $1.5 billion to Treasury to allocate to eligible state programs through the State Small Business Credit Initiative (SSBCI). These represent key initiatives of the Administration to increase lending to small businesses, and thereby support job creation. Both programs were slow to disburse funds, with Treasury approving the majority of SBLF and SSBCI applications during the last quarter of fiscal year 2011. Because the majority of applicants waited until near the application deadlines to apply, Treasury encountered significant delays in implementing the two programs. As a result, Treasury was rushed in making a number of SBLF investment decisions in order to meet the funding deadlines, and disbursed the initial installment of SSBCI funds without establishing clear oversight obligations of participating states. Now that Treasury has completed the approval process for these two programs, the challenge for Treasury is to exercise sufficient oversight to ensure that funds are used appropriately, SBLF dividends owed Treasury are paid, and programs achieve intended results.

SBLF – As of September 2011, Treasury had disbursed more than $4 billion to 332 financial institutions across the country. Of the institutions funded, 41.3 percent used SBLF funds to refinance securities issued under the Troubled Asset Relief Program (TARP) Capital Purchase Program. Institutions receiving investments under the SBLF program pay dividends to Treasury at rates that decrease as the institutions increase their qualified small business lending activity. During the first 4½ years of Treasury's investment, participating institutions initially pay dividends to Treasury of up to 5 percent, but that rate may be reduced to as low as 1 percent based on institutions' self-reported increases in small business lending. Institutions are under no obligation to make dividend payments as scheduled or to pay off previously missed payments before exiting the program. There are provisions for increased restrictions as dividends are missed, including a prohibition against an institution paying dividends on common stock and a provision for Treasury to appoint one or two members to the bank's board of directors. The effectiveness of these measures, however, can be affected if the institution's regulator has restricted it from making dividend payments.

Treasury faces challenges in measuring program performance and ensuring that the SBLF program meets its intended objective of increasing lending to small businesses. The intent of the authorizing legislation was to stimulate lending to small businesses, but participating institutions are not required to report how they use Treasury's investments and are under no obligation to increase their small business lending. Once participating institutions commingle SBLF disbursements with other funds, it is difficult to track how the funds are used.

Additionally, Treasury relies on unverified information on small business lending reported by participating institutions to measure performance and to make dividend rate adjustments.

SSBCI – As of September 2012, 56 states, territories, and eligible municipalities (participating states) had been awarded $1.4 billion in SSBCI funding. Funds awarded are disbursed in one-third increments. To date, Treasury disbursed $533 million of the $1.4 billion awarded. States participating in SSBCI may use funds awarded for programs that partner with private lenders to extend credit to small businesses. Such programs may include those that finance loan loss reserves; and provide loan insurance, loan guarantees, venture capital funds, and collateral support. States were required to provide Treasury with plans for using their funding allocations and report quarterly and annually on their use of funds. We conduct audits of participating states to determine whether SSBCI funds are being used as intended. In this regard, the Small Business Jobs Act requires Treasury to recoup funds we identify as having been recklessly or intentionally misused, and Treasury may withhold disbursements from a state based on the audit results.

Primary oversight of the use of SSBCI funds is the responsibility of each participating state. The states are required to provide Treasury with quarterly assurances that their programs approved for SSBCI funding comply with program requirements. However, Treasury will face challenges in holding states accountable for the proper use of funds as it has not clearly communicated the prohibited uses of funds and has changed program guidelines frequently, making it difficult for states to ensure the proper use of funds. Treasury has also not defined what constitutes a material adverse change in a state's financial or operational condition that the state must report to Treasury. As a result, Treasury will have difficulty finding states to be in default of program requirements and holding states accountable should our office find that a state has intentionally or recklessly misused funds.

Management of Recovery Act Programs

Treasury is responsible for overseeing an estimated $150 billion of Recovery Act funding and tax relief. Treasury's oversight responsibilities include programs that provide payments for specified energy property in lieu of tax credits, payments to states for low-income housing projects in lieu of tax credits, grants and tax credits through the Community Development Financial Institutions (CDFI) Fund, economic recovery payments to social security beneficiaries and others, and payments to U.S. territories for distribution to their citizens. Approximately $20 billion of the $22 billion provided for non-Internal Revenue Service (IRS) programs has been disbursed to recipients under Treasury's payments in lieu of tax credit programs – to persons for specified energy properties and to states for low-income housing projects. To date, all funds have been disbursed under the low-income housing program and the specified energy property program is beginning to wind down. In the past, we expressed concern about the small number of Treasury staff dedicated to these programs. However, we noted there was a process for the Department of Energy's National Renewable Energy Laboratory to perform a technical review of payment applications and advise Treasury on award decisions. Also, for larger dollar payments, Treasury requires the applicant to obtain a review of project costs by an independent public accounting firm. Nevertheless, Treasury must continue to ensure recipient compliance with award agreements for an extended period of time. Additionally, our Office of Investigations had several open matters involving claims for specified energy property projects.

Management of the Housing and Economic Recovery Act and the Emergency Economic Stabilization Act

Through several HERA and EESA programs, Treasury injected much needed capital into financial institutions and businesses.

Under HERA, Treasury continued to support the financial solvency of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) which are under the conservatorship of the Federal Housing Finance Agency. To cover the losses of the two government sponsored enterprises (GSE) and maintain a positive net worth, Treasury agreed to purchase senior preferred stock as necessary. As of June 30, 2012, Treasury invested a total of $187 billion in the two GSEs. The maximum amount available to each GSE under its agreement with Treasury is based on a formulaic cap which will set on December 31, 2012, at no less than $200 billion per enterprise. For the first time since being placed under conservatorship, Fannie Mae and Freddie Mac reported a positive net worth in the first and second quarters of 2012. The future of both GSEs is still in question and prolonged assistance may be required. However, as noted above, the funding cap will set on December 31, 2012.

Prior to the expiration of its purchase authority in December 2009, Treasury acquired $225 billion of mortgage-backed securities (MBS) issued by the two GSEs under a temporary purchase program. In light of improved market conditions, Treasury started to sell its MBS in March 2011. In March 2012, Treasury completed its sale of remaining MBS and reported that overall, cash returns of $250 billion were received from the MBS portfolio through sales, principal, and interest.

Through the Housing Finance Agency Initiative supporting state and local finance agencies, Treasury purchased $15.3 billion of securities issued by Fannie Mae and Freddie Mac backed by state and local Housing Finance Agency bonds (New Issue Bond Program) and committed $8.2 billion for a participation interest in the obligations of Fannie Mae and Freddie Mac (Temporary Credit and Liquidity Program). Treasury received payments of principal and interest on its securities and currently holds an investment of approximately $14 billion. Additionally, several state and local housing agencies opted out of the Temporary Credit and Liquidity Program reducing Treasury's commitment to about $5 billion. Treasury continues to monitor its investment in the Housing Finance Agency Initiative.

As required by Dodd-Frank, Treasury and the Department of Housing and Urban Development conducted a study on ending the conservatorship of Fannie Mae and Freddie Mac and minimizing the cost to taxpayers. The report on this study was presented to Congress in February 2011. Regarding the long-term structure of housing finance, the report provided three options for consideration without recommending a specific option. The three options are (1) a privatized system of housing finance with the government insurance role limited to the Federal Housing Administration (FHA), the U.S. Department of Agriculture (USDA), and the Department of Veterans Affairs (VA) with assistance for narrowly targeted groups of borrowers; (2) a privatized system of housing finance with assistance from FHA, USDA, and VA for narrowly targeted groups of borrowers and a guarantee mechanism to scale up during times of crisis; and (3) a privatized system of housing finance with FHA, USDA, and VA assistance for low- and moderate-income borrowers and catastrophic reinsurance behind significant private capital. Although specific legislation has been proposed in the Congress, the legislative process for housing finance reform is still in a formative stage and it is difficult to predict what lies ahead for winding down the Fannie Mae and Freddie Mac conservatorships and reforming housing finance.

TARP, established under EESA, gave Treasury the authorities necessary to bolster credit availability and address other serious problems in the domestic and world financial markets. Treasury's Office of Financial Stability administers TARP, and through several of its programs, made purchases of direct loans and equity investments in many financial institutions and other businesses, as well as guaranteed other troubled mortgage-related and financial assets. Authority to make new investments under the TARP program expired on October 3, 2010. Treasury, however, is continuing to make payments for programs which have existing contracts and commitments. One Treasury challenge in this area is managing and winding down its various investment programs. To date, Treasury has reported positive returns from the sale of its investments in the banking industry and the American International Group (AIG), and reduced its investments in the auto industry. Treasury is also still managing various housing programs to provide mortgage relief to homeowners and prevent avoidable foreclosures. Unless current conditions change and while we acknowledge the continuing difficulties facing Treasury with the housing programs, in recognition of the substantial progress the Department has made in exiting its investments we do not plan to report on TARP in future management and performance challenges memoranda. We also note EESA established a special inspector general for TARP and imposed oversight and periodic reporting requirements on both the special inspector general and Government Accountability Office.

Unmet Mandate

In addition to SBLF and SSBCI, the Small Business Jobs Act of 2010 provided Treasury with authority to guarantee the full amounts of bonds and notes issued for community and economic development activities not to exceed 30 years. Under this authority, Treasury may issue up to 10 guarantees of no less than $100 million each, but may not exceed $1 billion in total aggregate guarantees in any fiscal year. As the program administrator, CDFI Fund was tasked with setting regulations and implementing the program by September 27, 2012. CDFI Fund is experiencing challenges in standing up the program and has missed the program's statutory implementation date. Our office plans to assess the progress of the program's implementation in 2013.

Challenge 3: Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement (Repeat Challenge)

As we have reported in the past, ensuring criminals and terrorists do not use our financial networks to sustain their operations and/or launch attacks against the U.S. continues to be a challenge. Treasury's Office of Terrorism and Financial Intelligence (TFI) is dedicated to disrupting the ability of terrorist organizations to fund their operations. TFI brings together intelligence gathering and analysis, economic sanctions, international cooperation, and private-sector cooperation to identify donors, financiers, and facilitators supporting terrorist organizations, and disrupt their ability to fund them. Enhancing the transparency of the financial system is one of the cornerstones of this effort. Treasury carries out its responsibilities to enhance financial transparency through the Bank Secrecy Act (BSA) and USA Patriot Act. FinCEN is the Treasury bureau responsible for administering BSA.

Over the past decade, TFI has made good progress in closing the vulnerabilities that allowed money launderers and terrorists to use the financial system to support their activities. Nonetheless, significant challenges remain. One challenge is ensuring the continued cooperation and coordination of all the organizations involved in its anti-money laundering and combating terrorist financing efforts. A large number of federal and state entities participate with FinCEN to ensure compliance with BSA, including the four federal banking agencies, IRS, the Securities and Exchange Commission, the Department of Justice, and all the state regulators. Many of these entities also participate in efforts to ensure compliance with U.S. foreign sanction programs administered by Treasury's Office of Foreign Assets Control (OFAC).

To be effective, Treasury must establish and maintain working relationships with these numerous entities. Neither FinCEN nor OFAC have the resources or capability to maintain compliance with their programs without significant help from these other organizations. To this end, FinCEN had signed memoranda of understanding with 7 federal and 52 state regulators to ensure that information is exchanged between FinCEN and the entities charged with examining for BSA compliance. While important to promote the cooperation and coordination needed, it should be noted that these instruments are nonbinding and carry no penalties for violations, and their overall effectiveness has not been independently assessed.

Last year, financial institutions filed approximately 17 million BSA reports, including over 1.5 million suspicious activity reports (SAR). While the number of SARs has been increasing since 2001, that alone does not necessarily indicate everything is going well. Our audits have found problems with the quality of the data reported. Other audits have also identified gaps in the regulatory examination programs of the bank regulators and examining agencies.

Recently the vulnerability in large institutions' monitoring of transactions for money laundering and terrorist financing was revealed. In 2012, OCC filed a consent cease and desist order against Citigroup for failure to adopt and implement a compliance program that adequately covers the required BSA/anti-money laundering program elements due to its inadequate system of internal controls and ineffective independent testing. The bank did not develop adequate due diligence on foreign correspondent bank customers and failed to file SARs related to its remote deposit capture/international cash letter instrument activity in a timely manner. OCC also found weaknesses with other large banks' BSA programs. In July 2012 testimony related to a critical congressional report on OCC's oversight of HSBC's BSA program, the Comptroller of the Currency mentioned several actions that OCC was planning to take going forward. One such action was to assure BSA deficiencies are fully considered in a safety and soundness context and taken into account as part of the "management" component of a bank's CAMELS rating.[7]

FinCEN needs to continue its efforts to work with regulators and examining agencies to ensure that financial institutions establish effective BSA compliance programs and file accurate and complete BSA reports, as required. Furthermore, FinCEN needs to complete work to issue anti-money laundering regulations, as it determines appropriate, for some non-bank financial institutions, such as vehicle dealers; pawnbrokers; travel agents; finance companies; real estate closing and settlement services; and financial services intermediaries, such as investment advisors.

FinCEN faces the continuing challenge to enhance financial transparency in order to strengthen efforts to combat financial crime. So far, in this effort, FinCEN's attention has been on clarifying and strengthening customer due diligence (e.g., know your customer) regulatory requirements and supervisory expectations. This includes requiring

[7] CAMELS is a system used by federal banking agencies for evaluating the soundness of financial institutions on a uniform basis and for identifying those institutions requiring special supervisory attention or concern. A financial institution is assigned a composite rating and ratings on six components: Capital adequacy, quality of Assets, the capability of the board of directors and Management, the quality and level of Earnings, the adequacy of Liquidity, and Sensitivity to market risk.

institutions to identify beneficial ownership of their accountholders so that the true identities of their customers are not hidden. FinCEN issued an advance notice of proposed rulemaking in March 2012 to address this.

FinCEN became the authoritative source for BSA data when it transitioned the collection, processing, and storage of all BSA data from IRS in January 2012. FinCEN's BSA IT Mod program, begun in 2008, is being built to ensure efficient management, safeguarding, and use of BSA information. BSA IT Mod will reengineer BSA data architecture, update the infrastructure, implement more innovative web services and enhanced electronic filing, and provide increased analytical tools. FinCEN believes modernization will provide increased data integrity, and maximize value for its state and federal partners. We completed two audits of the program in which we concluded that FinCEN is generally meeting schedule and cost milestones, and had an appropriate oversight structure in place. As the modernization effort moves toward completion, FinCEN needs to continue to maintain heightened oversight of this program.

FinCEN mandated the use of its BSA E-Filing network effective July 2012, and for all BSA reports, March 2013. BSA E-Filing allows financial institutions to file reports with FinCEN electronically. We anticipate that this will improve data quality in that data will be more quickly entered into the database and that some of the errors or omissions that previously occurred through paper filings should be reduced if not eliminated. However, until this can be verified, FinCEN will need to continue to monitor data quality. We noted that FinCEN has a particularly difficult challenge in dealing with money service businesses (MSB). To that end, FinCEN has taken steps to improve MSB examination coverage and compliance. For example, in past years, FinCEN finalized new rules and increased enforcement designed to ensure MSBs comply with BSA requirements, including registration and report filing requirements. However, ensuring MSBs register with FinCEN has been a continuing challenge. Furthermore, IRS serves as the examining agency for MSBs, but has limited resources to inspect MSBs or even identify unregistered MSBs. FinCEN engaged the states to participate in joint MSB examinations with IRS, and for outreach programs aimed at these nonbank institutions. FinCEN, IRS, and the states need to work together to ensure that MSBs operating in this country are identified, properly registered, and in compliance with all applicable laws and regulations.

FinCEN has also been concerned with MSBs that use informal value transfer systems and with MSBs that issue, redeem, or sell prepaid access, through physical (cards or other devices) or non-physical (e.g., code, electronic serial number, mobile identification number, and/or personal identification number) means. MSBs using informal value transfers have been identified in a number of attempts to launder proceeds of criminal activity or finance terrorism. Similarly, prepaid access can make it easier for some to engage in money laundering or terrorist financing. In September 2010, FinCEN notified financial institutions to be vigilant and file SARs on MSBs that may be inappropriately using informal value transfers when they use financial institutions to store currency, clear checks, remit and receive funds, and obtain other financial services. In 2011, FinCEN issued a final rule applying customer identification, recordkeeping, and reporting obligations to providers and sellers of prepaid access, and continues to issue clarifying guidance for institutions to implement the requirements. Ensuring institutions properly implement these rules and maintain compliance will be a major challenge.

To detect possible illicit wire transfer use of the financial system, FinCEN also proposed a regulatory requirement for certain depository institutions and MSBs to report cross-border electronic transmittals of funds. FinCEN determined that establishing a centralized database will greatly assist law enforcement in detecting and ferreting out transnational organized crime, multinational drug cartels, terrorist financing, and international tax evasion. Ensuring financial institutions, particularly MSBs, comply with the cross-border electronic transaction reporting requirements, as well as managing this new database, is another significant challenge for FinCEN. It should be noted that this system cannot be fully implemented until FinCEN completes work on its BSA IT Mod program, scheduled for 2014.

Other matters of concern are beginning to appear or are on the horizon. One concern we reported before is that the focus on safety and soundness resulting from the recent financial crisis may have reduced the attention financial institutions have given to BSA and OFAC compliance. Another concern is the increasing use of mobile devices for banking, internet banking, internet gaming, and peer-to-peer transactions. FinCEN, OFAC, and other regulatory agencies will need to ensure that providers of these services ensure transactions are transparent and conform to BSA requirements. Monitoring the transactions of tomorrow may prove to be increasingly difficult for Treasury.

Given the criticality of this management challenge to the Department's mission, we continue to consider anti-money laundering and combating terrorist financing as inherently high-risk. In this regard, we have on-going BSA-related audits of FinCEN's MSB compliance program and OCC's BSA and USA Patriot Act examinations and enforcement actions. With respect to OFAC, we are reviewing its licensing program (where OFAC may grant exceptions to a sanction program as allowed under law) and performing a case study review of its Libyan sanctions program. We plan to complete these audits in fiscal year 2013.

Challenge 4: Gulf Coast Restoration Trust Fund Administration

In response to the Deepwater Horizon oil spill, Congress enacted as part of P.L. 112-141, the Resources and Ecosystems Sustainability, Tourist Opportunities, and Revived Economies of the Gulf Coast States Act of 2012 (Restore Act). This law established within Treasury the Gulf Coast Restoration Trust Fund and requires Treasury to deposit in the Trust Fund, 80 percent of administrative and civil penalties paid by responsible parties for the Deepwater Horizon oil spill. It is estimated that the Trust Fund could receive tens of billions of dollars from these penalties to be distributed for eligible activities affecting the Gulf Coast states (Alabama, Florida, Louisiana, Mississippi, and Texas). Treasury, in consultation with the Departments of the Interior and Commerce, is required to develop policies and procedures to administer the Trust Fund by January 2, 2013. The procedures are to include (1) procedures to assess whether programs and activities comply with applicable requirements, (2) auditing requirements to ensure that amounts in the Trust Fund are expended as intended, and (3) procedures for identification and allocation of funds available to Treasury under other provisions of law that may be necessary to pay administrative expenses directly attributable to the management of the Trust Fund. The Restore Act authorizes our office to conduct, supervise, and coordinate audits and investigations of projects, programs and activities funded under this legislation. Neither Treasury nor our office was provided specific funding in the act for carrying out our respective responsibilities.

The Restore Act established the allocation of available amounts in the Trust Fund during any fiscal year.

- 35 percent to the Gulf Coast states, in equal shares, for expenditure for ecological and economic restoration of the Gulf Coast region

- 30 percent to the Gulf Coast Ecosystem Restoration Council (Gulf Restoration Council)[8] pursuant to the council's approval of its comprehensive plan to undertake projects and programs using the best available science that would restore and protect the Gulf Coast region's natural resources, ecosystems, fisheries, marine and wildlife habitats, beaches, coastal wetlands, and economy
- 30 percent to the Gulf Restoration Council for allocation to the Gulf Coast states for eligible oil spill restoration activities, pursuant to the council's approval of the state's plan to improve the ecosystems or economy of the Gulf Coast region, using a regulatory formula
- 2.5 percent to the National Oceanic and Atmospheric Administration for its Gulf Coast Ecosystem Restoration Science, Observation, Monitoring, and Technology Program. This program is to be established by January 2013 to carry out research, observation, and monitoring to support the long-term sustainability of the ecosystem, fish stocks, fish habitat, and the recreational, commercial, and charter fishing industry in the Gulf of Mexico
- 2.5 percent to the Gulf Coast states, in equal shares, for competitive grant awards to nongovernmental entities and consortia in the Gulf Coast region, including public and private institutions of higher education, to establish centers for excellence to conduct Gulf Coast region research

The Restore Act prescribes how each distribution of funds will be further distributed and the conditions that must be met to receive funds. These conditions include that the amounts distributed be used in accordance with the legislation, that procurement rules and regulations be followed, and that the Secretary of the Treasury has the authority to withhold funding if the conditions are not met.

Treasury's Office of the Fiscal Assistant Secretary (OFAS) is currently developing regulations for the new program. We have been meeting with OFAS staff and providing our perspectives on controls as the regulations are being developed. What makes the administration of the act so challenging is that (1) regulations and associated policies and procedures need to be established and put into place quickly; (2) many of the entities/councils that are to receive and further allocate funding were not created before the enactment of the legislation and need to establish their own policies and procedures; and (3) there are many entities/councils that must cooperate for the funds to be distributed and spent in an appropriate manner. Treasury is also challenged by the fact that it must use existing resources to administer its responsibilities for the Trust Fund, and it is not a member of the entity, the Gulf Restoration Council, that will directly control how over half of the available amounts are spent.

