MESSAGE FROM THE SECRETARY OF THE TREASURY

November 15, 2010

Over the past two years, the Treasury Department has taken a series of unprecedented steps to pave the way for the nation's recovery from the worst recession in our lifetimes. The Department's top priority has been to serve the American people by strengthening the U.S. economy, helping create jobs, and restoring confidence in our financial system.

Since the last report, we have made important progress on all fronts. Over the past year, in addition to continued implementation of the Recovery Act, we have recovered most of our investments in the financial system; helped usher in a historic law to reform our financial system; crafted important new consumer protections; and significantly increased support for small businesses.

There is much work still to be done to get our economy growing faster. In 2010, the private sector added more than 1.1 million jobs—an average of 112,000 jobs a month for 10 straight months. Treasury will continue to work to build on these positive trends, accelerate job creation, and drive economic recovery.

The financial system today is also much stronger—and looks much different—than it did two years ago. The firms that remain are in a much better position to withstand future stress. Most banks have more capital than before the crisis and more than their global competitors. Overall, private capital has replaced public funds, and the government is winding down its financial system rescue efforts faster than anticipated.

Because of Treasury's careful stewardship of taxpayer dollars and the further strengthening of the financial system, the Troubled Asset Relief Program will likely cost substantially less than originally thought possible. Since its inception, the projected cost of this program has continued to decline dramatically. The Department has stopped committing new funds and has already recovered $204.1 billion of the total $387.7 billion that has been disbursed for the program, and has received nearly $28 billion in additional profits from dividends, interest, warrants, and other transactions. Moving forward, further progress towards replacing public support with private investment will continue to demonstrate Treasury's ongoing commitment to maximize repayments to taxpayers.

In addition to the important efforts to meet our immediate obligations, the Department worked closely with Congress to pass fundamental financial reform. Our financial system helped trigger the most severe economic recession in 70 years. The flaws in that system had to be fixed to protect future generations. In July, after months of negotiations and hard work, Congress passed the *Dodd-Frank Wall Street Reform and Consumer Protection Act*—the most sweeping financial reforms since the Great Depression. The President quickly signed it into law, and Treasury immediately began implementing the new reforms. The Department is now standing up the Consumer Financial Protection Bureau, conducting meetings of the Financial Stability Oversight Council, and putting in place the Office of Financial Research.

Against this backdrop of dramatic change, Treasury continues to pursue its goals of effectively managing U.S. Government finances, helping U.S. and world economies perform at full economic potential, promoting the nation's security through strengthened international financial systems, and efficiently managing the Department's resources.

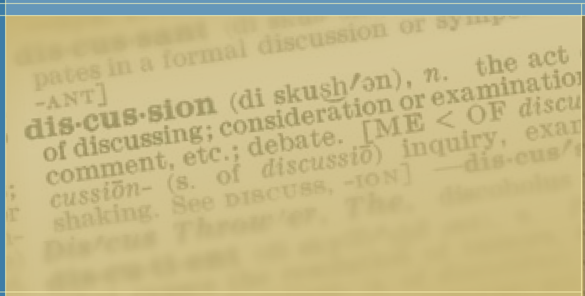
The Department again received an unqualified opinion on our Treasury consolidated financial statements, and we also received another unqualified opinion on the financial statements of our Office of Financial Stability/Troubled Asset Relief Program, which reflect the financial results of their second year of operations.

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
Secretary of the Treasury

PART I:

MANAGEMENT'S DISCUSSION AND ANALYSIS



INTRODUCTION

To repair and reform the financial system, Treasury implemented measures ranging from preparation and initial implementation of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) to ongoing rescue and economic recovery initiatives begun in 2008 and 2009 and to work with international partners to reform the international financial system. Treasury also plays a critical role in achieving one of the Obama Administration's top domestic priorities in the implementation of health care reform. In addition to these priorities, Treasury continued to focus on managing the government's finances and streamlining operations, including maximizing paperless transactions and strong performance management in fiscal year 2010.

The Dodd-Frank Act, passed in July 2010, introduced wide-ranging financial reforms to better protect consumers, prevent financial firms from taking risks that threaten the economy, and provide the government more effective tools to manage financial crises. To implement the Dodd-Frank Act, Treasury is establishing new regulatory bodies, including the Consumer Financial Protection Bureau, Financial Stability Oversight Council, Office of Financial Research, and Federal Insurance Office; overseeing the closure of the Office of Thrift Supervision and its integration into the Office of the Comptroller of the Currency; and working with other government agencies to develop new market regulations and guidance.