[8] The Gulf Restoration Council consists of the following members, or designees: (1) at the federal level, the Secretaries of the Interior, Army, Commerce, Agriculture, the head of the department in which the Coast Guard is operating (currently the Secretary of Homeland Security), and the Administrator of the Environmental Protection Agency; and (2) at the state level, the Governors of Alabama, Florida, Louisiana, Mississippi, and Texas.

Challenge Removed

Management of Capital Investments

As we have reported in past years, managing large capital investments, particularly information technology investments, is a difficult challenge for any organization, whether public or private. In the past, we have also reported on a number of capital investment projects that either failed or had serious problems. However, we believe Treasury's implementation activities for two capital investments, TNet and FinCEN's BSA IT Mod, while not perfect, demonstrated that the Department has made sufficient, sustainable improvement in managing and mitigating investment risk to warrant removal of this area from our list of the most serious management and performance challenges.

TNet - Treasury plans to spend $3.7 billion during the life cycle of its Information Technology Infrastructure Telecommunications Systems and Services investment. Treasury was originally to have begun implementation of TNet, a major component, in November 2007 but the project was delayed until August 2009. In September 2011, we reported serious problems with the initial contracting and project management of TNet that contributed to the delay and the unnecessary expenditure of $33 million to maintain the prior telecommunications system in the interim. TNet is now operational across Treasury. While it is not yet fully compliant with all Federal security requirements, Treasury has committed to correcting the weaknesses in a timely manner and has taken other steps to strengthen security.

FinCEN BSA IT Mod - As discussed in Challenge 3, Treasury, through FinCEN, is undertaking the BSA IT Mod program and achieved a major milestone when it successfully transitioned BSA data from IRS in January 2012. The project is expected to cost about $120 million and is on track to be completed in 2014. Pursuant to a Congressional directive, we completed two in a series of audits of BSA IT Mod. The first audit reported that FinCEN had developed a sound business case for the program and the Department and FinCEN had implemented a strong governance system. The audit did identify one issue dealing with the mapping of BSA data from the new system to legacy IRS systems, which was addressed. The second audit found that the program was on schedule and within budgeted cost. We did note a concern with changes in program oversight, which we concluded had not adversely impacted the program so far but would be an area of follow-up in our work going forward.

We do note that we have started or planned audits of two on-going and costly capital investments to determine whether sound project management and effective governance are in place.

BEP Enterprise - BEP Enterprise, or BEN, is intended to integrate the Bureau of Engraving and Printing's (BEP) manufacturing and administrative components in a unified platform to simplify and standardize procedures, increase efficiency, and eliminate unnecessary processes. The goals are to increase quality, reduce spoilage, and improve accountability. The cost for BEN is estimated at $123 million for initial implementation and $400 million over the 10-year life of the project. We initiated an audit of BEN in 2012 which we anticipate completing in fiscal year 2013.

Common identity management system - The Treasury Enterprise Identity, Credential and Access Management (TEICAM) is an effort to implement Homeland Security Presidential Directive 12 requirements for a common identity standard. Started in 2007, the investment's targeted life cycle is through 2018. The estimated TEICAM cost is $178 million as of this writing, which has increased $31 million since the estimate in my last challenges memorandum. Although recently Treasury reported the investment is on schedule, within cost, and operating as planned, the investment has incurred significant schedule variances. As of August 2012, the Treasury Chief Information Officer assessed the investment as medium risk. We plan to begin an audit of TEICAM in fiscal year 2013.

While removed as a challenge, because of the billions of dollars at risk both in terms of procurement and mission effectiveness, Treasury should continue to exercise vigilance in managing the capital investments described above and others it has underway and may undertake in the future.

Matters of Concern

Although we are not yet reporting these as management and performance challenges, we want to highlight areas of concern – cyber security, currency and coin production, and documenting key activities and decisions.

Cyber Security

Not surprisingly, Treasury's systems are interconnected and critical to the core functions of government and the Nation's financial infrastructure. Information security remains a constant area of concern and potential vulnerability for Treasury's systems.

As a result, an economic and national security challenge for which Treasury must be prepared, is to provide leadership to defend against the full spectrum of threats against financial institutions in particular, and the financial sector in general. Many U.S. banks face cyber threats to their infrastructure on a continuous basis. Recent examples include denial of service attacks against a number of large U.S. banks. Organized hacking groups leverage known and new vulnerabilities and use different methods to make attacks hard to detect and even harder to prevent. Given the evolving cyber-threat environment, Treasury will need to build on existing partnerships among financial institutions, regulators, and private entities in the financial sector, in order to be well-positioned to identify and respond to emerging cyber threats against financial institutions and the broader financial sector.

Currency and Coin Production

We have issued two reports related to the delayed introduction of the NexGen $100 notes caused by creasing in some of the finished notes. Our first report, issued in May 2011, discussed deficiencies related to the physical security over notes and sheets in the production facilities; we noted that BEP promptly addressed those matters. Our second report, issued in January 2012, reported on deficiencies with BEP's NexGen $100 note production process, project management, and the need to complete a comprehensive cost-benefit analysis for the disposition of the 1.4 billion finished NexGen $100 notes already printed but not accepted by FRB. Originally planned to be issued in February 2011, a decision still needs to be made regarding the introduction of the NexGen $100 note into circulation although production has resumed. In this regard, FRB, as the issuing authority, will make that determination. Another matter related to currency redesign that should be kept in mind is meaningful access to U.S. currency for blind and visually impaired individuals. In response to a court ruling on that matter, you discussed several methods that Treasury plans to use to provide such access. Among them, you described the inclusion of raised tactile features and high-contrast numerals that would help them distinguish denominations of U.S. currency notes. The lessons learned with NexGen $100 note underscore the need for sound and comprehensive project management as BEP undertakes this redesign effort.

Challenges also exist with coin production. In recent years, the Mint reported that the cost of producing penny and nickel coins were double their face value and that metal prices have caused the production costs to be higher than the coins' face value for the past 6 years. Treasury also suspended production of the dollar coins to save money in production and storage costs due to excess supplies on-hand and low demand for the coins. Even though the demand is not there, the fiscal year 2011 production costs of the dollar coin were approximately a fifth of the coin's face value.

In the medium- to long-term future, the impact of alternative payment systems and other technological advances – such as stored value cards, the Internet, and smartphones – to BEP's and the Mint's respective business models and practices must be considered. This is especially the case in light of the profound effect that such technology had on the U.S. Postal Service's business model. Accordingly, it will become more and more imperative that BEP and the Mint factor this into their business model and future planning and interactions with their customer, FRB.

Documenting Key Activities and Decisions

Two recently completed audits by my office highlighted lapses by the Department in maintaining a complete and concurrent record of key activities and decisions.

One audit involved the selection of financial agents for Treasury's investment in Fannie Mae and Freddie Mac MBS. The other audit involved Treasury's consultative role with the Department of Energy's Solyndra loan guarantee. In both cases, while some documentation was available, we were only able to piece together what had happened through extensive interviews with personnel and email reviews. It was only then that we could conclude that in the case of the selection of financial agents, that Treasury followed a reasonable approach, and in the case of the Solyndra loan guarantee, that a consultation by Treasury did occur, albeit rushed.[9] On-going work by my office shows that these are not isolated instances. We are often told that the exigencies at the time precluded the preparation of more complete documentation. While we appreciate the pressures that are involved, especially during times of economic crisis, maintaining proper documentation is a fundamental tenet of government accountability and transparency. Maintaining proper documentation is also in the best long-term interest of the Department, should, at a later date, it want to repeat its actions or they be called into question. In this regard, appropriate documentation can be as simple as contemporaneous notes providing a record of why decisions were made, the way they were made, and how the government satisfied itself that the decisions were the best course. We do note that Treasury has issued policy that addresses documentation requirements, such as

[9] *Treasury's Financial Agent Selection Process for the Agency Mortgage Backed Securities Purchase Program Was Not Fully Documented* (OIG-12-061; issued July 31, 2012); *Consultation on Solyndra Loan Guarantee Was Rushed* (OIG-12-048; issued April 3, 2012)

Treasury Directive Publication 80-05, *Records and Information Management Program*. In our view, this is a matter of Treasury management personnel needing to remain aware and vigilant, especially during times of economic crisis.

We have a final observation and this regards the Department's October 2012 consolidation and restructuring of BPD and FMS into BFS. Expected to save money in the long run, the initiative is laudable. Furthermore, early indications from our on-going review of the consolidation, is that planning for the consolidation, as well as communication with affected personnel, has been extensive. That said, such consolidations do entail risk as separate processes, systems, and workplace cultures are meshed together. Comprehensive planning and the involvement of senior leadership has been key to other recent and successful restructurings of government operations, such as with CFPB and the transfer of the functions of the former OTS. At this stage, we encourage Treasury's senior leadership to at least maintain its current level of effort in this important undertaking.

We would be pleased to discuss our views on the management and performance challenges and the other matters in this memorandum in more detail.

cc: Nani A. Coloretti
Acting Assistant Secretary for Management

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20005

INSPECTOR GENERAL
FOR TAX
ADMINISTRATION

October 15, 2012

MEMORANDUM FOR SECRETARY GEITHNER

FROM: J. Russell George J. Russell George
Inspector General

SUBJECT: Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2013

The *Reports Consolidation Act of 2000*[10] requires that the Treasury Inspector General for Tax Administration (TIGTA) summarize, for inclusion in the *Department of the Treasury Accountability Report for Fiscal Year 2013*, its perspective on the most serious management and performance challenges confronting the Internal Revenue Service (IRS).

Each year, TIGTA evaluates IRS programs, operations, and management functions to identify the areas of highest vulnerability to the Nation's tax system. For Fiscal Year 2013, the top management and performance challenges in order of priority are:

1. Security for Taxpayer Data and Employees;
2. Tax Compliance Initiatives;
3. Modernization;
4. Implementing the Affordable Care Act and Other Tax Law Changes;
5. Fraudulent Claims and Improper Payments;
6. Providing Quality Taxpayer Service Operations;
7. Human Capital;
8. Globalization;
9. Taxpayer Protection and Rights; and
10. Achieving Program Efficiencies and Cost Savings.

While TIGTA's assessment of the major IRS management challenge areas for Fiscal Year 2013 has remained relatively unchanged from the prior fiscal year, we decided to distinguish the significance of Tax Compliance Initiatives from Modernization. Last year, Tax Compliance Initiatives and Modernization were both ranked as number two. However, with the demand for accountability to the American taxpayer, we believe it is more important than ever for the IRS to efficiently and effectively collect taxes owed to the Federal Government. Lastly, the Implementing Tax Law

[10] 31 U.S.C. § 3516(d) (2006).

Changes challenge area was expanded to encompass the *Patient Protection and Affordable Care Act* (Affordable Care Act),[11] and is now titled Implementing the Affordable Care Act and Other Tax Law Changes.

Although not listed, complexity of the tax laws remains a serious underlying issue that has wide-ranging implications for both the IRS and taxpayers. This complexity, including frequent revisions to the Internal Revenue Code, makes it increasingly difficult for the IRS to explain and enforce the tax laws, and more costly and time-consuming for taxpayers trying to comply.

The following information detailing these management and performance challenges is being provided to promote economy, efficiency, and effectiveness in the IRS's administration of the Nation's tax laws.

SECURITY FOR TAXPAYER DATA AND EMPLOYEES

As our Nation's tax collector and administrator of the Internal Revenue Code, the IRS received more than 234 million tax returns, of which 143 million were from individual taxpayers, and collected more than $2.4 trillion in revenue in Fiscal Year 2011. Information from these tax returns is converted into electronic format, processed, and maintained in 178 computer system applications for use by IRS employees.

The IRS faces the daunting task of securing its computer systems against the growing threat of cyberattacks. Effective information systems security becomes essential to ensure that data are protected against inadvertent or deliberate misuse, improper disclosure or destruction, and that computer operations supporting tax administration are secured against disruption or compromise. According to the Department of Homeland Security's U.S. Computer Emergency Readiness Team, Federal agencies reported 43,889 cyberattacks in Fiscal Year 2011, an increase of about five percent since Fiscal Year 2010.[12]

Computer security has been problematic for the IRS since 1997, when the IRS initially reported computer security as a material weakness during its annual evaluation of internal accounting and administrative controls under the *Federal Managers' Financial Integrity Act of 1982*.[13] TIGTA continues to identify significant security weaknesses in this area. In addition, the Government Accountability Office reported that security deficiencies identified in conjunction with its review of the IRS's financial statement audits for Fiscal Years 2010 and 2011 are the basis of its determination that the IRS had a material weakness in internal controls over financial reporting related to information security.[14] While the IRS has made progress in the area of computer security, it still needs to continue to place a high priority on improvements.

Beyond safeguarding a vast amount of sensitive financial and personal data, the IRS must also protect approximately 100,000 employees and contractors working in approximately 630 facilities throughout the country. The IRS has enhanced security nationwide, including acquiring new or additional guard services at IRS facilities. Additionally, the

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[11] Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of the U.S. Code), as amended by the Health Care and Education Reconciliation Act of 2010, Pub. L. No. 111-152, 124 Stat. 1029.
[12] Office of Management and Budget, Fiscal Year 2011 Report to Congress on the Implementation of The Federal Information Security Management Act of 2002 (Mar. 2012).
[13] 31 U.S.C. §§ 1105, 1113, and 3512. The *Federal Managers' Financial Integrity Act* (FMFIA) requires that agency management establish and maintain effective internal controls to achieve the objectives of: 1) effective and efficient operations, 2) reliable financial reporting, and 3) compliance with applicable laws and regulations. The FMFIA also requires the head of each Executive agency to report annually to the President and Congress on the effectiveness of the internal controls and to identify any material weaknesses in those controls. Reporting material weaknesses under the FMFIA is not limited to weaknesses over financial reporting.
[14] GAO, Ref. No. GAO-12-165, *Financial Audit: IRS's Fiscal Years 2011 and 2010 Financial Statements* (Nov. 2011).

IRS obtained the services of an outside consultant to provide an independent review of its physical security. However, TIGTA determined that the IRS did not receive the in-depth, independent assessment regarding the security posture of its facilities as required by the contract, and the contractor declined to provide a validation of the acceptability of the IRS's security posture.[15]

During the last three years, threats to the IRS have increased 24 percent. Physical violence, harassment, and intimidation of IRS employees continue to pose significant challenges to the implementation of a fair and effective system of tax administration.

During Fiscal Year 2011, TIGTA evaluated in excess of 2,700 threat-related complaints. This resulted in the initiation of 1,400 threat investigations that required TIGTA Special Agents to promptly respond to mitigate those threats and to determine whether criminal prosecutions of the perpetrators making the threats were warranted.

Additionally, the ongoing public debate regarding the health care law and continued concern over the country's economy could fuel threats against the Federal Government, including IRS employees and facilities. These are challenging operating conditions for the IRS that underscore the need for continued vigilance in the area of physical and personnel security.

TAX COMPLIANCE INITIATIVES

Another serious challenge confronting the IRS is tax compliance. Despite an estimated voluntary compliance rate of approximately 83 percent in the IRS's January 2012 updated Tax Gap[16] estimates and IRS enforcement efforts, a significant amount of income remains unreported and unpaid. Tax compliance initiatives include the administration of tax regulations, collection of the correct amount of tax from businesses and individuals, and oversight of tax-exempt and government entities.

Increasing voluntary taxpayer compliance and reducing the Tax Gap are the focus of many IRS initiatives. Although the IRS reported that the Tax Gap is caused by both unintentional taxpayer errors (whether due to tax law complexity, confusion, or carelessness) and willful tax evasion or cheating, the IRS does not have sufficient data to distinguish the amounts attributable to each. The IRS also reported that a meaningful improvement in the voluntary compliance rate requires a long-term, focused effort involving taxpayer service, modernization, and enforcement. The IRS's strategy for reducing the Tax Gap is largely dependent on funding for additional compliance resources and legislative changes. In its Fiscal Year 2013 budget submission, the IRS requested a 7.6 percent increase in enforcement funds over its Fiscal Year 2012 enacted level.

Businesses and Individuals

The IRS estimated the gross Tax Gap for Tax Year 2006 to be approximately $450 billion. The underreporting of taxes, which is comprised of four major components (individual income tax, employment tax, corporate income tax, and estate and excise taxes), was estimated at $376 billion and accounted for the largest portion (approximately 84 percent) of the Tax Gap. The underpayment of taxes was approximately 10 percent, and the

[15] TIGTA, Ref. No. 2012-10-075, *An Independent Assessment of Facility Physical Security Was Not Performed in Compliance With Contract Requirements* (July 2012).
[16] The IRS defines the Tax Gap as the difference between the estimated amount taxpayers owe and the amount they voluntarily and timely paid for a tax year.

nonfiling of taxes was approximately six percent. The IRS will need to address the following impediments to more effectively address the Tax Gap:

- **Incomplete compliance research** that does not identify all the sources of noncompliance so that IRS resources can be targeted properly.
- **Insufficient compliance strategies** that do not always address the areas of highest risk of noncompliance. The IRS reported it is working to reengineer examination and collection procedures based on improved data from its National Research Project study of individual taxpayers.
- **Incomplete document matching programs** because the IRS does not have reliable third-party data for all taxpayer sectors and for all types of tax returns, most notably income earned by the self-employed. The IRS reported that, without these data, it cannot easily detect errors or potential fraud except through expensive and intrusive examinations.
- **Insufficient enforcement resources** to handle a growing caseload. The IRS has identified noncompliance and potential fraud cases it did not have the resources to work, allowing billions of dollars to be fraudulently refunded each year.

Tax-Exempt Entities

The IRS's challenge related to tax-exempt and government entities is providing assistance to those entities that provide a societal benefit while ensuring that the entities remain in compliance with the tax laws associated with their tax-exempt status. Legislative changes and judicial decisions contribute to a constantly changing environment affecting today's nonprofit and tax-exempt organizations. The *Pension Protection Act of 2006* [17] mandates that tax-exempt organizations file certain information electronically with the IRS. Previously, these organizations were not required to file an annual information return unless their gross receipts exceeded certain dollar thresholds. The Act further requires the IRS to publish and maintain a list of organizations whose tax-exempt status has been automatically revoked.

TIGTA reported that the Exempt Organizations function educated tax-exempt organizations on the requirements of the Act and identified and informed organizations that their tax-exempt status had been automatically revoked. However, the Exempt Organizations function did not identify all organizations that should have been informed about their revocations and did not clearly inform organizations on how to regain their tax-exempt status if they were still operating.[18] TIGTA also reported that while the Exempt Organizations function has greatly improved its timeliness with regard to acknowledging complaints against tax-exempt organizations, referrals were not always controlled or processed timely. If referrals are not properly accounted for or worked timely, the Exempt Organizations function may not identify tax-exempt organizations that are potentially in violation of Federal tax law or have referrals ready when new examination cases are needed.[19]

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[17] Pub. L. No. 109-280, 120 Stat. 780.
[18] TIGTA, Ref. No. 2012-10-027, *Appropriate Actions Were Taken to Identify Thousands of Organizations Whose Tax-Exempt Status Has Been Automatically Revoked, but Improvements Are Needed* (Mar. 2012).
[19] TIGTA, Ref. No. 2012-10-058, *Implementing Better Management Controls Would Improve the Exempt Organizations Function's Ability to Oversee and Timely Process Referrals* (June 2012).

Tax Return Preparers

Every year, more than half of all taxpayers pay someone else to prepare their Federal income tax returns. During the 2012 Filing Season,[20] the IRS processed approximately 71 million individual Federal income tax returns prepared by paid tax return preparers.

In December 2009, the IRS announced a suite of proposed reforms to improve oversight of the return preparer community. In September 2010, TIGTA reported that it will take years for the IRS to implement the Return Preparer Program and to realize its impact.[21] In December 2011, TIGTA reported that improvements are ongoing to ensure that the preparer registration process has effective controls and system validations.[22] However, not until January 2014 will all preparers be subjected to all suitability and competency tests.

MODERNIZATION

The Business Systems Modernization Program (Modernization Program) is a complex effort to modernize IRS technology and related business processes. It involves integrating thousands of hardware and software components while replacing outdated technology and maintaining the current tax system. The IRS originally estimated that completion of the Modernization Program would take up to 15 years and incur contractor costs of approximately $8 billion. The Modernization Program was funded for $330.2 million for Fiscal Year 2012 and the President's Budget request for Fiscal Year 2013 was also $330.2 million. The Modernization Program's goals include:

- Issuing refunds, on average, five days faster than existing legacy systems;
- Offering electronic filing capability for individuals, large corporations, small businesses, tax-exempt organizations, and partnerships, with dramatically reduced processing error rates;
- Delivering web-based services for tax practitioners, taxpayers, and IRS employees;
- Implementing data analytics to reduce improper payments and fraudulent refunds; and
- Providing IRS customer service representatives with faster and improved access to taxpayer account data with real-time data entry, validation, and updates of taxpayer addresses.

The IRS's modernization efforts continue to focus on core tax administration systems designed to provide more sophisticated tools to taxpayers and IRS employees. These efforts will provide the foundation for implementing a real-time tax system, reducing improper payments and fraudulent refunds, and providing the technology infrastructure and architecture that will enable taxpayers and other stakeholders the capability to securely access tax account information. These complex efforts continue to pose significant technological and business challenges for the IRS.

Since January 2012, the IRS has implemented daily updating of taxpayer accounts and daily processing of returns; however, the implementation of the Customer Account Data Engine 2 (CADE-2) relational database designed to

[20] The period from January 1 through April 15 when most individual income tax returns are filed.
[21] TIGTA, Ref. No. 2010-40-127, *It Will Take Years to Implement the Return Preparer Program and to Realize Its Impact* (Sept. 2010).
[22] TIGTA, Ref. No. 2012-40-010, *More Tax Return Preparers Are Filing Electronically, but Better Controls Are Needed to Ensure All Are Complying With the New Preparer Regulations* (Dec. 2011).

replace the 1960s-era Individual Master File is at risk of not meeting timeframes for providing data to other systems. Additionally, while the IRS has upgraded the Modernized e-File system to accept and process over 125 new individual tax forms, performance issues threaten goals to retire the legacy electronic filing system and have delayed the implementation of employment-related business forms. Modernizing legacy tax administration systems to receive and process CADE-2 data and to process new legislative changes, such as the Affordable Care Act, will continue to be a major challenge for the IRS.