As the economy recovers from the financial crisis and recession, Treasury has continued its efforts to restore growth and create jobs through implementation of the *Housing and Economic Recovery Act of 2008* (HERA), the *Emergency Economic Stabilization Act of 2008* (EESA), and the *American Recovery and Reinvestment Act of 2009* (Recovery Act); coordination with federal and state partners; execution of Treasury's Housing Programs; regulation of national banks and thrifts; and various other initiatives. As the financial system continues to stabilize and the economy recovers, the Troubled Asset Relief Program (TARP) will wind down and efforts will be focused on implementing financial regulatory reform and protection for consumers.

Treasury continued to secure strong international support through the Group of 20 (G-20) to reform the international financial system based on the fundamental principles of a strong regulatory framework, effective supervision, management of risks associated with systemic institutions, and transparent international assessment and peer review. The Department also helped strengthen global bank capital standards through establishment of a new Basel III capital agreement.

The Department has a major role in implementing health care reform. The IRS began developing new systems and business processes for near term provisions, conducting initial planning for longer-term provisions, and defining appropriate outreach activities for each affected taxpayer group. While implementing new provisions, the IRS continued to focus on its priority performance goal of improving voluntary tax compliance.

Fiscal year 2010 saw strong demand in wholesale government securities. During the year, the Department conducted over 290 government securities auctions, a near record, and issued $8.41 trillion in marketable Treasury securities. Only fiscal year 2009 had a greater number of auctions. On average, nominal note and bond auctions have been oversubscribed by 1.9 times, significantly above the previous record of 1.5 times in fiscal year 2009.

The Department accelerated its efforts to increase the number of electronic transactions with the public to reduce paper use, increase efficiency, and reduce costs. One of Treasury's three priority performance goals sets a target to increase electronic transactions with the public by 33 percent by the end of fiscal year 2011. Initiatives related to tax payments, savings bond purchases, benefit payments, and vendor invoicing will all be included in this effort. Savings are estimated at $400 million over five years. In addition to these initiatives, E-filing of tax returns continued to increase in 2010. Sixty-nine percent of individual returns were filed electronically, up from 66 percent in fiscal year 2009. Business returns electronically filed increased 12 percent over 2009, reaching 25.5 percent.

Finally, the Department launched a new performance management process led by the Deputy Secretary and coordinated through the Assistant Secretary for Management. Performance review meetings are conducted every quarter for Treasury bureaus and policy offices. The meetings in 2010 focused on clarifying missions, goals, and performance measures and formulation of the fiscal year 2012 budget. The performance review process will mature over the next fiscal year as a deeper understanding of the factors that drive performance are analyzed, and strategies are developed to deliver improved results.

For the online version of this report, please see *http://www.treasury.gov/offices/management/dcfo/accountability-reports*.

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 and nine 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.

International Affairs protects and supports U.S. economic prosperity by strengthening the external environment for U.S. growth, preventing and mitigating global financial instability, and managing key global challenges.

Terrorism and Financial Intelligence (TFI) marshals the Department's intelligence and enforcement functions with the twin aims of safeguarding the financial system against illicit use and combating intransigent regimes, terrorist facilitators, money launderers, drug kingpins, and other national security threats.

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

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

Treasurer of the United States serves as a senior advisor and representative of Treasury on behalf of the Secretary in the areas of community development, real estate, and other business development initiatives. The Treasurer also serves as one of the agency's principal advisors and is a spokesperson in the areas of financial literacy, education and public engagement.

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

Internally, the departmental offices are responsible for overall management of the Department. *The Office of Management and the Chief Financial Officer* is responsible for internal management and controls, as well ensuring contracting opportunities through the *Office of Small and Disadvantaged Business Utilization*. Support organizations 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 for the Department of the Treasury and its programs.

Bureaus

Bureaus employ 98 percent of Treasury's workforce and are responsible for carrying out specific operations assigned to the Department.

The Alcohol and Tobacco Tax and Trade Bureau (TTB) collects 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) designs and manufactures high quality notes and other financial documents that deter counterfeiting and meet customer requirements for quality, quantity, and performance.

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

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

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

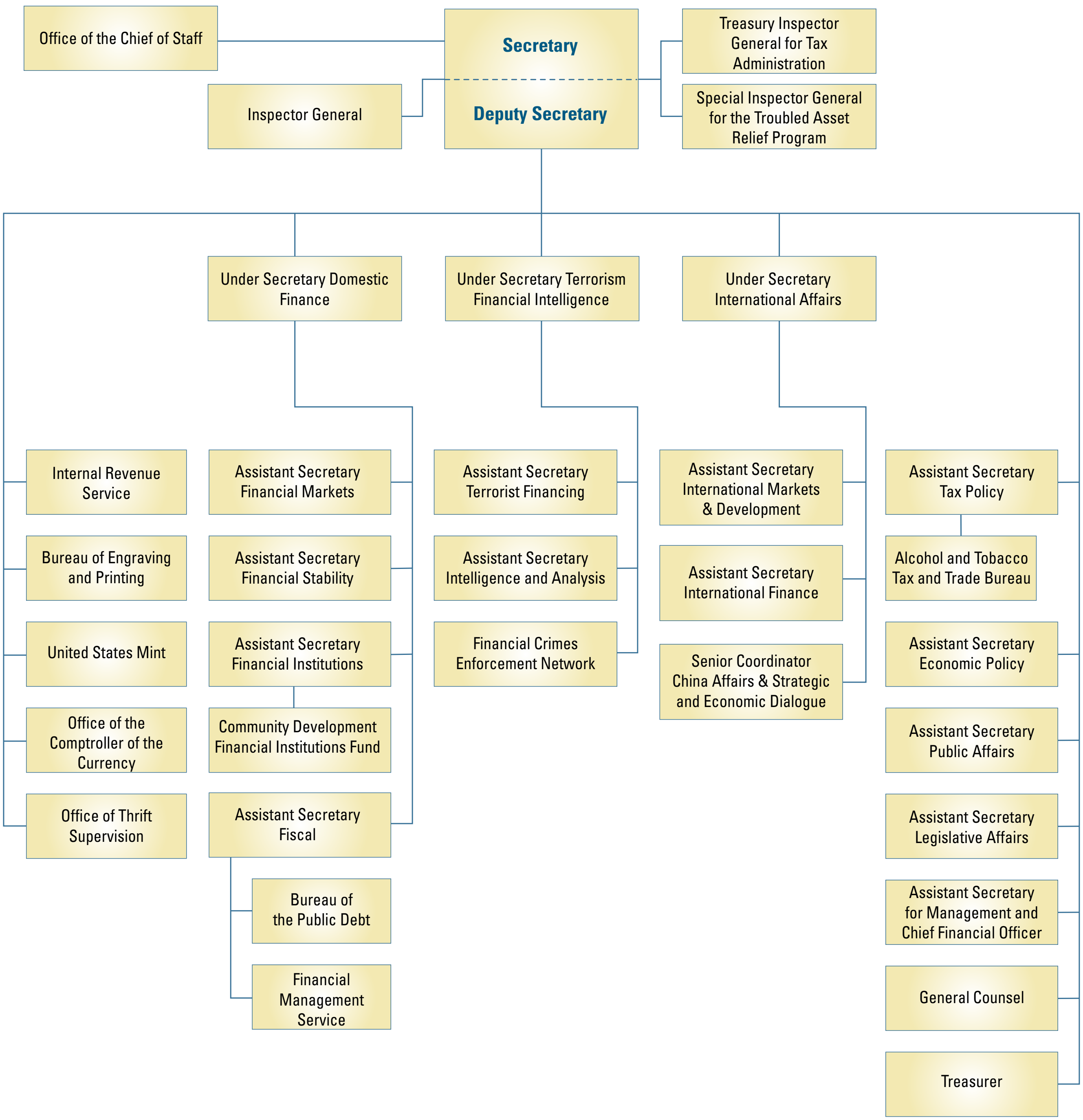
The Internal Revenue Service (IRS) is the largest of the Department's bureaus and determines, assesses, and collects tax revenue for the federal government.