The IRS has identified and reported the Modernization Program as a material weakness since 1995. However, in a June 2011 memorandum to the Department of the Treasury, the IRS Commissioner stated that the previously identified internal and management control issues have been fully addressed and that the Modernization Program no longer warranted being identified as a material weakness. The Department of the Treasury agreed to downgrade the material weakness. While we support the IRS's decision, we believe the Modernization Program remains a major management challenge, and the IRS should continue to stress improvements in its overall processes and performance.

IMPLEMENTING THE AFFORDABLE CARE ACT AND OTHER TAX LAW CHANGES

Each filing season tests the IRS's ability to implement tax law changes made by Congress. Correctly implementing late tax law changes remains a significant challenge because the IRS must often act quickly to assess the changes and determine the necessary actions to ensure that all legislated requirements are satisfied. In addition, the IRS must often create new or revise existing tax forms, instructions, and publications; revise internal operating procedures; and reprogram computer systems to accurately and timely process tax returns affected by the new tax law changes. Sometimes, despite all of its efforts, the IRS may have to delay the processing of some tax returns or quickly correct computer programming if early processing errors surface. Effective implementation of tax-related provisions of the Affordable Care Act and changes to tax laws will continue to challenge IRS resources.

Affordable Care Act

The Affordable Care Act contains an extensive array of tax law changes that will present a continuing source of challenges for the IRS in the coming years. While the Department of Health and Human Services will have the lead role in the policy provisions of the Affordable Care Act, the IRS will administer the law's numerous tax provisions. The IRS estimates that at least 42 provisions will either add to or amend the tax code and at least eight provisions will require the IRS to build new processes that do not exist within the current system of tax administration. Examples of new IRS responsibilities resulting from this law include:

- Providing tax credits to businesses and individuals to assist in covering the cost of health coverage;
- Administering the mandate for individuals to purchase health coverage or be subject to a penalty on their individual Federal tax returns;
- Administering multiple tax provisions designed to raise revenues to offset the cost of health care reform; and,
- Protecting additional data entrusted to the IRS from the risk of loss or identity theft.

Results of TIGTA audits illustrate the need for continued oversight of the IRS's administration of many of these tax-related provisions. TIGTA recently reported that the IRS did not require sufficient information to determine whether taxpayers claiming Small Business Health Care Tax Credits filed required employment taxes when these taxpayers entered into a contractual relationship with professional employment organizations to manage human resources.[23] TIGTA also determined that the IRS did not take adequate steps to ensure that taxpayers potentially liable for the indoor tanning excise tax were aware of the new tax law, particularly after the number of taxpayers filing tax returns reporting the excise tax for tanning services was much lower than expected.[24]

TIGTA also reported that taxpayers erroneously received millions of dollars in Adoption Credits. A provision in the Affordable Care Act increased the Adoption Credit and made the tax credit refundable.[25] Although the IRS requires taxpayers to attach documentation to their tax returns supporting Adoption Credit claims, it does not have the authority to deny the credits if documentation is not provided. As a result, tax returns without required documentation must be sent to the Examination function. As of December 23, 2011, the IRS had received 101,627 Adoption Credit claims totaling more than $1.2 billion for Fiscal Year 2010. We reported that 4,258 taxpayers received almost $49.3 million in Adoption Credits without sufficient supporting documentation.[26] Of these 4,258 taxpayers, TIGTA estimated that 953 tax returns claiming more than $11 million in Adoption Credits were erroneous.

Other Tax Law Changes

More than 1.5 million taxpayers who purchased a home between April 9 and December 31, 2008, and claimed the First-Time Homebuyer Credit (Homebuyer Credit), were required to begin repaying the credit on their Tax Year 2010 tax return. The credit is intended to be repaid over 15 years, in equal annual installments. However, the IRS experienced difficulties in implementing the repayment process. As of May 2, 2012, the IRS had inaccurately processed 66 percent (3,819 of 5,756) of taxpayer accounts for which the taxpayer filed a joint tax return with his or her spouse when the Homebuyer Credit was claimed but the ownership of the property was later transferred as part of a divorce settlement. As a result of incorrectly overstating the new Homebuyer Credit repayment obligation, the IRS incorrectly assessed more than $650,000 in additional tax for 136 tax accounts. The IRS also understated the net Homebuyer Credit repayment obligation for 3,683 taxpayers and erroneously reduced the amount these taxpayers were required to repay by more than $13.1 million.[27]

FRAUDULENT CLAIMS AND IMPROPER PAYMENTS

The *Improper Payments Information Act of 2002*[28] defines an improper payment as any payment that should not have been made or that was made in an incorrect amount (both overpayments and underpayments) under statutory, contractual, administrative, or other legally applicable requirements. The Administration has emphasized the

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[23] TIGTA, Ref. No. 2011-40-103, *Affordable Care Act: Efforts to Implement the Small Business Health Care Tax Credit Were Mostly Successful, but Some Improvements Are Needed* (Sept. 2011).
[24] TIGTA, Ref. No. 2011-40-115, *Affordable Care Act: Number of Taxpayers Filing Tanning Excise Tax Returns Is Lower Than Expected* (Sept. 2011).
[25] A refundable tax credit is a tax credit that is treated as a payment and can be refunded to the taxpayer. Refundable credits can create a Federal tax refund that is larger than the amount a person actually paid in taxes during the year.
[26] TIGTA, Ref. No. 2012-40-065, *Processes to Address Erroneous Adoption Credits Result in Increased Taxpayer Burden and Credits Allowed to Nonqualifying Individuals* (June 2012).
[27] TIGTA, Ref. No. 2012-40-119, *The Majority of Individual Tax Returns Were Processed Timely, but Not All Tax Credits Were Processed Correctly During the 2012 Filing Season* (Sept. 2012).
[28] Pub. L. No. 107-300, 116 Stat. 2350.

importance of reducing improper payments. On November 20, 2009, the President signed Executive Order 13520,[29] which included a strategy to reduce improper payments by increasing transparency, holding agencies accountable, and creating strong incentives for compliance. In addition, the *Improper Payments Elimination and Recovery Act of 2010* [30] placed additional requirements on Federal agencies to reduce improper payments. Erroneous and improper payments issued by the IRS generally involve improperly paid refunds, tax-return filing fraud, or improper payments to vendors or contractors.

Refundable Credits

The IRS administers numerous refundable tax credits. These refundable credits allow individual taxpayers to reduce their tax liability to below zero and thus receive a tax refund even if no income tax was withheld or paid. Two significant refundable credits are the Earned Income Tax Credit and the Additional Child Tax Credit.

During Tax Years 2006 through 2009, taxpayers claimed almost $470 billion in refundable credits. Due to post-refund examinations, taxpayers were required to repay more than an estimated $2.3 billion in erroneous credits. By the end of December 2011, the IRS had recovered an estimated $1.3 billion, of which more than 70 percent was collected through refund offsets.

Refunds for the Additional Child Tax Credit processed in Fiscal Year 2010 totaled $28.3 billion, and TIGTA reported that the IRS paid $4.2 billion for this credit in Processing Year 2010 to individuals who were not authorized to work in the United States. Taxpayers also repeatedly claimed erroneous Additional Child Tax Credits after being disallowed the credit in the previous year. TIGTA determined that the IRS could have saved an additional $108 million by reviewing claims made by taxpayers who were previously disallowed the credit. In addition, the IRS could have prevented issuance of approximately $419 million in erroneous Additional Child Tax Credit refunds had it reviewed the Additional Child Tax Credit at the same time the Earned Income Tax Credit was being reviewed.[31]

Fraudulent Payments

Identity theft is escalating and poses significant challenges for the IRS. In Calendar Year 2011, the IRS identified over 1.1 million incidents of identity theft that affected the Nation's tax system.[32] The IRS has stepped up its efforts against refund fraud and identity theft. These efforts include designing new identity-theft-screening filters that the IRS believes will improve its ability to identify false tax returns before they are processed and before fraudulent refunds are issued. As of April 19, 2012, the IRS reported that it has stopped the issuance of $1.3 billion of potentially fraudulent tax refunds as a result of the new identity-theft filters. However, TIGTA determined that the impact of identity theft on tax administration is significantly higher than the amount the IRS

[29] Executive Order No. 13,520, 74 Fed. Reg. 62201 (Nov. 25, 2009), *Reducing Improper Payments and Eliminating Waste in Federal Programs*.
[30] Pub. L. No. 111-204, 124 Stat. 2224.
[31] TIGTA, Ref No. 2012-40-105, *Expansion of Controls Over Refundable Credits Could Help Reduce the Billions of Dollars of Improperly Paid Claims* (Aug. 2012).
[32] This includes incidents in which taxpayers contacted the IRS alleging that they were victims of identity theft, as well as instances where the IRS identified identity theft. Many of the taxpayers that the IRS identified were not aware they were victims of identity theft because they either did not file tax returns or did not have filing requirements.

detects and prevents. Our analysis of Tax Year 2010 tax returns identified more than $5.2 billion in tax refunds issued to individuals filing tax returns with characteristics of identity-theft cases confirmed by the IRS.[33]

Contract and Other Payments

The IRS expends approximately $2.1 billion annually in contract spending, an area which continues to experience several risks for fraud and abuse. Previous TIGTA investigations and audits have identified millions of dollars in questioned costs and several instances of contractor fraud. During Fiscal Years 2010 and 2011, TIGTA's criminal investigative efforts contributed to court-ordered civil settlements which required Government contractors to pay $156 million and $113 million, respectively, to the U.S. treasury. These payments were the result of Federal procurement law violations that occurred with work contracted with multiple Federal agencies, including the IRS.

During these investigations, two recurring trends emerged: contracting officer's representatives were frequently overwhelmed by their workloads, and current business practices have not enhanced the IRS's ability to identify anomalies warranting additional review.

TIGTA recently performed an assessment of the IRS's controls over contract invoice review, approval, and payment processes to identify whether improper payments were made to contractors. TIGTA reported that the IRS did not have documentation supporting $384,430 of the invoiced labor hours that were paid. Applying the results to the population of labor charges, we estimate a total of $927,992 may have been erroneously paid.[34]

Another TIGTA review identified that the IRS is not always charging other entities for the full costs of the work performed on reimbursable agreements. We identified more than $28 million in costs incurred by the IRS that were not reimbursed. When the IRS is reimbursed less than the cost of performing reimbursable work, it must fund this work using its own operating budget, thereby reducing the funds available for tax administration.[35]

PROVIDING QUALITY TAXPAYER SERVICE OPERATIONS

The Department of the Treasury and the IRS recognize that the delivery of effective taxpayer service has a significant impact on voluntary tax compliance. Answering taxpayers' questions to assist them in correctly preparing their returns reduces the need to send notices and correspondence when taxpayers make errors. Taxpayer service also reduces unintentional noncompliance and shrinks the need for future collection activity. The IRS continues to focus on the importance of improving service by emphasizing it as a main goal in its strategic plan, including seeking innovative ways to simplify or eliminate processes that unnecessarily burden taxpayers or Federal Government resources.

Although the number of identity-theft cases is increasing, TIGTA found that the IRS is not effectively providing assistance to victims of identity theft. Identity-theft cases are not worked timely and can take more than a year to resolve. Communications between the IRS and victims are limited and confusing, and victims are asked multiple times to substantiate their identity, increasing the burden to these taxpayers. IRS guidelines are inconsistent and not

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[33] TIGTA, Ref. No. 2012-42-080, *There Are Billions of Dollars in Undetected Tax Refund Fraud Resulting From Identity Theft* (July 2012).
[34] TIGTA, Ref. No. 21012-11-101, *Deficiencies Continue to Exist in Verifying Contractor Labor Charges Prior to Payment* (Aug. 2012).
[35] TIGTA, Ref. No. 2011-10-076, *The Full Costs of Work Performed on Reimbursable Agreements Are Not Always Charged, Resulting in Reduced Funds Available for Tax Administration* (July 2012).

all functions within the IRS have guidelines for handling identity-theft issues. In November 2011, the IRS established a Taxpayer Protection Unit to manage identity-theft cases. However, during the 2012 Filing Season, taxpayers found it difficult to reach employees in this unit. The unit received more than 86,000 calls during the Filing Season, but was only able to answer about 21,000 of these calls. The average wait time for taxpayers was almost one hour.

The IRS assisted approximately 2 million individuals at its walk-in Taxpayer Assistance Centers during the 2012 Filing Season. In addition, more taxpayers are calling the IRS's toll-free telephone lines every year, with approximately 90 million calls attempted to the various toll-free telephone assistance lines during the 2012 Filing Season. However, as a result of budget constraints, tax return preparation was provided only on a limited number of days per week, and the IRS did not provide the planned extended hours for the Taxpayer Assistance Centers. Additionally, a reduction in funding for toll-free telephone and correspondence services resulted in a Level of Service goal for Fiscal Year 2012 of 61 percent, compared to the 70 percent the IRS achieved in Fiscal Year 2011.

Furthermore, our recent review of the Taxpayer Advocate Service's toll-free telephone lines determined that the Taxpayer Advocate Service does not have a formalized process to track or analyze the calls received by the ASK-TAS1 toll-free line to assess the effectiveness of its outreach efforts in generating cases meeting Taxpayer Advocate Service case criteria. Taxpayers specifically requesting Taxpayer Advocate Service assistance have several telephone options, including the ASK-TAS1 toll-free line staffed by Taxpayer Advocate Service personnel. Additional documentation and analysis is necessary to evaluate the impact of the ASK-TAS1 toll-free line and ensure that proposed changes to the line provide the expected benefits without adversely affecting taxpayers.[36]

HUMAN CAPITAL

Human capital is the Federal Government's most critical asset. At a time when agencies are preparing for increased retirements and taking on such challenges as implementing the numerous health care tax provisions, the recruitment and retention of employees plays a key role in maintaining a quality workforce. Like many Federal agencies, the IRS is faced with the major challenge of replacing existing talent caused by a large number of retirements expected over the next several years. In five years, about one-third of the IRS's workforce of approximately 100,000 employees will be eligible to retire. In the leadership ranks, over two-thirds of IRS executives will be eligible for retirement in five years. Adding to this challenge, the IRS offered early retirement and buyouts to more than 2,200 employees in Fiscal Year 2012.

The IRS's challenge of having the right people in the right place at the right time is made more difficult by many complex internal and external factors. The work performed by IRS employees continually requires greater expertise as tax laws become more complex and as attempts by taxpayers and tax practitioners to evade compliance with the tax laws grows and becomes more sophisticated. The IRS must also compete with other Federal agencies and private industry for the same human resources, which becomes more complicated as younger generations of employees move between jobs more frequently than their predecessors. Further, budget constraints, legislative changes, and economic shifts can create unforeseen challenges for the IRS in addressing its long-term human capital issues.

While the IRS is improving its human capital management practices and has developed a comprehensive agency-wide recruitment strategy, there is still much work to be done. TIGTA recently reported that the IRS has improved its

[36] TIGTA, Ref. No. 2012-10-052, *The Taxpayer Advocate Service's ASK-TAS1 Toll-Free Line Has Evolved Over Time, but Additional Steps Are necessary to Evaluate Its Impact* (June 2012).

process for onboarding new employees; however, managers interviewed by TIGTA indicated they were not following best practices, as identified in the comprehensive guidance the IRS developed for them. As a result, some best practices that would help new employees become more productive were not fully implemented. Improved processes would reduce the substantial cost of replacing employees who leave the IRS and would help the IRS meet its mission by ensuring that employees quickly become productive.[37]

The IRS is also at risk when the workforce turns over at a high rate resulting in the loss of experience. This loss of experience needs to be offset by strong managerial oversight and internal controls or it can foster an environment where employee misconduct and criminal acts can go unreported and undetected. All employees need to be aware and vigilant in their responsibilities for maintaining the highest degree of integrity within the Federal Government.

GLOBALIZATION

The scope, complexity, and magnitude of the international financial system presents significant enforcement challenges for the IRS. International business holdings and investment in the United States have grown from nearly $188 billion in 1976 to over $14.5 trillion in 2007, while U.S. business and investment grew from nearly $368 billion to nearly $15 trillion during the same period. The number of taxpayers conducting international business transactions continues to grow as technological advances provide opportunities for offshore investments that were once only possible for large corporations and wealthy individuals.

As technology continues to advance and cross-border transactions rise, the IRS is increasingly challenged by economic globalization. The IRS is confronted with a lack of information reporting on many cross-border transactions. In addition, the varying legal requirements imposed by different jurisdictions result in complex business structures that make it difficult to determine the full scope and effect of cross-border transactions.

The IRS has developed a strategic plan specifically for international tax issues with two major goals: (1) enforce the law to ensure that all taxpayers meet their obligation to pay taxes and (2) improve service to make voluntary compliance less burdensome. The IRS continues to realign and expand its international efforts under its Large Business and International Division. The IRS expects that these efforts will improve international tax compliance by allowing it to focus on high-risk issues and work cases with greater consistency and efficiency.

A top priority for the IRS has been to stop offshore tax cheating and bring these taxpayers, especially high net-worth individuals, back into the tax system. The IRS offered Offshore Voluntary Disclosure Initiatives in 2009 and 2011 to encourage taxpayers with hidden offshore assets and income to come back into the tax system using the IRS's Voluntary Disclosure Program. According to the IRS, these initiatives have resulted in the collection of over $4 billion. Due to the success of the first two initiatives, the IRS offered a third opportunity in 2012 for delinquent taxpayers to disclose their hidden offshore assets. In a review of the IRS's 2009 Offshore Voluntary Disclosure Initiative, TIGTA determined that the IRS's disclosure practices increased taxpayer compliance. However, additional oversight is necessary to ensure that information obtained from the voluntary disclosures is accurate and complete to

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[37] TIGTA, Ref. No. 2012-10-091, *The Onboarding Process Has Improved, but Additional Steps Should Be Taken to Ensure Employees Have the Tools, Resources, and Knowledge to be Successful and Productive* (Aug. 2012).

assist the IRS in identifying additional taxpayers and promoters who continue to defraud the Federal Government with their offshore activities.[38]

Another challenge that the IRS currently faces is the implementation of the *Foreign Account Tax Compliance Act* (FATCA).[39] The FATCA was enacted to combat tax evasion by U.S. persons holding investments in offshore accounts. Under this Act, a U.S. taxpayer with financial assets outside the United States will be required to report those assets to the IRS. In addition, foreign financial institutions will be required to report to the IRS certain information about financial accounts held by U.S. taxpayers or by foreign entities in which U.S. taxpayers hold a substantial ownership interest. The FATCA is being phased in by the IRS over several years. Individual taxpayers with an aggregate balance of more than $50,000 in foreign financial assets are required to file a disclosure statement with their income tax return.

TAXPAYER PROTECTION AND RIGHTS

The IRS must ensure that tax compliance activities are balanced against the rights of taxpayers to receive fair and equitable treatment. The IRS continues to dedicate significant resources and attention to implementing the taxpayer rights provisions of the *IRS Restructuring and Reform Act of 1998* (RRA 98).[40] The following audits related to taxpayer rights provisions are mandated annually: Notices of Levies; Restrictions on the Use of Enforcement Statistics to Evaluate Employees; *Fair Debt Collection Practices Act* [41] Violations; Notices of Liens; Seizures; Illegal Protestor Designations; Assessment Statute of Limitations; Collection Due Process Appeals; Denial of Requests for Information; Restrictions on Directly Contacting Taxpayers Instead of Authorized Representatives; and Separated or Divorced Joint Filer Requests.

In general, the IRS has improved its compliance with these statutory taxpayer rights provisions and in documenting that taxpayer rights were protected. However, TIGTA continues to identify the same deficiencies in the IRS's processing of collection due process cases. TIGTA reported in July 2012[42] that the Office of Appeals did not always classify taxpayer requests properly and, as a result, some taxpayers received the wrong type of hearing. TIGTA also identified an increase in errors relating to the determination of the Collection Statute Expiration Data on taxpayer accounts. In addition, TIGTA reported that Appeals personnel continue to fail to document their impartiality in all cases. These deficiencies may result in taxpayers not receiving their full rights during an appeal hearing.

As previously noted, the IRS is seeing a significant growth in identity-theft cases. Identity theft remains the single largest type of complaint submitted to the Federal Trade Commission's Consumer Sentinel Network.[43] The Federal Trade Commission estimates that as many as nine million Americans have their identities stolen each year. Identity

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[38] TIGTA, Ref. No. 2011-30-118, *The 2009 Offshore Voluntary Disclosure Initiative Increased Taxpayer Compliance, but Some Improvements Are Needed* (Sept. 2011).
[39] Pub. L. No. 111-147, Subtitle A, 124 Stat 71, *96-116 (2010)(codified in scattered sections of 26 U.S.C.).
[40] Pub. L. No. 105-206, 112 Stat. 685 (codified as amended in scattered section of 2 U.S.C., 5 U.S.C. app., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., and 49 U.S.C.).
[41] 15 U.S.C. §§1601 note, 1692-1692o (2006).
[42] TIGTA, Ref. No. 2012-10-077, *Office of Appeals Errors in the Handling of Collection Due Process Cases Continue to Exist* (July 2012).
[43] The Federal Trade Commission's Consumer Sentinel Network is an investigative cyber tool and complaint database, restricted to law enforcement use, that provides civil and criminal enforcement organizations immediate and secure access to identity theft and other consumer-related complaints.

theft affects the IRS and tax administration in two ways – fraudulent tax returns and misreporting of income.[44] Both can potentially harm taxpayers who are the victims of identity theft.