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

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

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

The Department of the Treasury Organizational Chart



THE TREASURY DEPARTMENT'S 2007-2012 STRATEGIC FRAMEWORK

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

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

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

FISCAL YEAR 2010 SUMMARY OF PERFORMANCE BY STRATEGIC GOAL

Strategic Goal	Key Accomplishments	Key Challenges	Trend
Effectively Managed U.S. Government Finances Cost*: 2009: $14.4 billion 2010: $15.5 billion	• Collected $2.3 trillion in tax revenue and $23.8 billion in federal excise taxes on tobacco, alcohol, firearms, and ammunition • Processed over 141.9 million individual returns and issued over 109.5 million refunds • Processed 69 percent of individual tax returns electronically, up from 66 percent in fiscal year 2009 • Converted nearly 1.5 million federal benefit check recipients to direct deposit in fiscal year 2010, 50 percent more than fiscal year 2009 • Conducted 47 percent more auctions than the fiscal year 2000 to 2008 average • Extended the average maturity of the debt by five months to an historic average of 58 months	• Continue to work toward the Congressional goal of having 80 percent of tax returns filed electronically • Continue "Paperless" initiatives to convert paper savings bonds, payments, vendor invoices, and collections to electronic forms • Implement tax provisions in the Patient Protection and Affordable Care Act • Expand efforts to address offshore tax evasion • Increase compliance among corporate returns • Improve audit coverage of high net-worth/high-income taxpayers • Continue to make progress toward completing the new taxpayer account database (the Customer Account Data Engine II) • Accurately forecast government receipts • Develop standard electronic invoicing platform and intra-governmental transaction processing systems	Performance ▶ Budget ▲ Cost ▲
U.S. and World Economies Perform at Full Economic Potential Cost*: 2009: $4.4 billion 2010: $5.5 billion	• Supported enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and initiated implementation of financial reforms • Continued implementation of the Emergency Economic Stabilization Act of 2008 to repair financial and housing markets • Improved mortgage availability and housing market stability by implementing the Housing and Economic Recovery Act of 2008 • Implemented economic stimulus measures under the American Recovery and Reinvestment Act of 2009 • Supported enactment of the Small Business Jobs Act of 2010 to strengthen the capacity of small businesses to create jobs • Coordinated with G-20 nations and other partners to strengthen international financial regulations • Contributed to fiscal stabilization efforts in countries most directly affected by the financial crisis and economic recession • Coordinated the economic track of the U.S. – China Strategic and Economic Dialogue • Led U.S. engagement in the multilateral development banks to further alleviate poverty and foster broad-based economic growth	• Stand up the Consumer Financial Protection Bureau, Financial Stability Oversight Council, Office of Financial Research, and Federal Insurance Office • Close the Office of Thrift Supervision and transfer its functions to the Office of the Comptroller of the Currency, the Federal Reserve, and the Federal Deposit Insurance Corporation • Reform the housing finance system to improve long-term market stability • Continue to monitor and mitigate risks at national banks and thrifts • Reduce mortgage delinquency and foreclosure rates • Maintain and promote open economies despite rising protectionist interests • Reform Medicare and Social Security to ensure long-term solvency • Manage cost, productivity, and quality issues related to coin and currency production • Increase financial literacy and access to financial services in low-income and underserved communities • Monitor compliance of Recovery Act tax provisions	Performance ▼ Budget ▲ Cost ▲