ACHIEVING PROGRAM EFFICIENCIES AND COST SAVINGS

Given the current economic environment and the increased focus by the Administration, Congress, and the American people on Federal Government accountability and efficient use of resources, the American people must be able to trust that their Government is taking action to stop wasteful practices and ensure that every tax dollar is spent wisely. During the Fall of 2011 through Summer 2012, numerous Department of the Treasury, Office of Management and Budget, and Presidential Executive Orders and other guidance documents were issued to ensure that the Government is a good steward of taxpayer money by identifying opportunities to promote efficient and effective spending and eliminating excess spending on conferences and travel.

This management challenge is even more compelling given the IRS's Fiscal Year 2012 budget, which was reduced over $300 million from Fiscal Year 2011, approximately a 2.5 percent cut. As a result, the IRS reduced its administrative costs, offered early outs and buy outs, and made difficult decisions in taxpayer service and enforcement operations.

While the IRS has made progress in using its data to improve program effectiveness and reduce costs, this area continues to be a major challenge. In a recent audit, we assessed the IRS's progress in achieving real estate cost savings to meet the President's Fiscal Year 2012 Federal real estate cost savings goals. On June 10, 2010, President Obama directed Government agencies to eliminate excess properties and achieve $3 billion in savings by the end of Fiscal Year 2012. Our review found that the IRS achieved some cost savings in support of the President's goal. However, these efforts are impeded by the lack of an established policy and effective strategy on implementing workstation sharing by IRS employees who telework. A policy requiring employees who telework to share workstations would allow the IRS to further reduce its long-term office space needs and achieve additional cost savings. This would allow the IRS to reduce its office space needs by almost 1 million square feet, resulting in potential rental savings of approximately $111.4 million over five years.[45]

CONCLUSION

This memorandum is provided as our annual summary of the most serious major management and performance challenges confronting the IRS in Fiscal Year 2013. TIGTA's *Fiscal Year 2013 Annual Audit Plan* contains our proposed reviews, which are organized by these challenges. If you have any questions or wish to discuss our views on the challenges in greater detail, please contact me at (202) 622-6500.

cc: Deputy Secretary
Acting Assistant Secretary for Management and Chief Financial Officer
Commissioner of Internal Revenue

[44] The Federal Trade Commission's Identity Theft website, *What is Identity Theft?* (http://www.ftc.gov/bcp/edu/microsites/idtheft/consumers/about-identity-theft.html#Whatisidentitytheft).
[45] TIGTA, Ref. No. 2012-10-100, *Significant Additional Real Estate Cost Savings Can be Achieved by Implementing a Telework Workstation Sharing Strategy* (Aug. 2012).

**MANAGEMENT'S RESPONSE TO THE
MANAGEMENT AND PERFORMANCE CHALLENGES IDENTIFIED BY THE
TREASURY INSPECTOR GENERAL
AND
TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION**

In their memoranda dated October 25 and 15, 2012, the Treasury Inspector General (IG) and Treasury Inspector General for Tax Administration (TIGTA), respectively, identified the major challenges facing management. The Department of the Treasury concurs with the IG and TIGTA on these challenges. These challenges do not necessarily indicate deficiencies in performance; rather, some represent inherent risks that must be monitored continuously. Moving forward, Treasury will continue to address these issues proactively. The following tables summarize the major management and performance challenges facing the Department of Treasury, and provide information on the actions taken by Treasury in fiscal year 2012 and planned for fiscal year 2013 and beyond. The IG's matters of concern are also addressed below.

Timothy F. Geithner
Secretary of the Treasury
November 15, 2012

RESPONSE TO OIG

OIG CHALLENGE NO. 1	SUMMARY OF MAJOR ISSUES
Transformation of Financial Regulation	• Maintain an effective Financial Stability Oversight Council process supported by the Office of Financial Research and Federal Insurance Office within Treasury • Build a streamlined banking regulatory structure that timely identifies and strongly responds to emerging risks

Financial Stability Oversight Council (Council)

Fiscal Year 2012 Accomplishments

- Held 11 meetings of the FSOC (Council) to discuss and analyze emerging market developments and financial regulatory issues
- Initiated monitoring for potential risks to U.S. financial stability, with a focus on significant financial market developments and structural issues within the financial system
- Began to evaluate certain nonbank financial companies for supervision by the Federal Reserve and enhanced prudential standards
- Designated eight financial market utilities to be subject to enhanced prudential standards and supervisory requirements
- Published the following studies and reports on:
  - Feasibility, benefits, costs, and structure of a contingent capital requirement for nonbank financial companies supervised by the Board of Governors and large, interconnected bank holding companies
  - Actions taken in response to the U.S. Government Accountability Office's report entitled, *National Credit Union Administration: Earlier Actions are Needed to Better Address Troubled Credit Unions*
- Continued to build out the Council's institutional framework, adopting rules of operation, releasing proposed regulations implementing Freedom of Information Act obligations, adopting a transparency policy, and passing a budget for the Council operations

Actions Planned or Underway

- Coordinate with the Council member agencies to consult with the Federal Reserve on developing rules for establishing enhanced prudential standards
- Continue identification of specific nonbank financial companies for supervision by the Federal Reserve and enhanced prudential standards

- Coordinate issuance of final regulations implementing the Volcker Rule with member agencies and on credit risk retention for asset-backed securities with member agencies
- Continue monitoring for potential risks to U.S. financial stability, with a focus on significant financial market developments and structural issues within the financial system

Office of Financial Research (OFR)

Fiscal Year 2012 Accomplishments

- Issued its first Annual Report to Congress, containing analysis and tools for monitoring threats to U.S. financial stability
- Provided analytical and data-related support to the Council and its member agencies, focusing initially on nonbank financial company designations and support for the Council's annual report
- Provided Council with the initial Financial Stability Monitor – a dashboard of financial stability metrics and indicators
- Supported the Council's Data Committee as a forum for Council-wide coordination on data-related issues, including data sharing, data standardization, and data security
- Continued to play a leadership role in achieving the global Legal Entity Identifier
- Launched a Working Paper Series and a Research Seminar Series
- Cohosted OFR-Council Conference, "The Macroprudential Toolkit: Measurement and Analysis" and conducted a workshop on stress testing
- Finalized preparations for an advisory committee under the Federal Advisory Committee Act procedures
- Established a comprehensive strategic planning and performance management system based on the OFR's first Strategic Framework and comprehensive implementation planning tools to ensure the OFR's research, data, human resources, budget, and other operational activities are aligned with and support its long-term goals
- Established foundational operational policies and procedures, including those related to information security
- Accelerated ramp-up in staffing (from 20 to 120), began build-out of core information technology (IT) and business infrastructure, and established foundational controls and procedures

Actions Planned or Underway

- Conduct essential research on risks to financial stability and evaluate responses to those risks in collaboration with outside researchers, with a particular focus on evaluating metrics for measuring risks to financial stability; evaluating stress tests that may prove useful in financial stability analysis; and promoting best practices in financial institution risk management
- Expand analytical and data-related support to the Council, including work to support the Council's designations of nonbank financial companies, providing data for the Council's use in connection with its Annual Report on financial stability, and by supporting work of the Council's Data Committee
- Build on the OFR's secure analytical environment through core investments in long-term IT infrastructure and collaboration tools
- Map the OFR's data security classification to other Council members as the basis for data sharing
- Continue to expand communication, including enhancements to the OFR website
- Update and implement the OFR's fiscal year 2012-2014 Strategic Framework, including the tracking of foundational performance measures tied to the Framework's established goals
- Continue the momentum to achieve the steady-state staffing projected for fiscal years 2014-2015

Federal Insurance Office (FIO)

Fiscal Year 2012 Accomplishments

- Drafting reports required by the Dodd-Frank Act, specifically the insurance regulatory modernization report and the annual report on the insurance industry
- Acted as leading insurance expert on the Council
    - Helped develop the Council's final rulemaking on determination of nonbank financial companies for consolidated supervision by the Federal Reserve and enhanced prudential standards
    - Provided insurance expertise in Council committees and working groups
    - Led the Stage 2 analysis of one nonbank financial company in connection with the Council's consideration of nonbank financial companies for supervision by the Federal Reserve and enhanced prudential standards

  - Contributed to the development of the Stage 2 analysis for another nonbank financial company being considered by the Council for supervision by the Federal Reserve and enhanced prudential standards
- Represented the U.S on the International Association of Insurance Supervisors (IAIS)
  - Played leading role in developing IAIS methodology for identifying globally significant international insurers (G-SIIs)
  - Collected and analyzed data for U.S. insurance firms being considered for designation as G-SIIs
  - Played leading role in developing policy measures to be applied to G-SIIs
  - Served on IAIS Executive Committee and Macro-Prudential Surveillance Working Group
- Initiated a European Union-U.S. Dialogue with the objective of comparing the design and efficiency of the respective supervisory regimes in order to promote consumer protection, business opportunity and effective regulation
  - The Dialogue has been guided by a Steering Committee that included the FIO Director and leaders from the European Commission, European Insurance and Occupational Pensions Authority, the Financial Services Authority, as well as the state regulators
  - Its work, conducted by separate technical committees, has included the analysis of the two regulatory regimes on the basis of eight key topics (professional secrecy/confidentiality, group supervision, solvency and capital requirements, reinsurance and collateral requirements, supervisory reporting, data collection and analysis, supervisory peer reviews, and independent third party review and supervisory on-site inspections)
- Continued to gather input on FIO's functions, authorities, and strategic priorities, including by engaging with state government leaders, consumer advocates, industry leaders, and international counterparts
- Convened the first Federal Government Insurance Forum in March 2012
- Developed data collection and analysis processes with OFRSelect members, convened and supported the first Federal Advisory Committee on Insurance
- Attended and participated in the Strategic and Economic Dialogue with China

Actions Planned or Underway

- Serve as the IAIS's Chairman of Technical Committee
- Release the studies and reports required by the Dodd-Frank Act
- Continue and expand participation in the Council and its supporting committees
- Support and provide leadership for IAIS initiatives, including the Executive Committee, the Financial Stability Committee, and the Technical Committee
- Develop indicia to measure, and implement processes to collect data, when determining affordability and accessibility of insurance to traditionally underserved communities
- Develop limits of FIO subject matter jurisdiction, in coordination with the Department of Health and Human Services
- Further develop insurance sector data collection and analysis processes with OFR
- Expand bi-lateral supervisory relationships in Asia and South America
- Further build and develop staff and resources

Office of the Comptroller of the Currency (OCC)

Fiscal Year 2012 Accomplishments

- Published final rule that addresses section 939A of the Dodd-Frank Act by removing references to credit ratings from OCC's regulations dealing with topics other than capital requirements replacing it with a new non-ratings based creditworthiness standard (i.e., investment grade standard)
- Published final market risk rule that implements various enhancements adopted by the Basel Committee on Banking Supervision to strengthen the capital requirements that apply to banks' trading activities
- Published a set of proposals that revised the agencies' current "advanced approaches" risk-based capital rules and replaced the agencies' current generally applicable risk-based capital rules with rules that implement various enhancement adopted by the Basel Committee
- Published a Notice of Proposed Rulemaking to implement the company-run stress tests for banks with assets greater than $10 billion and timeline for implementation stress test based on the size of the institution

- Issued interagency guidance on stress testing principles for banks with assets greater than $10 billion.
- Issued proposed rules implementing section 619 of the Dodd-Frank Act prohibiting and limiting the ability of a banking entity and a nonbank financial company supervised by the FRB to engage in propriety trading and to have certain interests in, or relationships with, a hedge fund or private equity fund (Volcker Rule)
- Adopted an interim final rule amending its lending limit rule to apply to certain credit exposures arising from derivative transactions and securities financing transactions, in response to a Dodd-Frank revision in the statutory definition of loans and extensions of credit to include certain exposures arising from derivative, repurchase and securities transactions
- Issued proposed rules for appraisals on higher-risked mortgages
- Developed rulemaking proposals to harmonize rules in the context of OCC-Office of Thrift Supervision (OTS) integration in the areas of securities, compliance and real estate, bank operations, and licensing
- Continued active participation in the Council and its various operating committees
- Signed Memorandum of Understanding with the Consumer Financial Protection Bureau (CFPB) implementing the coordination requirements for supervisory activities
- With other regulatory agencies, issued a statement on measurement of total assets of an insured bank, thrift or credit union for purposes of determining supervisory and enforcement responsibilities under the Dodd-Frank Act, referencing the CFPB's examination and enforcement authority regarding certain consumer financial laws over institutions with total assets of more than $10 billion, and their affiliates
- Developed and issued a semi-annual risk perspectives report that provides the industry and other interested parties the OCC's perspectives on issues that pose threats to the safety and soundness of those financial institutions regulated by the OCC
- Initiated an Independent Foreclosure Review process for people seeking review of their mortgage foreclosures, increased communication efforts to inform affected parties, and extended the deadline for review requests to December 31, 2012, pursuant to comprehensive OCC 2011 enforcement orders against four large national bank mortgage servicers regarding mortgage servicing and foreclosure deficiencies
- Completed operational integration of OTS and OCC staff and offices which included continued integration of OCC and OTS policies and examination handbooks
- Utilized a variety of supervisory and enforcement tools that resulted in the recapitalization of a total of 15 problem institutions through capital injections, merger, or acquisition

Actions Planned or Underway

- Continue to conduct on-site supervisory assessments of national banks and Federal savings associations, focusing on the quality of corporate governance, risk management practices, adequacy of loan-loss reserves, and capital
- Continue to perform individual bank examinations on a variety of other activities aimed at identifying and responding to systemic trends and emerging risks that could adversely affect asset quality or the availability of credit at national banks and federal savings associations and the banking system, and fair access to financial services
- Continue to integrate OCC national bank and OTS federal savings association rules under OCC regulations
- Work closely within Treasury and with other federal financial regulatory agencies to implement the Dodd-Frank Act reforms, and to monitor and respond to emerging risks to the stability of the U.S. financial system
- Continue to pursue a range of strategies to rehabilitate/recapitalize problem institutions
- Continue strategies to resolve problem banks effectively by identifying problems at the earliest possible stage; clearly communicating concerns and expectations to bank management and the Board of Directors; using focused enforcement actions to require the necessary corrective actions; and ensuring timely follow-up on the implementation and effectiveness of corrective actions
- Continue to use supervisory analytical tools, filters and risk based analytics to provide early identification of banks that may be vulnerable to existing or emerging risks

OIG CHALLENGE NO. 2	SUMMARY OF MAJOR ISSUES
Management of Treasury's Authorities Intended to Support and Improve the Economy	• Protect the taxpayer from unnecessary risk associated with the implementation and administration of programs intended to support and improve the economy, including the provisions of the: - *Small Business Jobs Act of 2010* - *American Recovery and Reinvestment Act of 2009* - *Housing and Economic Recovery Act of 2008* - *Emergency Economic Stabilization Act of 2008*

Small Business Lending Fund (SBLF)

Fiscal Year 2012 Accomplishments

- SBLF supports the Treasury strategic goal, "repair and reform the financial system and support the recovery of the housing market." In total, the SBLF provided $4.03 billion to 332 community banks and community development loan funds
- In fiscal year 2012, the SBLF program office transitioned from its fiscal year 2011 focus on application review and transaction execution activities to asset management, operations, compliance and controls, and outreach and reporting activities
- Specifically, the SBLF program office focused on the following activities:
  - Asset Management: Monitored the SBLF investment portfolio and made recommendations to senior Treasury officials on decisions related to investment performance and activities; all participants have made all expected dividend or interest payments
  - Operations: Managed the program's data and information in connection with participant reporting, dividend and interest payments, capital repayments, and correspondence
  - Compliance and Controls: Developed a compliance program which monitors participant conformance with program terms, including lending data, certification requirements, and other requirements provided for by the SBLF Securities Purchase Agreement. SBLF also developed and executed internal control procedures for processes across SBLF program office functions
  - Reporting and Outreach: Continued its outreach and reporting efforts in fiscal year 2012, as these activities included reporting to Congress on the program's transactions, costs, and the participants' use of funds as well as developing and distributing the program's first annual lending survey (As of June 30 2012, SBLF participants have increased small business lending by $6.7 billion over a $36.0 billion baseline)

Actions Planned or Underway

- For fiscal year 2013 and forward, the SBLF program office plans to continue its focus on asset management, dividend and interest operations, compliance and oversight, and outreach and reporting
- Specifically, the SBLF program office will focus on the following activities:
  - Asset Management: Plans continue to monitor the SBLF investment portfolio and make recommendations to senior Treasury officials on decisions related to investment performance and activities
  - Operations: Plans continue to manage the program's data and information in connection with participant reporting, dividend and interest payments, capital repayments, and correspondence
  - Compliance and Controls: (1) Plans continue to execute a compliance program to monitor participant conformance with program terms, including lending data, certification requirements, and other requirements provided for by the SBLF Securities Purchase Agreement; and (2) Plans continue to execute internal control procedures for processes across SBLF program office functions
  - Reporting and Outreach: Plans continue its outreach and reporting efforts in fiscal year 2013, as these activities include reporting to Congress on the program's transactions, costs, and the participants' use of funds as well as publishing the results of the program's first annual lending survey and issuing the second annual survey

State Small Business Credit Initiative (SSBCI)

Fiscal Year 2012 Accomplishments

- Approved 18 states for $300 million in SSBCI allocations in 2012 (As of September 30, 2012 Treasury had approved 57 states, territories, the District of Columbia, and consortia of municipalities (Participating States) for $1.44b in Allocated Funds. Of the 57 Participating States, 56 had received their first of three disbursements of funds; and 5 had received their second disbursement)
- Processed requests from Participating States to modify Approved State Programs for 8 states
- Published National Compliance Standards to recommend best practices to meet or exceed the compliance expectations that Treasury has for that Participating States in terms of oversight, supervision, and accountability
- Revised Frequently Asked Questions (FAQ) in response to OIG recommendations including the addition of an FAQ defining a material adverse change in a state's fiscal or operational condition that must be reported to Treasury
- Held a national conference attended by 160 managers and stakeholders from 53 Participating States
- Conducted three open conference calls to build awareness and understanding of the National Compliance Standards and the revised and new FAQs, and to provide guidance for compliance related questions
- Implemented an on-line reporting system for Participating States to utilize in order to submit quarterly and annual reports
- Initiated compliance sampling of transactions which were reported by Participating States in the December 31, 2011 annual report
- Provided ongoing technical assistance to Participating States, including 33 site visits

Actions Planned or Underway

- Host a second national conference of Participating State managers and other key stakeholders in October 2012, in Chicago
- Process modification and disbursement requests from Participating States on an ongoing basis
- Continue to provide guidance and prompt responses to questions initiated by Participating States

Management of Recovery Act Programs

Fiscal Year 2012 Accomplishments

- Managed the low income housing and specified energy property programs, including the extension of the specified energy property program by one year under Section 707 of the Job Creation Act, by supplementing a small core staff in Departmental Offices with support from Treasury bureaus
- Provided follow-up and support as necessary to Recovery Act Community Development Financial Institutions (CDFI) Program and Native American CDFI Assistance Program awardees with remaining federal reporting requirements in fiscal year 2012 (35 of original 69 Recovery Act awardees), to ensure timely reporting to Federal Reporting.gov (100 percent on-time rate was achieved for fiscal year 2012)
- Provided follow-up and support as necessary to all 69 Recovery Act CDFI Program and Native American CDFI Assistance Program awardees, to ensure timely receipt of quarterly reports to the CDFI Fund (99 percent on-time reporting was achieved for fiscal year 2012)
- Verified final report submission to Federal Reporting.gov by 13 Recovery Act CDFI Program and Native American CDFI Assistance Program awardees
- Continued an interagency agreement for the energy program with the Department of Energy to assist with the technical aspects of that program
- Implemented an annual reporting process for the low-income housing program to ensure projects funded under the program remain qualified

Actions Planned or Underway

- Continue to provide follow-up and support to 22 remaining Recovery Act CDFI Program and Native American CDFI Assistance Program awardees with federal reporting requirements, to ensure 100 percent on-time reporting
- Provide follow-up and support to all 69 Recovery Act CDFI Program and Native American CDFI Assistance Program awardees to ensure on- time reporting of quarterly reports submission to the CDFI Fund
- Continue the compliance monitoring programs related to the low-income housing and specified energy property programs

- Continue to coordinate with IRS's compliance initiative project regarding the energy program
- Continue assessment of staffing needs

Management of the Housing and Economic Recovery Act (HERA) and the Emergency Economic Stabilization Act (EESA)

Fiscal Year 2012 Accomplishments

- Continued to manage the wind-down of remaining Troubled Asset Relief Program (TARP) investments in a manner that balanced exiting investments as soon as practicable with maximizing returns for taxpayers
- Collected 88.5 percent of the $417.6 billion in program funds disbursed under TARP
- Continued to implement the housing programs funded under TARP, which are designed to prevent avoidable foreclosures; these efforts have directly helped more than one million people avoid foreclosure and indirectly helped millions more by setting new standards throughout the mortgage servicing industry

Actions Planned or Underway

- Continue to manage the wind-down of remaining TARP investments in a manner that balances exiting as soon as practicable with maximizing returns for taxpayers
- Continue to implement the housing programs funded under TARP, which are designed to prevent avoidable foreclosures

OIG CHALLENGE NO. 3	SUMMARY OF MAJOR ISSUES
Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act (BSA) Enforcement	• Prevent and detect money laundering and terrorist financing • Promote U.S. and international financial systems that are safe and transparent • Ensure continued cooperation and coordination of all organizations involved in anti-money laundering and combatting terrorist financial efforts • Create safeguards over the use of BSA information