Table continued on next page

Strategic Goal	Key Accomplishments	Key Challenges	Trend
Prevented Terrorism and Promoted the Nation's Security Through Strengthened International Financial Systems Cost*: 2009: $570 million 2010: $668 million	• Obtained commitment from financial institutions to reduce business relations with Iran and Iranian banks • Implemented sanctions against North Korean arms trafficking, luxury goods procurement, and illicit economic activities • Supported establishment of the Afghanistan Threat Finance Cell • Enhanced mechanisms to combat mortgage and loan modification fraud and detect health care fraud • Provided key information on Southwest border cash flows to law enforcement • Seized over $1 billion in forfeitures and recoveries	• Fully implement anti-money laundering and counter-terrorist financing laws in key countries • Continue to support efforts in Mexico to detect, interdict, and investigate the flow of illicit proceeds from narcotics and human smuggling • Modernize Bank Secrecy Act information and analysis • Develop compliance practices and regulations for newly regulated industries, such as pre-paid access cards and mortgage brokers • Strengthen evaluation methodology for Terrorism and Financial Intelligence impact measure	Performance ▲ Budget ▲ Cost ▲
Management and Organizational Excellence Cost*: 2009: $296 million 2010: $337 million	• Achieved second most-improved agency in the Best Places to Work Rankings by the Partnership for Public Service • Provided management, financial, budget, IT, facilities, procurement, and human capital support to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act • Exceeded procurement savings and high-risk contract reduction goals set by Office of Management and Budget (OMB) • Maintained status as the only agency to consistently receive fully green marks on the OMB Environment and Energy Scorecard • Established and conducted data driven budget and performance reviews at the Deputy Secretary level for all bureaus	• Increase implementation of SIGTARP recommendations for the Troubled Asset Relief Program • Launch re-designed Treasury website • Implement next stage of Homeland Security Presidential Directive 12 (HSPD-12) logical and physical access • Continue consolidation of Treasury data centers • Implement Enterprise Content Management technology initiative to improve Department-wide efficiency • Continue to implement aggressive paper reduction targets • Complete all material loss review work (due to bank failures) on time • Close planned corrective actions from audits on time • Streamline hiring process	Performance ▲ Budget ▲ Cost ▲

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

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

TREASURY'S PRIORITY PERFORMANCE GOALS

The Department established three Priority Performance Goals in 2010 to drive its focus and achieve measurable results for the American people in the next two years. These goals are based on existing priorities and the strategic goals of the Treasury Department.

Repair and Reform the Financial System

The financial crisis of the last two years, with its attendant recession, job losses, and foreclosures, has required the Department to take extraordinary actions to preserve the functioning of financial and housing markets and restore confidence in the integrity of the financial system. Gaps and weaknesses in the supervision and regulation of financial firms limited the government's ability to:

- Monitor and prevent risks that built up in the financial system
- Provide adequate protections for consumers and investors

Increase Voluntary Tax Compliance

Improving both service and enforcement, along with reforms to simplify the tax law, are essential to ensure the U.S. tax system remains the most effective and fairest voluntary compliance system in the world. Reliance on a voluntary compliance tax system requires:

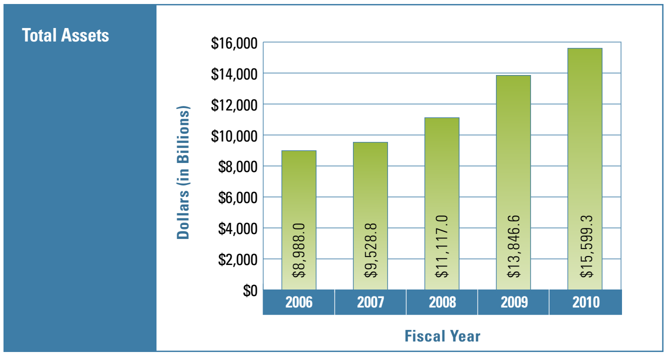
- Effective taxpayer services that enable taxpayers to understand and meet their tax obligations
- Effective enforcement to ensure that all businesses and individuals pay the tax they owe

Significantly Increase the Number of Electronic Transactions with the Public

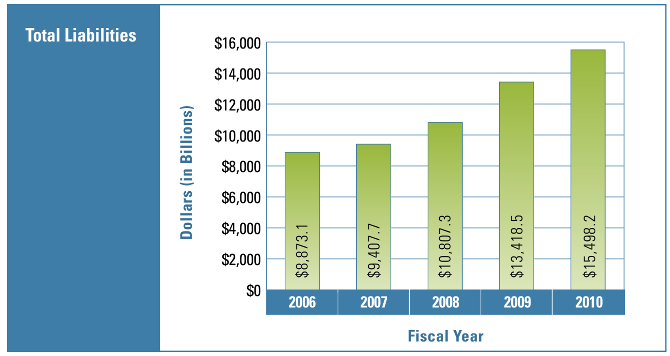
The safety, security, efficiency, and reliability of Treasury transactions are paramount to maintaining public trust. Billions of transactions for payments to recipients, savings bonds purchases, and tax collections are executed in a year. Increasing the number of electronic transactions with the public will:

- Reduce costs
- Reduce errors
- Decrease the public's vulnerability to fraud
- Increase convenience for recipients and taxpayers
- Reduce environmental impact