FinCEN

Fiscal Year 2012 Accomplishments

- Continued to enhance the sharing of information derived from compliance examinations through: 69 memoranda of understanding (MOU) with federal and state regulators; coordination with State regulators and the IRS on examination and risk targeting of non-bank financial institutions [particularly money service businesses (MSB)]; and agreement with the National Association of Insurance Commissioners to include examination for compliance with FinCEN's regulations within the scope of State insurance regulator examinations
- Subjected non-bank residential mortgage lenders and originators to requirements to establish anti-money laundering programs and file suspicious activity reports (SARs), worked with the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators on a joint examination framework, and issued guidance on regulatory expectations for bank mortgage lending affiliates subject to examination by Federal banking regulators
- Required mandatory electronic filing of most BSA reports by June 30, 2012, subject to certain limited exemptions and exceptions, and released new unified reporting templates for all industries to file SARs and Currency Transaction Reports, which will become mandatory by March 2013, and further improve the quality of reported information
- Issued Notice of Proposed Rulemakings that would apply anti-money laundering (AML) program and SAR rules to housing government-sponsored enterprises, applied reporting requirements on the international transport of certain tangible prepaid access devices, and applied certain special measures under Section 311 of the USA PATRIOT Act; also issued an Advance Notice of Proposed Rulemaking to solicit public comment on questions related to the development of a customer due diligence (CDD) regulation that would clarify, consolidate, and strengthen existing CDD obligations and incorporate collection of beneficial ownership information
- Conducted strategic analytical studies and published reports promoting greater awareness of emerging money laundering trends and vulnerabilities, including assessments related to mortgage fraud, title and escrow companies, and the gaming industry, and issued analytical reports to state regulatory authorities on activities involving MSBs in addition to overall BSA filing trends within their jurisdictions

Actions Planned or Underway

- Continue cooperative efforts with Federal and State regulatory agencies, pursuing memorandum of understandings with additional state insurance regulators, and promoting greater leveraging of resources between the IRS and state regulatory agencies on non-bank financial institution examinations – including implementation of compliance strategies for industries that have been recently subject to FinCEN's regulations
- Continue working towards finalizing rulemaking proposals, as well as proposed and/or final regulations related to AML program and SAR rules for investment advisers, proposed and/or final regulations pursuant to Section 311 of the USA PATRIOT Act, and various technical and other regulatory amendments in conjunction with review of existing regulations
- Continue to implement the BSA IT Modernization Program, and continue the transition of remaining paper filers to electronic filing and all filers to the new unified reporting formats
- Continue to issue guidance to institutions as needed and to issue additional financial institution advisories as risks emerge
- Continue to publish analytic products, which assess trends and patterns in mortgage fraud and other financial crimes as appropriate, and develop new processes to streamline recurring analytic reports using FinCEN modernization tools in order to provide faster turnarounds to customers
- Continue to exercise enforcement authorities for violations of FinCEN's regulations, where appropriate

OCC

Fiscal Year 2012 Accomplishments

- Examined national banks and Federal savings associations to combat money laundering and terrorist financing, and to protect the integrity of the U.S. financial system through banks' compliance with the BSA, AML, and USA PATRIOT Act laws and regulations, taking enforcement actions when appropriate
- Issued a cease and desist order against Citibank, N.A., Sioux Falls, South Dakota, for violating the BSA and its underlying regulations (The order required the bank to take comprehensive corrective actions to improve its BSA compliance program)
- Worked with the Federal Financial Institutions Examination Council to issue a statement on outsourced Internet cloud computing services that discusses key risk considerations associated with these activities
- Continued to review training, staffing, recruitment, policies, and interagency coordination to make improvements to the BSA/AML supervision program
- Continued to work closely with the Treasury's Office of Terrorism and Financial Intelligence, FinCEN and Office of Foreign Assets Control to promote the implementation of sound international anti-money laundering and counter terrorist financing standards
- Revised and clarified the operation of the cross-functional Large Bank BSA Review Team to bring different perspectives to bear and react more timely where a bank has multiple instances of Matters Requiring Attention or apparent violations of the required components of the BSA/AML program
- Developed directions to examiners to view serious deficiencies in a bank's BSA/AML compliance area, including program violations, as presumptively adversely affecting a bank's Management component rating and provided guidance on how to document application of this approach in determining the Management component rating

Actions Planned or Underway

- Revise approach to citing BSA/AML violations in order to provide more flexibility for individual pillar violations to be cited, and identified steps to more promptly obtain a holistic view of a bank's BSA/AML compliance
- Continue examination, enforcement activities, and cooperative efforts with FinCEN and other federal banking agencies

OIG CHALLENGE NO. 4	SUMMARY OF MAJOR ISSUES
Gulf Coast Restoration Trust Fund Administration	• Monitor regulations and associated policies and procedures that need be established • Coordinate with many entities/councils that are to receive and further allocate funding, and need to establish policies and procedures • Use Treasury's existing resources to administer its responsibilities for the Trust Fund

Fiscal Year 2012 Accomplishments

- Ongoing consultation with Departments of Commerce and Interior
- Obtained anomaly for the fiscal year 2013 continuing resolution
- Discussed issues and questions with Gulf Restoration Council members including all five states
- Discussed issues and questions with other external stakeholders such as the Florida Association of Counties and several environmental groups
- Briefed staff of five Senators on current thinking regarding required Treasury regulation
- Ongoing discussions with OMB and White House Council on Environmental Quality
- Drafted Treasury regulation

Actions Planned or Underway

- Obtain OMB approval of draft regulation
- Continue to brief staff for interested Congress members, as requested
- Share draft regulation with Gulf Restoration Council members prior to public comment
- Provide for 30-day comment period
- Publish final (or interim final) rule in January 2013
- Work with OMB to establish trust fund account structure
- Develop memorandum of understanding with Federal members of the Gulf Restoration Council
- Develop policies and procedures for ongoing review/oversight of program

Matters of Concern No. 1	SUMMARY OF MAJOR ISSUES
Cyber Security	• Build on existing partnerships among financial institutions, regulators, and private entities in the financial sector • Identify and respond to emerging cyber threats against financial institutions and the broader financial sector

Fiscal Year 2012 Accomplishments

- Partners: (1) Strengthened the public/private partnership by clarifying roles and improving the leadership model; and (2) Commissioned a review of the system of the sector coordinating council (Financial Services Sector Coordinating Council for Critical Infrastructure Protection, FSSCC), the sector communications utility (Financial Services Information Sharing and Analysis Center, FS-ISAC), and the regulatory committee (Financial and Banking Information Infrastructure Committee, FBIIC)
- Information Sharing: (1) Piloted an information-sharing platform, to exchange sensitive information between the financial sector and the defense industrial base (Global Information Sharing Framework); (2) Launched an initiative to adapt a defense industrial base sensors program [Defense Enhanced Cyber security Services (DECS)] to help protect the financial sector; and (3) Extended the communications networks beyond the specialists in the largest, most active firms to executives at various levels and to firms of all sizes
- Policy Development: (1) Provided substantial input on key Administration cyber security proposals, including legislation, potential executive orders, and potential policy directives; (2) Provided insights and potential solutions regarding the stated and imputed positions of industry and regulators; and (3) Pursued opportunities for bridging sector-specific options and cross-sector options, often by participating in interagency-led programs

- Identification of Emerging Threats: (1) Convened classified discussions with 60 Chief Information Officers and Chief Information Security Officers from 30 firms to identify and address emerging threats; and (2) Collaborated with private and public sector partners to assess the emerging risks associated with the Internet Corporation for Assigned Names and Numbers proposal to delegate new financial Internet suffixes, including ".bank", ".mortgage", ".insurance", and ".retirement"
- Response to Emerging Threats: (1) Coordinated government and industry responses to attacks on individual institutions and on major sub-sectors of financial services; and (2) Facilitated requests for Technical Assistance and existing Memoranda of Understanding to deploy government resources in defense of critical infrastructure

Actions Planned or Underway

- Partners: Promoting heightened capabilities among partners, including supporting enhanced access, staffing and automation at the sector communications utility (Financial Services Information Sharing and Analysis Center, FS-ISAC)
- Information Sharing: (1) Partnering with Department of Homeland Security (DHS) to adapt the defense industrial base sensors program (DECS) to meet the needs of the financial sector and all of the other critical infrastructure sectors; (2) Partnering with DHS, the intelligence community and law enforcement to build a cyber-intelligence capability dedicated to protecting the financial sector; and (3) With the FSSCC and FS-ISAC, enlisting the trade associations to extend effective crisis management and communications to firms of all sizes
- Policy Development: (1) Continuing to provide input on key Administration cyber security proposals, as well as actively pursuing the implementation of adopted policies; and (2) Supporting and institutionalizing the integration of financial services-specific efforts with DHS' cross-sector activities
- Identification of Emerging Threats: (1) Commissioning and managing a multi-year research project with the Institute for Defense Analyses, to identify, assess and address emerging systemic threats to critical infrastructure; (2) Continuing to provide input on the potential risk of domain name expansion (e.g. ".bank"); and (3) Actively collaborating with private and public sector stakeholders to address the risks and to capitalize on any opportunities
- Response to Emerging Threats: (1) Continuing to address individual incidents and patterns of attack; and (2) Pursue long-term improvement in the processes by which the federal government assists in the defense of the financial sector

Matters of Concern No. 2	**SUMMARY OF MAJOR ISSUES**
Currency and Coin Production	• Oversee issues related to BEP's redesign of NexGen $100 note while engaging in sound and comprehensive project management • Oversee the United States Mint's costs associated of producing penny, nickel coins, and the suspended production of the dollar coins

Fiscal Year 2012 Accomplishments

- The Bureau of Engraving and Printing (BEP) established a Portfolio and Project Management Office that will develop and institutionalize standardized project management processes
- The BEP implemented a Production Validation protocol in collaboration with the Federal Reserve Board (FRB) and the United States Secret Service, to ascertain whether preproduction testing met agreed upon standards (Validation at the Western Currency Facility (WCF) was successful and the NexGen $100 note was put back into production; in fiscal year 2012, the WCF delivered 1.1 billion NexGen $100 notes to the FRB)
- The United States Mint created a Research and Development (R&D) Center at its facility in Philadelphia to improve capacity to conduct ongoing R&D as it relates to coin production and any opportunities that will create efficiencies

Actions Planned or Underway

- The BEP production validation for the NexGen $100 note will commence in Washington, DC with production expected to commence by mid-year
- The United States Mint will deliver an alternative coinage materials report to Congress in fiscal year 2013 that will provide an assessment for both metal and production costs
- The BEP will continue to work with the FRB, as they are the issuing authority for all currency and will determine the release date for the NexGen $100 note
- The BEP is working with the Office of Personnel Management to create a multi-tier candidate assessment tool to identify the most qualified candidates for the Portfolio and Project Management Office

Matters of Concern No. 3	**SUMMARY OF MAJOR ISSUES**
Documenting Key Activities and Decisions	• Promote an effective records management program to ensure Treasury management personnel remain aware and vigilant

Fiscal Year 2012 Accomplishments

- The Department received the 2012 Archivist Achievement Award which recognizes the Federal agencies that are collaborative, use technology in innovative ways to solve records management challenges, and demonstrates support of the Presidential Memorandum--Managing Government Records goals to improve performance, policies and practices; promote openness; and accountability by better documenting agency actions and decisions
- The Treasury Learning Management System is now available for all Treasury bureaus to increase awareness among all Treasury employees and contractors regarding their roles and responsibilities to preserve and manage Treasury's records and information in accordance with a variety of laws, regulations, and Treasury directives
- The Office of Treasury Records, in conjunction with the Treasury Printing & Graphics Division, partnered to offer high-quality digitization services to offices within the Department of Treasury which is a cost-effective paper-to-electronic solution that minimizes records storage facility fees
- The Department sponsored 29 records management related training sessions during April 2012 that attracted 590 participants from 43 Federal government agencies including the Department of the Treasury
- Ensured compliance with Federal records regulations, Treasury's Office of Treasury Records conducted reviews of each bureau records management program, documented findings, and made recommendations to improve the effectiveness and efficiency in the respective programs

Actions Planned or Underway

- Updating the Department's policy for records management, to address the use, retention, and disposition of social media and web 2.0 technologies
- Continue receiving quarterly reports from the Treasury bureaus on the status of their Plans of Action and Milestones pursuant to the bureau assessments conducted for ensuring Departmental senior level awareness of the status of bureaus' records management program efforts

Matters of Concern No. 4	**SUMMARY OF MAJOR ISSUES**
Consolidation of Bureau of the Public Debt (BPD) and Financial Management Service (FMS) into Bureau of the Fiscal Service (BFS)	• Ensure the consolidation and restructuring of BPD and FMS into BFS that its separate processes, systems, and workplace cultures are integrated

Fiscal Year 2012 Accomplishments

- Drafted a comprehensive consolidation implementation plan
- Communicated extensively with affected personnel, the National Treasury Employees Union, Congress, and other key stakeholders
- Implemented the initial organizational structure
- Established a new mission and vision

Actions Planned or Underway

- Focus on assisting employees during this transition by providing training and professional outplacement services
- Continue to manage risks by training employees to take on mission-critical functions and clearly communicating organizational structure and reporting relationships
- Continue to engage employees and involve senior leadership in the planning and implementation

RESPONSE TO TIGTA

TIGTA CHALLENGE NO. 1	SUMMARY OF MAJOR ISSUES
Security for Taxpayer Data and Employees	Promote measures for appropriate physical security and protection of financial, personal, and other information

Fiscal Year 2012 Accomplishments

- For the fiscal year 2012 financial statement audit, GAO reported a downgrade of the Information Security material weakness to a significant deficiency based on the results of their testing confined to the generally accepted accounting principles (GAAP) statements; due to the difference in scope as a result of the requirements of the Federal Managers Financial Integrity Act (FMFIA) and the IRS testing completed as of June 30, 2012, IRS will continue to report Information Security as a material weakness; internal testing will continue in order to substantiate an internal downgrade of the existing material weakness
- Realized significant progress in masking Social Security Numbers (SSN) on IRS notices to taxpayers; through the use of Two-Dimensional Barcode Technology, the IRS has reduced the use of SSNs on 46 nonpayment notices, affecting 18.9 million annual taxpayer notices based on the fiscal year 2011 actual
- Deployed the Criminal Investigation Disaster Recovery environment (including servers, networking, and Storage Area Network) at the Martinsburg Enterprise Computing Center that will provide recovery of IT infrastructure and systems
- Integrated the enterprise Authorization (e-Authentication) service with IRS.Gov and the Registered User Portal to allow taxpayers online access to register, request, and obtain an official electronic tax transcript
- Installed Enterprise Physical Access Control System (ePACS) solutions in several IRS locations to ensure secure and reliable forms of identification and access control via the use of SmartID credentials
- Identified, mitigated, and responded to thousands of cyber incidents
- Produced hundreds of advisories and bulletins informing responsible system administrators and users of mitigation actions to address current vulnerabilities and threats impacting IRS systems

Actions Planned or Underway

- Reduce the use of SSNs on an additional 12 notices, increasing the total number of masked nonpayment notices to 58, impacting 20.4 million taxpayer notices
- Build on existing e-Authentication system to provide an additional layer of security for taxpayers and the IRS and support integration of new applications and conversion of existing applications
- Support the new Registered User Portal Initiative and position new Affordable Care Act (ACA) applications by integrating the e-Authentication system with the new portal infrastructure to provide standardized security services in ACA applications with external entities

TIGTA CHALLENGE NO. 2	SUMMARY OF MAJOR ISSUES
Tax Compliance Initiatives	Improve compliance and fairness in the application of the tax laws

Businesses and Individuals

Fiscal Year 2012 Accomplishments

- Conducted research studies to improve voluntary compliance and to allocate resources more effectively including:
    - Revised existing workload selection systems and new machine-learning aids developed based on sample data derived from the Tax Year 2006 National Research Program (NRP) study
    - Delivered for audit review the first returns from the NRP sample of corporate income taxpayers; this was the first reporting compliance study of corporate taxpayers in 30 years
    - Delivered the initial sample returns for a new study involving fuel excise compliance research
- Continued testing soft notices as alternatives to traditional Automated Underreporter (AUR) contacts, mailing several thousand notices from inventory selected from the analytics tool
- Transitioned the Compliance Assurance Program to a permanent element of the IRS compliance strategy and added taxpayer instructions to IRS.gov
- Implemented a cross-functional compliance and outreach plan to address prisoner tax noncompliance

- Improved Questionable Refund Program (QRP) filters for selection criteria, increasing referrals 134 percent
- Produced a new analytical tool, Tier Structure Tool (TST), to aid enforcement of pass-through entities; TST provides the ability to identify the ultimate owners of partnerships, increases the early resolution of tax issues and enhances the administration of Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) procedures

Actions Planned or Underway

- Continue to improve and develop new examination case selection models
- Increase compliance presence and implement actions to combat high levels of noncompliance among Individual Tax Identification Number (ITIN) returns improperly claiming Additional Child Tax Credit
- Analyze the results from the fiscal year 2012 and fiscal year 2013 AUR High Income High Wealth test to expedite classification should the work prove to be productive
- Proceed with Small Business Tax Workshop translations for the following languages: Chinese, Korean, Portuguese, Russian, Polish, French Creole, and Arabic

Tax-Exempt Entities

Fiscal Year 2012 Accomplishments

- Developed the Select Check tool, an on-line search tool that allows users to select an exempt organization and check certain information about its federal tax status and filings, and their eligibility to receive tax-deductible charitable contributions
- Developed a virtual workshop used at stakeholder liaison meetings, to provide guidance to exempt organizations impacted by auto-revocation
- Revised automatic revocation notice to include contact information for organizations seeking to regain tax-exempt status
- Identified and addressed non-compliant exempt organizations based upon data from the redesigned Form 990 (Return of Organization Exempt from Income Tax)

Actions Planned or Underway

- Conduct promoter investigations on tax-exempt and government entity issues
- Support the Security and Exchange Commission's new Office of Municipal Securities to promote compliance with federal tax and securities rules and deter securities fraud
- Identify noncompliant retirement plans based upon risk-modeling data
- Complete implementation of recommendations to improve the staggered determination letter process for employee plans

Tax Return Preparers

Fiscal Year 2012 Accomplishments

- Implemented Phase 2 of the Return Preparer Strategy:
    - Initiated competency testing for paid return preparers seeking to become Registered Tax Return Preparers, conducted more than 31,000 tests and approved applications from approximately 570 continuing education providers
    - Completed the first Preparer Tax Identification Number (PTIN) renewal season; there are approximately 730,000 return preparers with a valid PTIN
    - Began issuance of Registered Tax Return Preparer (RTRP) credentials, a new professional designation for all paid tax return preparers who are not attorneys, Certified Public Accountants, or Enrolled Agents
    - Created Complaint Referral Process to enable both the public and other tax professionals to report claims of improper behavior by a return preparer on Form 14157 (Return Preparer Complaint)
    - Continued to administer a Facebook page, which has thousands of regular followers, and launched a LinkedIn page

Actions Planned or Underway

- Enhance the way the IRS identifies and addresses preparers with the highest risk of noncompliance by using more focused data gathering from the NRP and expanding the treatment methods

TIGTA CHALLENGE NO. 3	**SUMMARY OF MAJOR ISSUES**
Modernization	Improve taxpayer service and efficiency of operations

Fiscal Year 2012 Accomplishments

- Deployed CADE 2 Transition State 1, successfully moving to a daily processing cycle for tax processing and posting of individual taxpayer accounts
  - Allowed faster refunds for more taxpayers
  - Produced more timely account updates (viewable by IRS customer service representatives within 48 hours versus an average of nine days in filing season 2011)
  - Issued taxpayer notices faster (2.79 million notices sent to taxpayers with accounts processed daily versus approximately 284,000 in filing season 2011)
  - Processed over 3 billion transactions and issued 123.4 million refunds totaling $373 billion
- Deployed Modernized e-file (MeF) Release 7 for filing season 2012 and included the rollout of over 130 remaining 1040-family schedule and forms; enhancements expanded MeF reach to 100 percent of the e-File population, or approximately 98.3 million fliers; to date, IRS processed over 101.7 million 1040-related returns and over 11.1 million Business Master File returns through MeF
- Deployed the “Send My Transcript” application, which allows taxpayers to make online requests to send official tax return and tax account transcripts to banks and other financial institutions; initiated the Proof of Concept (PoC) program with multiple vendors and financial institutions

Actions Planned or Underway

- Complete feed from the CADE 2 Database to the Integrated Data Retrieval System, after completion of filing season 2013
- Based on findings and recommendations from the four month pilot study, implement improvements to the “Send My Transcript” PoC application to offer new functionality and attract new adoptees
- Complete Phase II of the Data Center Consolidation Initiative plan

TIGTA CHALLENGE NO. 4	**SUMMARY OF MAJOR ISSUES**
Implementing the Affordable Care Act and Other Tax Law Changes	Effectively implement new tax provisions, including tax-related health care provisions of the *Patient Protection and Affordable Care Act* (ACA), and the *American Recovery and Reinvestment Act* (Recovery Act)

Affordable Care Act (ACA)

Fiscal Year 2012 Accomplishments

- Completed the second filing season for the Small Business Health Care Tax Credit
  - Continued compliance activities on selected tax returns
  - Revised Form 8941 (Credit for Small Business Health Insurance Premiums) to reduce burden on filers and enable IRS to better focus compliance efforts
  - Prepared implementation of phase two of the credit that takes effect in 2014
  - Continued extensive outreach including webinars and reached out to stakeholders including insurance agents/brokers and Hispanic Chambers of Commerce
- Completed the second year of the ACA industry fees for Branded Prescription Drugs collecting $2.8 billion for calendar year 2012
  - Implemented Release 2 of the Branded Prescription Drug Industry Fee Project, which included revisions to Form 8947 (Report of Branded Prescription Drug Information), enhanced due diligence processes, and fee calculation adjustments
- Continued implementation of the new ACA hospital requirements set forth in §501(r)
  - Identified the universe of 3,377 hospital organizations in order to conduct community benefit reviews once every three years
  - Completed 1,406 planned reviews in fiscal year 2012