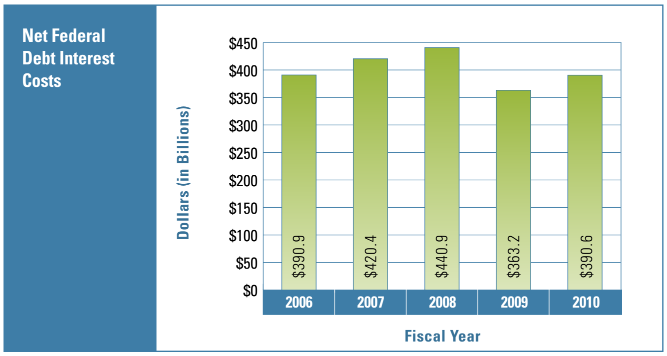
FINANCIAL HIGHLIGHTS



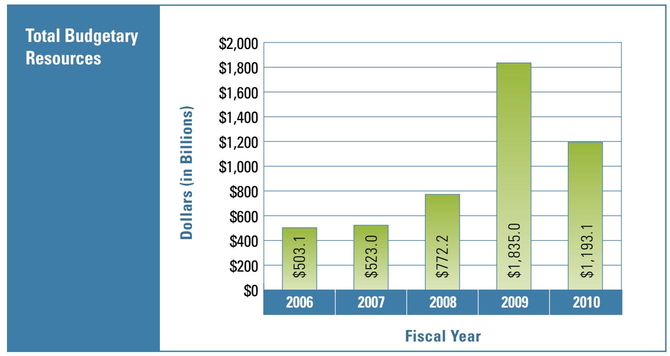
The increase of $1.8 trillion in total assets in fiscal year 2010 is largely due to the increase in future funds required from the General Fund of the U.S. Government to pay for the federal debt owed to the public and other federal agencies.



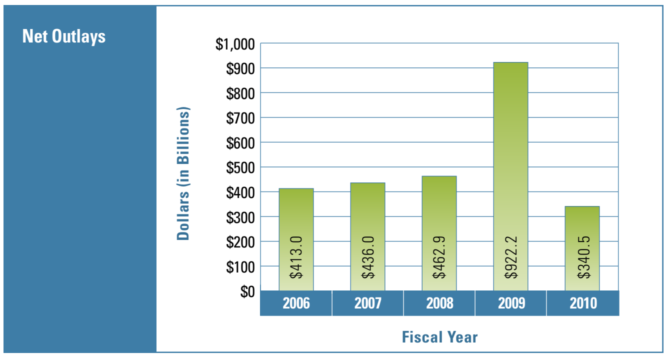
Total liabilities increased by $2.1 trillion from fiscal year 2009 to fiscal year 2010. The majority of the increase is due to borrowings from other federal agencies and debt issued to the public.



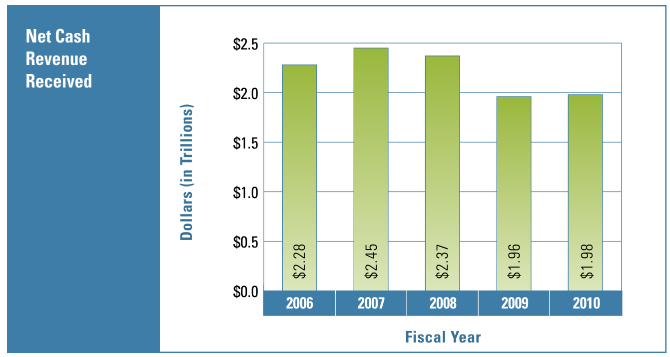
The increase of $27.4 billion in net interest paid on the federal debt is due to the increase in the debt. Total federal debt and interest payable increased by $1.66 trillion in fiscal year 2010.



The majority of the decrease in total budgetary resources for fiscal year 2010 was due to the reduction of Troubled Asset Relief Program (TARP) activity and investments in the Government Sponsored Enterprises (GSEs).



The majority of the $581.7 billion decrease in net outlays was due to the reduction of Troubled Asset Relief Program (TARP) activity and investments in the Government Sponsored Enterprises (GSEs).



Net cash revenue received on behalf of the U.S. Government increased by $12.7 billion for fiscal year 2010. This increase can be attributed to an overall improvement in the economy.

FISCAL YEAR 2010 PERFORMANCE BY STRATEGIC GOAL

Effectively Managed U.S. Government Finances

The Treasury Department manages the nation's finances by collecting money due to the United States, making its payments, managing its borrowing, investing when appropriate, and performing central accounting functions. In fiscal year 2010, the Treasury implemented tax provisions contained in the *Patient Protection and Affordable Care Act of 2010* (ACA) and the *Hiring Incentives to Restore Employment Act of 2010* (HIRE). The Department also sought to improve processes for tax filing and payments and created a new Office of Financial Innovation and Transformation (FIT).

IRS Implementation of the Patient Protection and Affordable Care Act of 2010

The ACA was signed into law on March 23, 2010 and was later amended by the *Health Care and Education Reconciliation Act of 2010* on March 30, 2010. ACA represents the largest set of tax law changes in more than 20 years, with more than 40 provisions that amend the tax laws. Although the new law goes into effect gradually over many years, numerous provisions like the Small Business Health Care Tax Credit, the Qualifying Therapeutic Discovery Credit, and the expanded Adoption Credit require immediate action.

The IRS established teams to implement the various provisions. Efforts focused on:

- Developing new systems and business processes for near-term provisions
- Conducting initial planning for longer-term provisions
- Defining appropriate outreach activities for each affected taxpayer group

The IRS and the Department of Health and Human Services (HHS) partnered to form a coordinating committee to assess cross-cutting policy considerations. Interagency working teams were formed to assess operational needs such as data infrastructure, eligibility, enrollment, customer service, communications, and payment of premium tax credits. The IRS is assessing the overall impact of new health insurance exchanges on tax administration and analyzing information technology (IT) system designs that will be needed for enrollment verification, payment and accounting processes, tax reconciliation, and administration of both individual and employer requirements.

Provisions effective in later years will place new administrative responsibilities on the IRS and require new systems, business processes, and coordination with other federal and state entities. Efforts will continue into fiscal year 2011. In addition, TIGTA reviewed the ACA for its impact on tax administration.

Creation of Office of Financial Innovation and Transformation

In fiscal year 2010, Treasury created the FIT to develop a standard electronic invoicing platform and intra-governmental transaction processing systems. The goals of this effort are to lower overall financial transaction processing costs, facilitate the resolution of audit issues, and increase transparency of financial information. FIT's work comes at a critical time as agencies are looking for ways to improve financial transaction procedures that are inefficient, fragmented, and expensive. Performance will be measured by the reduction in duplicative systems and improved transparency. Potential government-wide savings are estimated at hundreds of millions of dollars annually.

Implemented the Hiring Incentives to Restore Employment Act

The HIRE Act of 2010 provides employers an incentive to hire workers who have been unemployed for 60 days or longer by exempting wages paid to these workers from the employer's 6.2 percent share of Social Security payroll taxes for the remainder of the year. In addition to exempting employers from these payroll taxes, the HIRE Act allows employers to claim a tax credit of up to $1,000 for each newly hired qualifying worker who is retained for one year.

The IRS collaborated with the payroll industry to implement these provisions. Treasury estimated that businesses hired

8.1 million new workers who were unemployed for 60 days or longer between February to August 2010, making those businesses eligible to receive HIRE Act tax exemptions and credits.

Increased Tax Compliance through Greater Openness and Transparency

The IRS continues to use more efficient strategies to ensure large corporate taxpayers are in compliance. The Commissioner of the IRS announced changes to filing uncertain tax positions, mainly that filers will now be required to provide a concise description for positions taken on their tax returns. Providing descriptions will increase certainty and lead to more efficient examinations. Over the next year, IRS examiners will receive special training on the handling of uncertain tax positions.

In exchange for more openness and transparency before filing, the IRS Compliance Assurance Process (CAP) program has helped resolve issues with large corporate taxpayers earlier and ensured filing of more accurate returns. The CAP program allows taxpayers who identify their tax issues to get certainty with respect to their tax obligations at the time of filing, as opposed to having to wait for the IRS to examine issues during an audit. The CAP program benefits both the IRS and the taxpayer by fostering compliance, reducing the time it takes to process a return, and improving both customer and employee satisfaction while maintaining a high level of quality. In fiscal year 2010, participation increased to 112 corporate taxpayers, with all 102 from 2009 returning.