  - Published proposed regulations on financial assistance policies, limitations on charges, and billing and collection practices of tax-exempt hospital organizations

- Published a revenue procedure and proposed/temporary regulations on the tax exemption of 501(c)(29) organizations (co-op health insurance issuers)
- Published guidance on 22 ACA tax provisions, including Premium Tax Credit, employer provisions, and requirements for group health plans
- With the Department of Health & Human Services (HHS) and other federal agencies, developed new information technology systems that will allow health insurance exchanges beginning in October 2013 to receive federal tax information necessary to make determinations of income-based eligibility for government health programs (e.g., Medicaid) or other financial assistance (e.g., advance premium tax credits)
- Continued ACA outreach activities emphasizing information that taxpayers and tax preparers need to know for 2012 tax return preparation, upcoming developments for filing season 2013, and the major changes for the health insurance exchange system that impact the 2014 tax return (filing season 2015)
- Continued implementation of other ACA mid-horizon provisions
- Analyzed results from a soft letter mailing and federal-state data matching to estimate the indoor tanning services non-filer population; conducted data matching study to identify entities that were liable for tanning tax but had not filed a return and referred cases for audit as appropriate

Actions Planned or Underway

- Continue implementation of ACA mid-horizon provisions including Hospital Insurance Tax on High Income Taxpayers, Net Investment Income Tax, and Industry Fees (Patient-Centered Outcomes Research Trust Fund, and Health Insurance Providers)
- Launch the IRS portion of the HHS/IRS IT interface along with establishing data sharing agreements in support of the 2013 Exchange system Open Season
- Continue working with Federal and State agencies on implementation leading to October 2013 Exchange open season, including outreach, guidance, information technology, and safeguarding of federal tax data
- Continue ACA outreach to stakeholders including individuals, employers, states, insurers, tax professionals, and other third parties

Other Tax Law Changes

Fiscal Year 2012 Accomplishments

- Revised computer programming to ensure the accuracy of First-Time Homebuyer Credit repayment data and updated processing procedures to ensure repayments of the credit are correctly processed
- Implemented a non-compliant withholding (federal income tax withholding that is claimed on a tax return, but which was not actually withheld) rule to prevent the erroneous payment of noncompliant withholding on Social Security Benefits, as well as any refundable credit claimed on returns with noncompliant withholding
- Implemented new American Opportunities Tax Credit rules to prevent the erroneous payment of the Refundable American Opportunities Tax Credit
- Continued to partner with the Software Developers Working Group to improve tax preparation software to help preparers meet their due diligence requirements and reduce errors on Earned Income Tax Credit (EITC) returns
- Completed testing the AUR system for the implementation of the new merchant card and security cost basis reporting, wrote Internal Revenue Manual (IRM) instructions, developed training material to support new security cost basis legislation, and developed the data collection instruments that will be used in the test
- Revised Form 5695 (Residential Energy Credits) to request additional information to support eligibility requirements

Actions Planned or Underway

- Plan activities to add additional issues, such as Fuel Tax Credit and Notice to Shareholder for Long Term Capital Gains, to the noncompliant withholding rule
- Continue to address the duplicate use of addresses and bank account information as a source of scheming and clustering regarding Social Security Numbers (SSNs) and Individual Tax Identification Numbers (ITINs)
- Identify, work, and monitor cases for both Merchant Card and Security Cost Basis Reporting

TIGTA CHALLENGE NO. 5	SUMMARY OF MAJOR ISSUES
Fraudulent Claims and Improper Payments	Effective use of taxpayer funds

Refundable Credits

Fiscal Year 2012 Accomplishments

- Identified more than one thousand Questionable Refund Program (QRP) schemes, comprised of more than two million individual tax returns with billions of potentially fraudulent refund claims, which were detected prior to refunds being issued
- Partnered with the United States Postal Inspection Service and other law enforcement partners to recover tax refund checks and prepaid cards issued in connection with identity theft related returns
- Began multiple duplicate taxpayer identification number (multi-DUPTIN) testing and completed a review of Earned Income Tax Credit (EITC) recertification no-change and default cases
- Influenced the accuracy of EITC returns filed by focusing on EITC paid preparer treatments, including due diligence audits, visits by agents, streamlined injunctions, and educational and compliance notices to first-time and experienced preparers
- Updated EITC Central on IRS.gov (www.eitc.irs.gov), which provides educational and marketing outreach tools for partners, practitioners and media
- Implemented the Automated Questionable Credit (AQC) Program, a streamlined statutory notice process that extends compliance coverage to untreated or under-treated categories of refund fraud or noncompliance cases
- Required EITC paid preparers to complete and attach Form 8867 (Paid Preparer's Earned Income Credit Checklist) to their client's return to meet EITC due diligence requirements
- Collaborated with the Treasury Department in a Partnership Fund project to determine if state data could aid the IRS in administering the EITC

Actions Planned or Underway

- Modify the filters using the pre-certification selection criteria that indicates relationship and residency for EITC recertification
- Complete stand-up and training of two AQC operational groups
- Develop pre-refund examination filters to ensure historical information is available and used to identify taxpayers who claim erroneous refundable credits

Fraudulent Payments

Fiscal Year 2012 Accomplishments

- Conducted an Identity Theft Sweep Week working with the Justice Department's Tax Division and local U.S. Attorneys' offices, resulting in 105 targeted individuals in 23 states; the sweep included 939 criminal charges filed in connection with 69 Indictment/Information filings related to identity theft
- Implemented new filters to detect ID theft before returns were processed and formed a Taxpayer Protection Unit (TPU); TPU customer service representatives' efforts have led to the selection of 387,000 potential identity theft cases, of which 219,000 were confirmed to be identity theft or misled cases, protecting revenue of over $1.49 billion for the IRS
- Created an Identity Theft Clearinghouse to develop and refer identity theft refund fraud schemes for investigation
- Developed the Identity Theft Victim Disclosure Waiver pilot project in Florida, allowing the disclosure of returns and return information associated with accounts of known and suspected victims of identity theft to designated state and/or local law officials, with the express written consent of those victims
- Increased the effectiveness of the identity protection filters and indicators resulting in the isolation of over 450,000 returns and preventing the payout of $1.85 billion in fraudulent refunds, a 45 percent increase over the prior year
- Implemented several new filters to detect ID Theft before returns were processed
- Accelerated the matching of individual tax returns and related information returns to better identify fraudulent returns prior to processing
- Coded the accounts of deceased taxpayers whose SSNs were previously used by identity thieves to file fraudulent returns, and marked accounts of deceased taxpayers whose final tax returns have already been filed

- Revised the 1040 series electronic tax forms to allow for the entry of an Identity Protection Personal Identification Number (IP PIN), and provided IP PINs to over 250,000 taxpayers for the 2012 filing season to ensure taxpayers who were subject to identity theft did not encounter delays in processing their tax returns
- Established a cooperative agreement with more than 100 financial institutions to reject questionable refund deposits

Actions Planned or Underway

- Conduct audits for the multi-DUPTIN program and coordinate with Submission Processing to address the processing of returns with questionable TINs for dependency exemptions
- Continue analyses of Entity Theft and Entity Fabrication issues to prevent non-compliant or fraudulent refund claims
- Enhance the effectiveness of the IP PIN by confirming the address of the impacted taxpayer and issuing the preliminary and actual IP PIN notices earlier to the taxpayer; double the number of IP PINs issued this filing season from 250,000 to 500,000
- Expand Disclosure Waiver Program to include additional states: New York, New Jersey, Pennsylvania, Georgia, Alabama, Oklahoma, Texas, and California
- Collaborate with Social Security Administration (SSA) to more timely use the information related to deceased taxpayers provided to us by SSA, and on a potential change to the routine release of information contained in the Death Master File

Contract and Other Payments

Fiscal Year 2012 Accomplishments

- Developed and disseminated both a User Guide and a Manager Guide to assist business units in performing and monitoring Receipt and Acceptance according to established guidelines, processes, and controls
- Provided guidance on oversight and enforcement responsibilities, and evaluated whether current span of control provides appropriate oversight and made changes, as appropriate
- Developed and provided clear guidance to Credit Card Services on performance of their oversight and enforcement responsibilities for compliance with Purchase Card Program procedures
- Developed interim guidance on reimbursable work cost estimates to augment the Reimbursable Operating Guidelines, ensuring business units submit any and all supporting documentation on costing prior to agreement signature in accordance with the revised guidance

Actions Planned or Underway

- Develop and implement processes to mark or exclude false Forms W-2 (Wage and Tax Statement) from the automated verification process
- Conduct an on-going, full review of all reimbursable agreements
- Reinforce existing policies and procedures governing effective contract management with revamped training for Contracting Officer's Technical Representatives (COTRs) across the IRS

TIGTA CHALLENGE NO. 6	SUMMARY OF MAJOR ISSUES
Providing Quality Taxpayer Service Operations	Improve taxpayer service

Fiscal Year 2012 Accomplishments

- Achieved a Level of Service of 67.6 percent while answering 30.8 million assistor calls
- Launched IRS2Go v2 Smartphone application, with three new features that allow taxpayers to request their transcripts, get the latest news, and watch IRS videos; IRS2Go is available for both iOS and Android devices and has been downloaded by over 450,000 users
- Launched a redesigned IRS.gov website, transitioning the main navigation from role-based (i.e. individual, business, or retirement plan administrator) to intent-based (i.e., file a return, pay a tax bill, check refund status), providing a more efficient path for taxpayers to achieve their goals
- Deployed telephone typewriter One Call Solution, which allows deaf and hard of hearing taxpayers to make a single call to the IRS and gain access to a customer service representative
- Continued to develop new multilingual documents to deliver content about tools and services available to Limited English Proficiency (LEP) taxpayers; translated 47 notices into the top five LEP languages of Spanish, Korean, Chinese, Russian, and Vietnamese and posted to the Multilingual Gateway

- Engaged partners and provided greater access to available services through Saturday service events and other special service days like EITC awareness days
- Completed Virtual Service Delivery (VSD) pilot offering virtual face-to-face service to taxpayers at 15 Taxpayer Assistance Centers nationwide, and two Stakeholder Partnerships, Education, and Communication partner sites
- Continued to provide extended service hours at several locations and alternative service delivery methods to expand service to taxpayers

Actions Planned or Underway

- Continue to monitor VSD activity in the pilot sites, use performance metrics and surveys of taxpayers to gauge satisfaction with the process, and implement 18 more potential VSD sites
- Develop a Spanish version of the IRS2Go Smartphone application
- Re-engineer the next e-services product, Taxpayer Identification Number Matching, which will increase match rate results using search rules modeled after return processing rules
- Formalize the process to track and analyze the impact of targeted outreach on the Taxpayer Advocate Service toll-free assistance line (1-877-ASK-TAS1)

TIGTA CHALLENGE NO. 7	**SUMMARY OF MAJOR ISSUES**
Human Capital	Enable the IRS to achieve its mission

Fiscal Year 2012 Accomplishments

- Reduced time-to-hire to 61.4 days, well below IRS's Hiring Reform's goal of 80 days
- Increased use of cutting edge technologies such as Facebook, Twitter, GovLoop, SecondLife, and LinkedIn to reach wide and diverse applicant pools, promote IRS as an employer of choice, and develop talent pipelines
- Initiated IRS Disability Connection Recruitment Council to obtain valuable feedback from internal and external partners to improve on-boarding process of persons with disabilities
- Increased virtual career fair opportunities, reducing travel costs, and continuing to leverage partnerships and building the applicant pipeline
- Provided service-wide guidance to corporate and embedded human resources staffs and hiring managers with focus on the new Pathways Program
- Continued to use the "Face of the IRS" Program to educate and promote IRS to internal and external applicant pools through recruiting events in which current employees assist in identifying highly interested attendees, speak about work experiences, and provide feedback to recruiters after the event
- Continued the Executive Sponsor Program, which allowed IRS Executives to meet with high level staff on college campuses and participate on non-IRS employment advisory boards, teach in the classroom, and lead case competition projects while recruiting for the IRS
- Implemented Geographic Leadership Communities initiative, which comprises of cross-functional groups of executives that host development opportunities and community building workshops in specific geographic areas
- Received the Bersin & Associates 2012 Learning Leaders Award for utilizing innovative, efficient, and effective approaches to employee learning and talent management

Actions Planned or Underway

- Develop a Service-wide onboarding strategy; the strategy should include components such as: a checklist with step-by-step guidance that should be completed by both new employees and managers during the onboarding process; a process to collect feedback; and additional measures and analyses to evaluate the process
- Enhance IRS Career sites to showcase resources, tools, training, and other information available for managers and HR teams with emphasis on recruitment of veterans and persons with disabilities
- Reassess methods and tools for gathering, analyzing, and monitoring data to determine the right number and skills of the acquisition workforce as resources/tools become available

TIGTA CHALLENGE NO. 8	SUMMARY OF MAJOR ISSUES
Globalization	Increase the outreach efforts to foreign governments on cross-border transactions

Fiscal Year 2012 Accomplishments

- Collected more than $5.5 billion in back taxes, interest, and penalties from the 38,000 voluntary disclosures made under the first two IRS offshore voluntary disclosure initiatives (OVDI) of 2009 and 2011; approximately 1,500 entity disclosures were made through June 2012 under the new program announced in January 2012
- Implemented procedures to conduct a 100 percent review of inputs to the E-Trak Offshore Voluntary Disclosure Program system
- Administered Exchange of Information provisions of U.S tax treaties and tax information exchange agreements (TIEAs) by coordinating specific requests to and from foreign governments
- Created the Advance Pricing and Mutual Agreement Program , a critical component of Transfer Pricing Operations, to develop and share resources and expertise for greater efficiencies and improved case presentation
- Improved cross-border relationships and interactions through participation in organizations such as the Organization for Economic Cooperation and Development , and the Inter-American Center of Tax Administrations
- Continued developing the Gifts-in-Kind project, an international exam-related project that deals with the movement of in-kind charitable gifts offshore
- Collaborated on global outreach, compliance, and guidance issues with key stakeholders, including the Department of Labor and the Pension Benefit Guaranty Corporation to expand joint US Territory compliance and virtual outreach efforts
- Opened new international money laundering investigations, via the Global Illicit Financial Team, that focused on large institutions that facilitate global money laundering
- With FBI, Secret Service, and Homeland Security, developed additional targets in the concealment of illegal proceeds through International financial Institutions and other professional money laundering organizations in the International Money Laundering arena

Actions Planned or Underway

- Continue offshore compliance programs focused on abusive arrangements involving offshore transactions
- Gather information about foreign accounts held by U.S. taxpayers via TIEAs and implementation of the Foreign Account Tax Compliance Act
- Expand the Joint Audit Initiative with foreign tax administrations and taxpayers by coordinating with treaty partner jurisdictions to determine whether there is interest in taking specific Joint Audits forward
- Develop cases on global money launderers through partnership with the Treasury's Office of Terrorism and Financial Intelligence

TIGTA CHALLENGE NO. 9	SUMMARY OF MAJOR ISSUES
Taxpayer Protection and Rights	Apply the tax laws fairly

Fiscal Year 2012 Accomplishments

- Reinforced taxpayer protection and rights through leadership messages at all levels of the organization
- Created a cross-functional team to address the increasing volume of identity theft cases and the incomplete processes used to resolve victim issues
- Developed a waiver to share perpetrator information with local law enforcement, enabling state and local law enforcement officials with evidence of identity theft involving fraudulently filed federal tax returns to obtain return information with the consent of identity theft victims
- Decreased legitimate returns as a percentage of total unposted returns over a three year period from a peak of 79 percent to a current rate of 30 percent; also decreased the average number of days to manually review a legitimate return over the same time period from 85 days to 25 days.
- Released 22 redesigned notices to clearly explain the collection process and options available to taxpayers

Actions Planned or Underway

- Enhance the expertise of employees resolving identity theft cases by establishing specialized identity theft groups and implementing procedure enhancements
- Expand the partnerships for data exchanges regarding prevention of identity theft with additional states
- Develop a refresher class on the topic of determining timeliness of Collection Due Process (CDP) and equivalent hearing requests; the class will be made available as a Continuing Professional Education topic to Appeals technical employees who work CDP cases
- Identify additional process efficiencies from the barcode technology

TIGTA CHALLENGE NO. 10	SUMMARY OF MAJOR ISSUES
Achieving Program Efficiencies and Cost Savings	Use resources to focus on producing the best value for stakeholders

Fiscal Year 2012 Accomplishments

- Implemented a shared workstation program for telework employees
- Began multi-year space optimization/rent reduction initiative to significantly reduce real estate footprint. Initiating 72 projects has reduced space by 603,000 square feet, resulting in annual rent savings of over $13.1 million
- Met or exceeded all "green target goals" on the Department of the Treasury scorecard for Sustainability and Energy
- Implemented a paperless Time and Attendance Reporting system, eliminating nearly 3 million pieces of paper with a cost savings of approximately $146,000
- With the IRS operating divisions, prepared cost-based performance measures to provide timely, accurate, and useful data for decision making for several major IRS programs, including Field Collection and Automated Collection System
- Expanded the use of cost accounting information to improve program efficiency, including the analysis of the cost per hour of Correspondence and Field exams
- Eliminated Section 1204 (Basis for Evaluation of Employees) program travel costs and reduced managerial burden by conducting all independent reviews virtually

Actions Planned or Underway

- Complete 62 additional space optimization/rent reduction projects, for projected annualized savings of $15.5 million and space reduction of 542,000 square feet
- Collaborate with operating divisions to identify additional cost-based performance measures oriented towards enforcement activities

SECTION D: SUMMARY OF FINANCIAL STATEMENT AUDIT AND MANAGEMENT ASSURANCES

SUMMARY OF FINANCIAL STATEMENT AUDIT

Audit Opinion	Unqualified				
Restatement	No				
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Material Weakness in Internal Control Over Financial Reporting at the IRS	1	0	0	0	1

SUMMARY OF MANAGEMENT ASSURANCES

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	Qualified					
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS – Unpaid Tax Assessments	1	0	0	0	0	1

Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Qualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS – Computer Security	1	0	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 (FMFIA § 2)	3	0	0	0	0	3

Conformance with Financial Management System Requirements (FMFIA § 4)						
Statement of Assurance	Systems conform to financial management system requirements					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
Total Non-conformances	0	0	0	0	0	0

Compliance with Federal Financial Management Improvement Act (FFMIA)		
	Agency	Auditor
Overall Substantial Compliance	No	No
1. System Requirements	No	
2. Accounting Standards	No	
3. USSGL at the Transaction Level	Yes	

SECTION E: IPIA (AS AMENDED BY IPERA)

On July 22, 2010, President Obama signed into law the *Improper Payments Elimination and Recovery Act* (IPERA, Pub. L. 111-204). IPERA amends the *Improper Payments Information Act* (IPIA), generally repeals the *Recovery Auditing Act*, and significantly increases agency payment recapture efforts by expanding the types of payments to be reviewed and lowering the dollar threshold of annual payments that requires agencies to conduct payment recapture audit programs. Agencies continue to be required to review their programs and activities annually to identify those susceptible to significant improper payments. OMB Circular No. A-123, *Management's Responsibility for Internal Control,* Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments* (A-123, Appendix C), amended April 14, 2011, defines "significant improper payments" as gross annual improper payments in a program exceeding both the threshold of 2.5 percent and $10 million of total program outlays or $100 million regardless of the improper payment percentage. A-123, Appendix C, also requires agencies with programs susceptible to significant improper payments to implement corrective action plans that include improper payment root cause identification, reduction targets, and accountable officials.

Section 2(B) of IPERA allows the development of an alternative for meeting the requirements for obtaining a statistically valid estimate of the annual amount of improper payments for federal programs that are so complex that developing an annual error rate is not feasible. Agencies may establish an annual estimate for a high-risk component of a complex program (e.g., a specific program population) with OMB approval. Agencies must also perform trend analyses to update the program's baseline error rate in the interim years between detailed program studies. When development of a statistically valid error rate is possible, the reduction targets are revised and become the basis for future trend analyses.

I. RISK ASSESSMENT

Each year, the Department develops a comprehensive inventory of the funding sources for all programs and activities and distributes it to the Treasury bureaus and offices. The bureaus and offices must perform risk assessments at the payment type level (e.g., payroll, contracts, vendors, travel, etc.). The Department's risk assessment process follows the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control Integrated Framework. The framework includes:

1. Internal Control Environment
2. Risk Assessment
3. Internal Control Activities
4. Information and Communications
5. Monitoring

The factors addressed to determine risk levels include:

Operating Environment – Existence of factors which necessitate or allow for loosening of financial controls; any known instances of fraud

Payment Processing Controls – Management's implementation of internal controls over payment processes including existence of current documentation, the assessment of design and operating effectiveness of internal controls over payments, the identification of deficiencies related to payment processes, and whether or not effective compensating controls are present

Internal Monitoring Activities – Periodic internal program reviews to determine if payments are made properly; strength of documentation requirements and standards to support testing of design and operating effectiveness for key payment controls

Human Capital – Experience, training, and size of payment staff; ability of staff to handle peak payment requirements; level of management oversight, and monitoring against fraudulent activity

Prior to the enactment of the IPERA changes to IPIA, Treasury maintained and performed a robust improper payment risk assessment process in which the new IPERA payment types were included. During fiscal year 2011, Treasury enhanced its risk assessment tool by expanding the scope of risk assessment factors which were included in the revised A-123, Appendix C, and continued using this tool in fiscal year 2012.

For those payment types resulting in high-risk assessments that comprise at least 2.5 percent and $10 million in total program outlays or $100 million at any rate, (1) statistical sampling must be performed to determine the actual improper payment rate, and (2) a corrective action plan must be developed and submitted to the Department and OMB for approval. Responses to the risk assessments produce a score that falls into pre-determined categories of risk. The following table describes the actions required at each risk level:

Risk Level	Required Action(s)
High Risk $\geq$ 2.5% Error Rate & > $10 Million or $100,000,000	Corrective Action Plan
Medium Risk	Review Payment Controls for Improvement
Low Risk	No Further Action Required

The risk assessments performed across the Department in fiscal year 2012 resulted in all programs and activities being of low or medium risk susceptibility for improper payments, except for the IRS's Earned Income Tax Credit (EITC) program. The EITC's high-risk status is well-documented, having been identified previously in the former Section 57 of OMB Circular No. A-11, *Preparation, Submission, and Execution of the Budget*, and has been deemed a complex program for the purposes of the IPIA. OMB's guidance requires additional reporting on programs deemed high-risk; that information, for the EITC program only, follows.

II. Statistical Sampling

EITC Program

This section describes how the IRS currently develops its erroneous payment projections for the EITC.

The EITC is a refundable federal tax credit that offsets income taxes owed by low-income workers and, if the credit exceeds the amount of taxes owed, provides a lump-sum refund to those who qualify. The most recent projection is based on a tax year 2008 reporting compliance study that estimated the level of improper overclaims for fiscal year 2012 to range between $11.6 to $13.6 billion and 21.0 percent (lower bound) to 24.6 percent (upper bound) of approximately $55.4 billion in total program payments.

The complexity of the EITC program, the nature of tax processing, and the expense of compliance studies preclude statistical sampling on an annual basis to develop error rates for comparison to reduction targets. The estimates are based primarily on information from the IRS's National Research Program (NRP) reporting compliance study of individual income tax returns for tax year 2008—the most recent year for which compliance information from a statistically valid, random sample of individual tax returns is available.

Under the tax year 2008 NRP reporting compliance study, which reviewed individual income tax returns filed during calendar year 2009 for tax year 2008, 2,300 of the returns in the regular NRP sample were EITC claimants randomly selected for examination.

This selection method allows the measures for the individual income tax return filing population to be estimated from the results of the NRP sample returns. Because one of the objectives of the NRP is to provide data for compliance measurement, NRP procedures and data collection differ from those followed in standard examination programs. NRP classification and examination procedures are more comprehensive in scope and depth than those for standard examination programs. These expanded procedures were designed to provide a more thorough determination of what taxpayers should have reported on their returns. The tax year 2008 NRP individual income tax return study covered filers of all types of individual income tax returns.

The NRP study results for this EITC claimant subset of NRP returns were the primary source of data for the improper payments estimates. Other data and information sources used for the estimates included the IRS Enforcement Revenue Information System, which tracks assessments and collections from IRS enforcement-related activities, and Treasury Department fiscal year 2012 EITC budget estimates.

III. Corrective Actions

This section describes the ongoing and planned corrective actions to reduce the improper payment rate for Treasury's only high-risk susceptible program, the EITC.

Root Causes

The root causes of EITC improper payments are from the following sources:

Authentication – An estimated 75 percent or $9.5 billion in improper payments result from authentication errors. These errors include errors associated with the inability to authenticate qualifying child eligibility requirements, mainly relationship and residency requirements, filing status, when married couples file as single or head of household, and eligibility in nontraditional and complex living situations. Authentication is completed on a portion of this error category during pre-refund examinations.

Verification – An estimated 25 percent or $3.1 billion in improper payments result from verification errors. These errors relate to improper income reporting which allows claimants to fall within the EITC income limitations and qualify for the EITC. The errors include both underreporting and overreporting of income by both wage earners and taxpayers who report being self-employed. Income reported through information returns such as Forms W-2, Forms 1099, etc., which can be used for verification of some income, becomes available only after tax returns are processed. Under law IRS must process income tax returns within 45 days of receipt or pay interest to taxpayers.

Base Program

In 2012, the IRS prevented approximately $4 billion from being paid in error. The prevention activity primarily focused on three areas:

- **Examinations** – IRS identifies tax returns for examination and holds the EITC portion of the refund until an audit can be conducted. This is the only ongoing IRS audit program where exams are conducted before a refund is released. The examination closures and enforcement revenue protected in the charts below do not include test initiatives
- **Math Error** – Refers to an automated process in which the IRS identifies math or other irregularities and automatically prepares an adjusted return for a taxpayer. Legislation is required for math error use
- **Document Matching** – Involves comparing income information provided by the taxpayer with matching information (e.g., W-2s, 1099s) from employers and other third parties to identify discrepancies

The chart below shows significant results from fiscal year 2007 through an estimate of fiscal year 2013. In fiscal year 2012 alone, the IRS conducted an estimated 487,491 examinations, issued approximately 275,000 math error notices, and closed nearly 1 million document matching reviews.

Compliance Activities

	FY07	FY08	FY09	FY10	FY11*	FY12**	FY13***	FY07-FY13 Total
Examination Closures	503,267	503,755	508,180	473,999	483,574	487,491	487,000	2,960,266
Math Error Notices	393,263	432,797	355,416	341,824	293,450	275,000	240,000	2,331,750
Document Matching ****	734,603	727,916	688,087	904,920	1,178,129	985,172	985,000	5,218,827
Amended Returns[1]		32,473	25,395	19,347	14,317	13,287	13,000	104,819

* Restated actual.
** Preliminary estimates.
*** Estimate based on fiscal year 2012 preliminary data.
**** Document Matching includes enterprise data. Enterprise data not available for fiscal year 2007.
[1] Amended returns are a subset of Examination Closures.

These compliance activities had a significant effect. Treasury projects that continued enforcement efforts will protect a total of approximately $26 billion in revenue through fiscal year 2013, as shown below.

Enforcement Revenue Protected (Dollars in Billions)

	FY07	FY08	FY09	FY10	FY11*	FY12**	FY13***	FY07-FY13 Total
Examination Closures	$ 1.49	$ 2.00	$ 2.15	$ 1.97	$ 2.04	$ 2.05	$ 2.05	$ 13.75
Math Error Notices	$ 0.41	$ 0.44	$ 0.40	$ 0.41	$ 0.35	$ 0.32	$ 0.28	$ 2.61
Document Matching ****	$ 1.29	$ 1.23	$ 1.17	$ 1.43	$ 1.32	$ 1.55	$ 1.55	$ 9.54
Amended Returns		$ 0.07	$ 0.07	$ 0.06	$ 0.04	$ 0.04	$ .04	$ 0.32
TOTAL	$ 3.19	$ 3.74	$ 3.79	$ 3.87	$ 3.75	$ 3.96	$ 3.92	$ 26.22

* Restated actual.
** Preliminary estimates.
*** Estimate based on fiscal year 2012 preliminary data.
**** Document Matching includes enterprise data. Enterprise data not available for fiscal year 2007.

Maximizing Current Business Processes

- In fiscal year 2012, IRS completed activities associated with a suite of EITC paid preparer treatments, selected from a risk-based model, that include letters and notices, Knock and Talk Visits, traditional Due Diligence Visits, and Streamlined Injunctions. The IRS also conducted a Real-Time Preparer Pilot that used real-time data to assess EITC preparer risk and test the effectiveness of compliance treatments both before and during the filing season.
- IRS completed strategic studies to update the estimates of the two key EITC performance measures, participation rate and error rate, which comply with the *Government Performance and Results Act of 1993*. IRS also delivered estimates of EITC participation for tax year 2009, using a Census-IRS match. In addition, IRS used research data from the fiscal year 2011 enterprise research strategy to develop a fiscal year 2012 strategy in partnership with internal organizations to better focus EITC compliance and outreach activities.
- The IRS continued its partnership with members from two key tax software associations to reduce EITC errors and assist preparers in meeting their EITC due diligence requirements. This year the team recommended revisions to Form 8867, Paid Preparer's Earned Income Credit Checklist. The team also strengthened Volunteer Income Tax Assistance preparer due diligence by improving the intake questionnaire and addressed opportunities to provide guidance to preparers of Household Help returns.

IV. Improper Payment Reporting

The following table provides the improper payment reduction outlook for Treasury's only high risk susceptible program, the EITC:

Improper Payment (IP) Reduction Outlook (Dollars in Billions)

Program	2011 Outlays	2011 %	2011 $	2012 Outlays	2012 IP%	2012 IP$	2013 Est. Outlays	2013 IP%	2013 IP$	2014 Est. Outlays	2014 IP%	2014 IP$	2015 Est. Outlays	2015 IP%	2015 IP$
EITC Upper Bound Estimate	$64.7	25.8%	$16.7	$55.4	24.6%	$13.6	$57.9	24.6%	$14.2	$51.8	24.6%	$12.7	$52.7	24.6%	$13.0
EITC Lower Bound Estimate	$64.7	21.2%	$13.7	$55.4	21.0%	$11.6	$57.9	21.0%	$12.2	$51.8	21.0%	$10.9	$52.7	21.0%	$11.1

The term "Outlays" equals "Estimated Claims."
Estimated Claims: Estimated total claims for the EITC are based on projections of EITC tax expenditures plus outlays as estimated by the Office of Tax Analysis within the Department of the Treasury, adjusted to account for the difference between taxpayer claims and accounts received by taxpayers due to return processing and enforcement.
IP % and IP $: These estimates follow the prior approach which provided a range for the error rate (%) and improper payments amounts ($).

Underpayments are not included in the estimate of improper payments. Underpayments do not appear with sufficient frequency in the statistically valid test data to have a measurable effect on the estimate.

V. Recapture of Improper Payments Reporting

In accordance with IPERA and OMB Circular No. A-123, Appendix C, Treasury performs and reports annually on its payment recapture program. In fiscal year 2011, Treasury incorporated the IPERA amendments into the existing Treasury payment recapture (recovery audit) program, and continued to address them in fiscal year 2012. Prior to the enactment of the IPERA changes to IPIA, Treasury maintained and performed a robust improper payment risk assessment process which already included the new IPERA payment types.

During fiscal year 2012, Treasury issued contracts and other reviewed payments totaling approximately $10 billion. The amended act expanded the payment types reviewed beyond just contracts to include grants, benefits, loans, and miscellaneous payments.

Treasury's annual risk assessment process includes a review of pre-payment controls that minimize the likelihood and occurrence of improper payments. Treasury requires each bureau and office to conduct post-award audits and report on payment recapture activities, contracts issued, improper payments made, and recoveries achieved. Bureaus and offices may use payment recapture audit contingency firms to perform many of the steps in their payment recapture auditing program and identify candidates for payment recapture action. However, no Treasury bureaus used contractors to perform recapture activities. Treasury employees performed this work.

Treasury considers both pre- and post-reviews to identify payment errors a sound management practice that should be included among basic payment controls. All Treasury bureaus have a process in place to identify improper payments during post-reviews. At times, bureaus may use the results of IG and GAO reviews to help identify payment anomalies and target areas for improvement. However, Treasury applies extensive payment controls at the time each payment is processed, making recapture activity minimal.

Payment Recapture Audit Reporting

Type of Payment	Amount Subject to Review for 2012 Reporting	Actual Amount Reviewed and Reported (2012)	Amount Identified for Recovery (2012)	Amount Recovered (2012)	% of Amount Recovered out of Amount Identified (2012)	Amount Outstanding (2012)	% of Amount Outstanding out of Amount Identified (2012)
Contracts	$ 7,088,266,898	$ 7,278,612,256	$ 464,722	$ 358,490	77%	$ 343	0.07%
Grants	$ 664,056,873	$ 664,056,873	$ 489,042	$ 489,042	100.%	$ 0	0%
Benefits	$ 629,912,653	$ 2,576,496	$ 13,530	$ 1,369	0%	$ 12,161	90%
Loans	$ 802,974,000	$ 0	$ 0	$ 0	0%	$ 0	0%
Other	$ 2,473,854,277	$ 2,226,897,695	$ 2,953,097	$ 2,839,482	96%	$ 7,052	0.24%

Type of Payment	Amount Determined Not to be Collectable (2012)	% of Amount Determined Not to be Collectable out of Amount Identified (2012)	Amounts Identified for Recovery (2005-2011)	Amounts Recovered (2005-2011)	Cumulative Amounts Identified for Recovery (2005-2012)	Cumulative Amounts Recovered (2005-2012)	Cumulative Amounts Outstanding (2005-2012)	Cumulative Amounts Determined Not to be Collectable (2005-2012)
Contracts	$ 0	0%	$ 7,503,026	$ 6,295,392	$ 7,967,748	$ 6,653,882	$ 343	$ 75,130
Grants	$ 0	0%	$ 428,274	$ 428,274	$ 917,316	$ 917,316	$ 0	$ 0
Benefits	$ 0	0%	$ 1,438	$ 1,438	$ 14,968	$ 1,438	$ 12,161	$ 0
Loans	$ 0	0%	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Other	$ 685	.02%	$ 46,380	$ 46,256	$ 2,999,477	$ 2,885,738	$ 7,052	$ 685

During fiscal year 2012, four Treasury entities determined that conducting a Payment Recapture Audit on various programs would not be cost effective. The Bureau of the Public Debt – Debt Activity Programs, the Financial Management Service – International Assistance Programs, the Treasury Executive Office of Asset Forfeiture – Forfeiture Payments and the Office of Financial Stability – Hardest Hit Fund Housing Finance Agency Program.

The Bureau of the Public Debt's Debt Activity Programs reflected a low level of risk in every group and payment type in fiscal year 2012.

The Financial Management Service's non- federal payments to the Multilateral Development Bank are submitted by either a voucher on a letter of credit administered by the Federal Reserve Bank of New York or through direct cash payments via the Secure Payment System. These payments present a low level of improper payment risk based on the number of payments annually and the quality of third party controls.

The Treasury Executive Office of Asset Forfeiture's program payments to state and local law enforcement agencies are intergovernmental payments that represent a low risk of improper payment. In addition, the Treasury Executive Office of Asset Forfeiture staff reviews payments monthly for accuracy.

In accordance with legal agreements, the Office of Financial Stability's Hardest Hit Fund Housing Finance Agency Program submits advance payments to state housing finance agencies who disburse to the final recipients. OFS performs compliance reviews designed to evaluate the overall control environment of the state housing finance agency administration of the program and recommends improvements as appropriate.

Based on the justifications submitted by the four Treasury bureaus, payment recapture audits for these programs were not deemed cost effective.

In fiscal year 2012, Treasury's payment recapture audit activities identified $685 in uncollectible travel voucher overpayments. Treasury determined that it was not cost-effective to pursue collection of this immaterial amount.

Payment Recapture Audit Targets

The payment recapture audit targets listed below are preliminary estimates developed by Treasury bureaus and offices based on historical performance and current payment recapture audit programs.

Type of Payment	2012 Amount Identified	2012 Amount Recovered	2012 Recovery Rate (Amount Recovered / Amount Identified)	2013 Recovery Rate Target	2014 Recovery Rate Target	2015 Recovery Rate Target
Contracts	$ 464,722	$ 358,490	77%	85%	85%	85%
Grants	$ 489,042	$ 489,042	100%	85%	85%	85%
Benefits	$ 13,530	$ 0	0%	85%	85%	85%
Loans	$ 0	$ 0	0%	85%	85%	85%
Other	$ 2,953,097	$ 2,839,482	96%	95%	95%	95%

Aging of Outstanding Overpayments

Type of Payment (contract, grant, benefit, loan, or other)	CY Amount Outstanding (0-6 months)	CY Amount Outstanding (6 months – 1 year)	CY Amount Outstanding (Over 1 year)
Contracts	$ 343	$ 0	$ 28
Grants	$ 0	$ 0	$ 0
Benefits	$ 0	$ 0	$ 1,369
Loans	$ 0	$ 0	$ 0
Other	$ 5,933	$ 1,127	$ 0

Disposition of Recaptured Funds

Type of Payment (Contracts, Grants, Benefits, Loans, other)	Agency Expenses to Administer the Program	Payment Recapture Auditor Fees	Financial Management Improvement Activities	Original Purpose	Office of the Inspector General	Returned to Treasury
Contracts	$ 0	$ 0	$ 0	$ 267,542	$ 0	$ 28
Grants	$ 0	$ 0	$ 0	$ 489,042	$ 0	$ 0
Benefits	$ 0	$ 0	$ 0	$ 0	$ 0	$ 1,369
Loans	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Other	$ 0	$ 0	$ 0	$ 31,473	$ 0	$ 0

Overpayments Recaptured Outside of Payment Recapture Audit

Source of Recovery	Amount Identified CY	Amount Recovered CY	Amount Identified PY	Amount Recovered PY	Cumulative Amount Identified (CY + PY)	Cumulative Amount Recovered (CY+PY)
Statistical Samples	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Post Payment Reviews or Audits	$ 112	$ 112	$ 0	$ 0	$ 112	$ 112
OIG Reviews	$ 8	$ 8	$ 6,234	$ 3,113	$ 6,242	$ 3,121
Single Audit Reports	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
Self-Reported	$ 2,896,776	$ 2,896,776	$ 0	$ 0	$ 2,896,776	$ 2,896,776
Reports from Public	$ 155,484	$ 149,402	$ 0	$ 0	$ 155,484	$ 149,401

VI. Accountability

The Secretary of the Treasury has delegated responsibility for addressing improper payments to the Assistant Secretary for Management and Chief Financial Officer (ASM/CFO). Improper payments fall under the Department's management and internal control program. A major component of the internal control program is risk assessments, which are an extension of each bureau's annual improper payment elimination and recovery review process, as required under A-123, Appendix C. Under Treasury Directive 40-04, *Treasury Internal (Management) Control Program*, executives and other managers are required to have management control responsibilities as part of their annual performance plans. With oversight mechanisms such as the Treasury CFO Council and the IRS's Financial and Management Controls Executive Steering Committee (FMC ESC), managerial responsibility and accountability in all management and internal control areas are visible and well-documented. Treasury has identified executives who are responsible and accountable for reducing the level of EITC overclaims, while other senior and mid-level officials have responsibility for monitoring progress in this area as bureau and program internal control officers.

VII. Information Systems and other Infrastructure

Overall, Treasury has the internal controls, human capital, and information systems and other infrastructure it needs to reduce improper payments to the targeted levels.

VIII. Limiting Statutory and Regulatory Barriers

Treasury's overall management assessment of IPERA did not uncover any limiting statutory or regulatory barriers with the exception of the high-risk EITC program.

A number of factors continue to serve as barriers to reducing overclaims in the EITC program. These include:

- Complexity of the tax law (including the need for Congressional authorization of math error authority)
- Structure of the EITC
- Confusion among eligible claimants
- High turnover of eligible claimants
- Unscrupulous return preparers
- Fraud

No one of these factors can be considered the primary driver of program error. Furthermore, the interaction among the factors makes addressing the credit's erroneous claims rate, while balancing the need to ensure the credit makes its way to taxpayers who are eligible, extremely difficult.

IX. Additional Comments

In fiscal year 2012, the OIG issued Report Number OIG-12-044, *Treasury was Not in Compliance with IPERA for Fiscal Year 2011*, which covered the IPERA program as presented in Treasury's fiscal year 2011 Agency Financial Report. During fiscal year 2012, the Department partially implemented corrective actions to address the findings and recommendations in the OIG report.

SECTION F:
MATERIAL WEAKNESSES AND AUDIT FOLLOW-UP

This section provides detailed descriptions of Treasury's material weakness inventory, including summaries of actions taken and planned to resolve the weaknesses; tracking and follow-up activities related to Treasury's GAO, OIG, TIGTA, and SIGTARP audit inventory; an analysis of potential monetary benefits arising from audits performed by Treasury's three IGs; and an update on Treasury's financial management systems framework.

I. Treasury's Material Weaknesses

Management may declare audit findings or internal situations as a material weakness whenever a condition exists that may jeopardize the Treasury mission or continued operations. The FMFIA requires agency reporting on material weaknesses.

FMFIA and FFMIA

The FMFIA requires agencies to establish and maintain internal controls. The Secretary must evaluate and report annually on the operations and financial reporting controls (FMFIA Section 2) and financial systems (FMFIA Section 4 and FFMIA) that protect the integrity of federal programs. The requirements of the FMFIA serve as an umbrella under which other reviews, evaluations, and audits should be coordinated and considered to support management's assertion about the effectiveness of internal control over operations, financial reporting, and compliance with laws and regulations.

As of September 30, 2012, Treasury had three material weaknesses under Section 2 of the FMFIA, summarized as follows:

Summary of FMFIA Material Weaknesses			
Balance at the Beginning of FY 2012	3	0	3
Reassessed during FY 2012	0	0	0
Balance at the End of FY 2012	3	0	3

Below are detailed descriptions of Treasury's three material weaknesses:

Internal Revenue Service – Unpaid Tax Assessments The IRS needs to improve its internal control over Unpaid Assessments. Original key elements: • Subsidiary ledger does not track and report one Trust Fund Recovery Penalty (TFRP) balance • Untimely posting of TFRP assessments and untimely review of TFRP accounts • IRS' general ledger for its custodial activities does not use the standard federal accounting classification structure - closed • General ledger cannot accurately report the Taxes Receivable balance without a statistical estimation process	
✓ Improved the financial classification of individual multi-officer/multi-corporation accounts by splitting the account to a greater level of detail ✓ Improved financial classification of single assessments involving multiple individual CSED balance due returns in Taxes Receivable, Compliance Assessments and Write-offs	☐ Implement the financial classification of business multi-officer/multi-corporation accounts by splitting the account to a greater level of detail (2013) ☐ Implement single assessments involving multiple business CSED balance due returns in Taxes Receivables, Compliance Assessments and Write-offs (2013) ☐ Perform "look-back" analysis on FY 2010 audit sampled items to assess accuracy of the business rules for classifying unpaid assessments (2013) ☐ Determine process improvements for entering data into IDRS to decrease errors posting to Master File (2013) ☐ Target Downgrade/Closure: Fiscal year 2015

Material Weakness Description	
Internal Revenue Service - Computer Security The IRS has various computer security controls that need improvement. Original key elements: • Adequately restrict electronic access to and within computer network operational components – closed • Adequately ensure that access to key computer applications and systems is limited to authorized persons for authorized purposes • Adequately configure system software to ensure the security and integrity of system programs, files, and data • Appropriately delineate security roles and responsibilities within functional business operating and program units, per Federal Information Security Management Act (FISMA) - closed • Appropriately segregate system administration and security administration responsibilities - closed • Sufficiently plan or test the activities required to restore certain critical business systems where unexpected events occur • Effectively monitor key networks and systems to identify unauthorized activities and inappropriate system configurations • Provide sufficient technical, security-related training to key personnel - closed • Certify and accredit 90 percent of all systems – closed • Additional internal control testing to substantiate resolution of material weakness	
Actions Completed in FY 2012	**What Remains to be Done**
✓ Established and maintain metrics for system and computer application - Access Control ✓ Established and maintain metrics for security and integrity of system programs, files, and data – System Software Configuration ✓ Established and maintain metrics for restoring critical business systems – IT Contingency Planning ✓ Established Metrics Plan. Successfully measuring compliance of each Top Level domain – Audit Trails	□ Develop application monitoring capability for Release 2 Supplement – Audit Trails □ Network and system monitoring for Release 3 – Audit Trails □ Deployment of Release 3 – Audit Trails □ Develop a centralized capability for External Entities for Release 3 – Audit Trails □ Enhance procedures for monitoring internal controls over IRS automated systems identified as material to the financial reporting process □ Develop procedures for conducting internal controls review of externally controlled financial systems providing data identified as material to IRS financial statements □ Target Downgrade/Closure: Fiscal year 2014

Material Weakness Description	
Financial Management Service – Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements The government does not have adequate systems, controls, and procedures to properly prepare the Consolidated Government-wide Financial Statements. Original key elements: • The government lacks a process to obtain information to effectively reconcile the reported excess of net costs over revenue with the budget deficit, and when applicable, a reported excess of revenue over net costs with the budget surplus • Weaknesses in financial reporting procedures in internal control over the process for preparing the Consolidated Financial Statements	
Actions Completed in FY 2012	**What Remains to be Done**
✓ Partially reconciled fiscal year 2011 budget deficit to agency financial reporting ✓ Refined analysis model for unreconciled transactions that affect the change in net position ✓ Accounted for intra-governmental differences through formal consolidating and elimination accounting entries using all reciprocal fund categories including the General Fund ✓ Completed closing package submitted to GAO by federal agencies ✓ Developed an approach for implementation of the Treasury General Fund and related General Ledger system ✓ Established traceability from agency financial statements and footnote disclosures to the Consolidated Financial Statements (CFS) for completeness	□ Complete timely reconciliation of annual budget deficit to agency financial reporting □ Complete reciprocal category for the Treasury General Fund □ Implement changes identified by the FASAB Reporting Entity Task Force once it completes its review and finalize procedures for inclusion of current non-reporting entities, e.g., legislative and judicial branches □ Implement the Treasury General Fund □ Include all disclosures related to criminal debt and risk assumed □ Include all loss contingencies related to treaties □ Targeted Downgrade/Closure: Fiscal year 2014

II. Audit Follow-up Activities

During fiscal year 2012, Treasury continued to place emphasis on both the general administration of internal control issues throughout the Department and the timely resolution of findings and recommendations identified by GAO, OIG, TIGTA, SIGTARP, external auditors, and management. During the year, Treasury continued to implement enhancements to the tracking system called the "Joint Audit Management Enterprise System" (JAMES). JAMES is a Department-wide, interactive, web-based system accessible to management, OIG, TIGTA, SIGTARP, and others. The system tracks information on audit reports from issuance through completion of all corrective actions required to address findings and recommendations contained in an audit report. JAMES is the official system of record for Treasury's audit follow-up program.

Potential Monetary Benefits

The *Inspector General Act of* 1978, as amended, Public Law 95-452, requires the IGs and secretaries of executive agencies and departments to submit semiannual reports to the Congress on actions taken on audit reports issued that identify potential monetary benefits. The Department consolidates and analyzes all relevant information for inclusion in this report. The information contained in this section represents a consolidation of information provided separately by OIG, TIGTA, SIGTARP, and Treasury management.

In the course of their audits, the IGs periodically identify questioned costs, recommend that funds be put to better use, and identify measures that demonstrate the value of audit recommendations to tax administration and business operations. "Questioned costs" include a:

- Cost that is questioned because of an alleged violation of a provision of a law, regulation, contract, or other requirement governing the expenditure of funds
- Finding, at the time of the audit, that such costs are not supported by adequate documentation (i.e., an unsupported cost)
- Finding that expenditure of funds for the intended purpose is unnecessary or unreasonable

The Department regularly reviews progress made by the bureaus to realize potential monetary benefits identified in audit reports, and coordinates with the auditors as necessary to ensure the consistency and integrity of information on monetary benefit recommendations tracked in JAMES.

The statistical data in the following summary tables represent audit report activity for the period from October 1, 2011 through September 30, 2012. The data reflect information on OIG, TIGTA, and SIGTARP reports that identified potential monetary benefits.

Audit Report Activity With Potential Monetary Benefits for Which Management Has Identified Corrective Actions (OIG, TIGTA, and SIGTARP) October 1, 2011 through September 30, 2012 (Dollars in Millions)

	Disallowed Costs		Funds Put to Better Use		Revenue Enhancements		Totals	
	Reports	Dollars	Reports	Dollars	Reports	Dollars	Report Total	Total Dollars
Beginning Balance	10	$72.2	11	$9,905.2	8	$3,735.7	29	$13,713.1
New Reports	7	10.0	12	22,066.6	8	327.4	27	22,404.0
Total	17	82.2	23	31,971.8	16	4,063.1	56	36,117.1
Reports Closed	3	2.1	12	22,672.1	8	2,015.5	23	24,689.7
a. Realized or Actual[1]	3	0.3	5	49.5	1	3.1	9	52.9
b. Unrealized or Written off[1]	1	1.8	10	22,622.7[2]	8	2,012.3[3]	19	24,636.8
Ending Balance	**14**	**$80.1**	**11**	**$9,299.7**	**8**	**$2,047.6**	**33**	**$11,427.4**

[1] *Report numbers in categories a and b may not equal the Reports Closed. One report can be included in one or both categories.*

[2] *This figure includes six TIGTA reports, with $22.2 billion written off, for which IRS management did not concur with TIGTA's projected benefits; and four TIGTA reports with $406.3 million written off, for which TIGTA does not agree with the IRS that the benefits have not been realized.*

[3] *This figure includes five TIGTA reports, with $1.6 billion written off, for which IRS management did not concur with TIGTA's projected benefits; and two TIGTA reports, with $406.2 million written off, for which TIGTA does not agree with the IRS that the benefits have not been realized.*

The following table presents a summary of OIG, TIGTA, and SIGTARP audit reports with potential monetary benefits that were open for more than one year as of the end of fiscal years 2010, 2011, and 2012.

Number of Reports with Potential Monetary Benefits Open for More than One Year (Dollars In Millions)

	PAR/AFR Report Year	9/30/2010	9/30/2011	9/30/2012
OIG	No. of Reports	1	0	0
	$ Projected Benefits	$ 10.5	$ 0	$0
TIGTA	No. of Reports	12	11	9
	$ Projected Benefits	$ 1,783.7	$ 4,384.6	$10,018.5
SIGTARP	No. of Reports	0	0	2
	$ Projected Benefits	$ 0	$ 0	$8.7

The following table presents a summary of the audit reports containing potential monetary benefits, broken out by year of report issuance, on which management decisions were made on or before September 30, 2011, but the final actions had not been taken as of September 30, 2012.

Details of the Audit Reports with Potential Monetary Benefits on Which Management Decisions Were Made On or Before September 30, 2011, But Final Actions Have Not Been Taken as of September 30, 2012 (Dollars In Millions)

Bureau	Report No.	Report Issue Date	Brief Description	Dis-allowed Costs	Funds Put to Better Use	Revenue Enhance-ment	Total	Due Date
IRS	2006-1c-142	9/25/2006	The IRS Contracting Officer (CO) should use the results of the Defense Contract Audit Agency (DCAA) report to fulfill his/her duties in awarding and administering contracts.	$ 32.4	-	-	$ 32.4	10/15/2012
FY 2006	**1**			**$ 32.4**			**$ 32.4**	
FY 2007	**N/A**			-	-	-	-	N/A
FY 2008	**N/A**			-	-	-	-	N/A
IRS	2009-10-107	7/24/2009	IRS should develop procedures requiring that workstation sharing levels are included in space needs assessments. When implementing these procedures, IRS should adjust its space needs to reflect workstation sharing and take action to release any unneeded space identified, where appropriate.	-	30.0	-	30.0	1/15/2014
IRS	2009-1c-134	9/28/2009	The IRS CO should use the results of the DCAA report to fulfill his/her duties in awarding and administering contracts.	0.1	-	-	0.1	10/15/2012
FY 2009	**2**			**$ 0.1**	**$ 30.0**	**$ 0**	**$30.1**	
IRS	2010-40-117	9/14/2010	IRS should revise the criteria used to determine who will receive a notice to include individuals identified by the Duplicate TIN Use database when (1) a TIN is used as a secondary taxpayer on one tax return and as a dependent and/or for the EITC on another tax return, and (2) a TIN is	-	1,297.6	-	1,297.6	1/15/2013

			used as a qualifying child for the child and dependent care credit, adoption credit, education credits, and child tax credit.					
FY 2010	**1**			**$ 0**	**$ 1,297.6**	**$0**	**$1,297.6**	
IRS	2011-1c-017	2/24/2011	IRS should use the DCAA audit report to fill his/her duties in awarding and administering contracts. When negotiations are completed, the CO will provide the TIGTA a copy of the Price Memorandum or other documentation of the actual cost savings achieved.	0.2	-	-	0.2	2/24/2016
IRS	2011-1c-080	8/23/2011	The IRS CO should use the DCAA report in the administration of the contract and determine whether the questioned costs should be recovered.	0.1	-	-	0.1	8/31/2016
IRS	2011-41-083	9/16/2011	IRS should revise the Form 8863 to require taxpayers to provide identifying information for the educational institution that the student(s) being claimed for the education credits attended.	-	6,829.5	-	6,829.5	1/15/2013
IRS	2011-30-112	9/26/2011	IRS should consider reducing the time between each Master File notice by seven days.	-	-	1,800.0	1,800.0	1/15/2013
IRS	2011-1c-122	9/28/2011	The IRS CO should use the DCAA report in the administration of the contract and determine whether the questioned costs should be recovered.	28.6	-	-	28.6	9/30/2016
OFS	SIG-AR-11-003	4/14/2011	OFS should review previously paid legal fee bills to identify unreasonable or unallowable charges, and seek reimbursement for those charges, as appropriate.	0.7	-	-	0.7	4/30/2013
OFS	SIG-AR-11-004	9/28/2011	OFS should determine the allowability in questioned, unsupported legal fees and expenses paid to specified law firms.	8.1	-	-	8.1	11/11/2012
FY 2011	**7**			**$37.7**	**$6,829.5**	**$1,800.0**	**$8,667.2**	
Total	**11**			**$70.2**	**$8,157.1**	**$1,800.0**	**$10,027.3**	

The following table provides a snapshot of OIG and TIGTA audit reports with significant recommendations reported in previous semiannual reports for which corrective actions had not been completed as of September 30, 2011 and September 30, 2012, respectively. OIG and TIGTA define "significant" as any recommendation open for more than one year. There were no "Undecided Audit Recommendations" during the same periods.

Audit Reports with Significant Unimplemented Recommendations				
	9/30/2011		9/30/2012	
	OIG	TIGTA	OIG	TIGTA
No. of Reports	7	12	5	17

The following table provides a snapshot of the number of recommendations made in SIGTARP audit reports and quarterly reports for which corrective actions had not been completed as of September 30, 2011 and September 30, 2012, respectively. SIGTARP defines a recommendation as "unimplemented" if it is listed as "partially implemented," "in process," or "not implemented" in SIGTARP's quarterly report.

Unimplemented SIGTARP Recommendations		
	9/30/2011	9/30/2012
No. of Unimplemented Recommendations	12	25

APPENDIX:
GLOSSARY OF ACRONYMS

Glossary of Acronyms	
ABS	Asset-Backed Securities
ACA	Patient Protection and Affordable Care Act
ACH	Automated Clearing House
AD	Audit Division
AFR	Agency Financial Report
AGI	Adjusted Gross Income
AGP	Asset Guarantee Program
AIFP	Automotive Industry Financing Program
AIG	American International Group, Inc.
AML	Anti-money laundering
APG	Agency Priority Goal
AQC	Automated Questionable Credit
ARC	Administrative Resource Center
ASM/CFO	Assistant Secretary for Management & Chief Financial Officer
AUR	Automated Underreporter
BEA	Bank Enterprise Award
BEP	Bureau of Engraving and Printing
BPD	Bureau of the Public Debt
BSA	Bank Secrecy Act
BYOD	Bring Your Own Device
CADE 2	Customer Account Data Engine 2
CAP	Capital Assistance Program
CAP	Compliance Assurance Process
CDCI	Community Development Capital Initiative
CDD	Customer Due Diligence
CDDB	Custodial Detail Database
CDE	Community Development Entity
CDFI	Community Development Financial Institutions
CDLF	Community Development Loan Fund
CDP	Collection Due Process
CE	Continuing Education
CFIUS	Committee on Foreign Investment in the United States
CFPB	Consumer Financial Protection Bureau
CFO	Chief Financial Officer
CFS	Consolidated Financial Statements
CIGFO	Council of Inspectors General on Financial Oversight
CMBS	Commercial Mortgage Backed Securities
CO	Contracting Officer
COSO	Committee of Sponsoring Organizations of the Treadway Commission
Council	Financial Stability Oversight Council

Glossary of Acronyms	
CPP	Capital Purchase Program
CRS	Centralized Receivables Services
DCAA	Defense Contract Audit Agency
DCFO	Deputy Chief Financial Officer
DCP	Office of D.C. Pensions
DIP	Debtor-in-Possession
DO	Departmental Offices
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
DOL	Department of Labor
EESA	Emergency Economic Stabilization Act of 2008
EFTPS	Electronic Federal Tax Payment System
EITC	Earned Income Tax Credit
ESF	Exchange Stabilization Fund
EU	European Union
Fannie Mae	Federal National Mortgage Association
FARS	Financial Analysis and Reporting System
FASAB	Federal Accounting Standards Advisory Board
FATCA	Foreign Account Tax Compliance Act
FCDA	Foreign Currency Denominated Assets
FCRA	Federal Credit Reform Act
FDIC	Federal Deposit Insurance Corporation
FECA	Federal Employees' Compensation Act
FEHBP	Federal Employees Health Benefits Program
FFB	Federal Financing Bank
FFMIA	Federal Financial Management Improvement Act
FHA	Federal Housing Administration
FHFA	Federal Housing Finance Agency
FinCEN	Financial Crimes Enforcement Network
FIO	Federal Insurance Office
FMD	Financial Management Services/Miscellaneous
FMFIA	Federal Managers' Financial Integrity Act
FMIS	Financial Management Information System
FMS	Financial Management Service
FMU	Financial Market Utilities
FPA	Federal Program Activities
FRB	Federal Reserve Bank
FRBNY	Federal Reserve Bank of New York
Freddie Mac	Federal Home Loan Mortgage Corporation
FSB	Financial Stability Board
FTO	Fine Troy Ounce
FY	Fiscal Year
G-7	Group of Seven

Glossary of Acronyms	
G-20	Group of Twenty
GAAP	Generally Accepted Accounting Principles
GAB	General Arrangement to Borrow
GAFSP	Global Agriculture and Food Security Program
GAO	Government Accountability Office
GM	General Motors Company
GSA	General Services Administration
G-SIFI	Global Systematically Important Financial Institution
GSE	Government Sponsored Enterprise
GTAS	Government-wide Treasury Account Symbol Adjusted Trial Balance System
GWA	Government-wide Accounting
HAMP	Home Affordable Modification Program
HERA	Housing and Economic Recovery Act
HFA	Housing Finance Agency
HHF	Hardest Hit Fund
HHS	Department of Health and Human Services
HUB	Historically Underutilized Business
HUD	Department of Housing and Urban Development
IA	International Affairs
IAIS	International Association of Insurance Supervisors
IG	Inspector General
IMF	International Monetary Fund
IPERA	Improper Payments Elimination and Recovery Act of 2010
IPIA	Improper Payments Information Act of 2002
IPP	Invoice Processing Platform
IRC	Internal Revenue Code
IRS	Internal Revenue Manual
IRS	Internal Revenue Service
IT	Information Technology
ITIN	Individual Tax Identification Number
JAMES	Joint Audit Management Enterprise System
LEI	Legal Entity Identifier
LEP	Limited English Proficiency
LIBOR	London Interbank Offered Rate
LIC	Low-Income Community
MBS	Mortgage-Backed Security
MDB	Multilateral Development Bank
MeF	Modernized Electronic File
MHA	Making Home Affordable Program
MOU	Memorandum of Understanding
MRADR	Market Risk Adjusted Discount Rate
MSB	Money Services Businesses
NAB	New Arrangement to Borrow
NACA	Native American Community Development Financial Institutions Assistance
NIBP	New Issue Bond Program

Glossary of Acronyms	
NMTC	New Markets Tax Credit
NRP	National Research Program
NS/EP	National Security and Emergency Preparedness
NTPI	Non-tax Paperless Initiative
NYSE	New York Stock Exchange
OAS	Office of International Affairs
OCC	Office of the Comptroller of the Currency
OFAC	Office of Foreign Assets Control
OFAS	Office of the Fiscal Assistant Secretary
OFIT	Office of Financial Innovation and Transformation
OFR	Office of Financial Research
OFS	Office of Financial Stability
OIG	Office of Inspector General
OMB	Office of Management and Budget
OPEB	Other Post-Employment Benefits
OPM	Office of Personnel Management
ORB	Other Retirement Benefits
OTA	Office of Technical Assistance
OTC	Over-the-Counter
OTS	Office of Thrift Supervision
PB	President's Budget
P.L.	Public Law
POC	Proof of Concept
PP&E	Property, Plant, and Equipment
PPIF	Public-Private Investment Fund
PPIP	Public-Private Investment Program
PTIN	Preparer Tax Identification Number
QFI	Qualified Financial Institution
QRP	Questionable Refund Program
Recovery Act	American Recovery and Reinvestment Act of 2009
RMBS	Residential Mortgage Backed Securities
RMLO	Regulatory Mortgage Lenders and Originators
RTRP	Registered Tax Return Preparer
S&ED	Strategic and Economic Dialogue
SAR	Suspicious Activity Report
SBA	Small Business Administration
SBLF	Small Business Lending Fund
SBR	Statement of Budgetary Resources
SDR	Special Drawing Rights
SEC	Securities and Exchange Commission
SFFAC	Statement of Federal Financial Accounting Concepts
SFFAS	Statement of Federal Financial Accounting Standards
SIG	Special Inspector General
SIGTARP	Special Inspector General for TARP
SOS	Statement of Spending

Glossary of Acronyms	
SPSPA	Senior Preferred Stock Purchase Agreements
SPV	Special Purpose Vehicle
SSBCI	State Small Business Credit Initiative
SSC	Shared Services Council
SVC	Stored Value Card
TAA	Trade Adjustment Assistance
TAC	Taxpayer Assistance Center
TAIFF	Troubled Asset Insurance Finance Fund
TALF	Term Asset-Backed Securities Loan Facilities
TARP	Troubled Asset Relief Program
TCLP	Temporary Credit and Liquidity Program
TEFRA	Tax Equity and Fiscal Responsibility Act of 1982
TEICAM	Treasury Enterprise Identity Credential and Access Management
TEOAF	Treasury Executive Office for Asset Forfeiture
TFF	Treasury Forfeiture Fund
TFI	Terrorism and Financial Intelligence
TFTP	Terrorist Finance Tracking Program
TGA	Treasury General Account
TIEA	Tax Information Exchange Agreement
TIER	Treasury Information Executive Repository
TIGTA	Treasury Inspector General for Tax Administration
TIPS	Treasury Inflation-Protected Securities
TNET	Treasury Network
TOP	Treasury Offset Program
TPU	Taxpayer Processing Unit
TRIA	Terrorism Risk Insurance Act
TST	Tier Structure Tool
TRuPS	Trust Preferred Securities
TTB	Alcohol and Tobacco Tax and Trade Bureau
UA	Unpaid Assessment
USA PATRIOT Act	Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001
USDA	United States Department of Agriculture
USC	United States Code
USPS	United States Postal Service
USSGL	United States Standard General Ledger
VA	Department of Veterans Affairs
VSD	Virtual Service Delivery
WHBAA	Worker, Homeownership, and Business Assistance Act of 2009
WMD	Weapons of Mass Destruction

Website Information

Treasury	www.treasury.gov
Alcohol and Tobacco Tax and Trade Bureau	www.ttb.gov
Bureau of Engraving & Printing	www.bep.gov
Bureau of the Public Debt	www.publicdebt.treas.gov
Community Development Financial Institutions Fund	www.cdfifund.gov
Financial Crimes Enforcement Network	www.fincen.gov
Financial Management Service	www.fms.treas.gov
Internal Revenue Service	www.irs.gov
Office of the Comptroller of the Currency	www.occ.gov
U.S. Mint	www.usmint.gov
The Financial Stability Plan	www.financialstability.gov
Making Home Affordable Program	www.makinghomeaffordable.gov
The Recovery Act	www.recovery.gov
Office of Inspector General	www.treasury.gov/oig
Treasury Inspector General for Tax Administration	www.tigta.gov
Office of the Special Inspector General for the Troubled Asset Relief Program	www.sigtarp.gov

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