Tax Returns Filed Electronically

In fiscal year 2010, Treasury processed 141.9 million individual returns and issued more than 109.5 million refunds totaling $366 billion. Sixty-nine percent of individual returns were filed electronically, up from 66 percent in fiscal year 2009. Business returns filed electronically increased 12 percent over 2009, reaching 25.5 percent. Although this is a clear improvement, Treasury has not yet reached the Congressional goal of 80 percent of tax returns filed electronically. Treasury is improving online resources and engaging in a tax preparer strategy to improve the E-file rate.

Improved Outreach and Automated Tools to Improve Taxpayer Service

Treasury strives to ensure taxpayers have access to the information and support necessary to meet their tax obligations. The IRS continued to improve its automated web tools and services, such as "Where's My Refund?," Earned Income Tax Credit (EITC) assistant, and podcasts. Over 213 million tax products were downloaded, an increase of almost 12 percent. In addition, the IRS created YouTube videos on subjects including the Education Tax Credit, Making Work Pay, and the Homebuyer Credit (see *www.youtube.com/user/irsvideos*). Many were available in English, American Sign Language, and Spanish.

The IRS and its partners provide free tax assistance to the elderly, disabled, and people with limited English proficiency at more than 12,000 Volunteer Income Tax Assistance and Tax Counseling for the Elderly sites throughout the nation. More than 3.1 million tax returns were prepared in fiscal year 2010. To assist taxpayers in the Gulf Coast, Treasury provided a dedicated toll-free telephone line and hosted a Gulf Coast Assistance Day at seven Taxpayer Assistance Centers in the Gulf Coast region. Overall, the customer service representative level of service increased from 70 percent in fiscal year 2009 to 74 percent in fiscal year 2010.

TTB continued its efforts to promote voluntary compliance among industry members in 2010 through industry seminars, web site tutorials, and other outreach efforts. Despite the prolonged economic downturn, efforts were successful in maintaining the voluntary compliance rate achieved in fiscal years 2008 and 2009. TTB had a compliance rate of 94 percent for timely filed tax payments among large excise taxpayers this fiscal year.

Expanded Enforcement of Tax Laws to Ensure Tax Compliance

IRS enforcement initiatives continued to focus on pursuing noncompliant high-income and high net-worth individuals and reducing overseas tax evasion. As a result of these efforts, fiscal year 2010 IRS total enforcement revenue was $57.6 billion, exceeding the $48.9 billion in revenue received in fiscal year 2009 by 18 percent. The number of audits of high net-worth individuals increased more than five percent.

The IRS strengthened international enforcement efforts by doubling its offshore presence, including establishing new offices in Asia and Central America, placing additional law enforcement personnel at existing offices, and expanding interactions with key international organizations involved in tax and financial law compliance. The IRS also identified and examined 17,888 foreign resident tax returns with tax deficiencies totaling over $1.4 billion.

To enforce the floor stocks tax (FST) on tobacco products in the *Children's Health Insurance Program Reauthorization Act of 2009* (CHIPRA), TTB developed a targeted audit plan. TTB completed more than 250 field visits to verify FST payment, which identified $10.2 million in additional tax, or an average underpayment of $40,000. FST collections at the end of the fiscal year totaled nearly $1.3 billion. During fiscal year 2010, TTB carried out 35 joint investigations with various federal, state, and local law enforcement agencies, resulting in the seizure of more than 3,000 cases of alcohol beverage products and nearly 100,000 cartons of cigarettes having an estimated federal and state tax liability of $30 million.

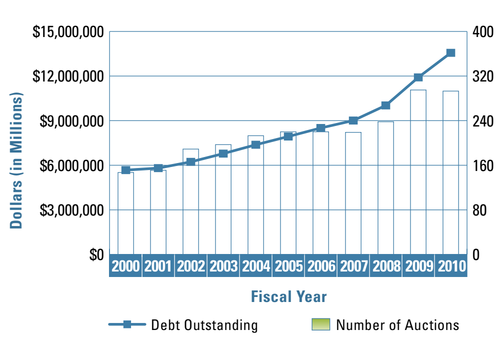
High Number of Debt Auctions with High Demand

There has been an unprecedented demand for Treasury securities. In fiscal year 2010, the Department conducted over 290 government auctions, a near-record. On average, nominal note and bond auctions have been oversubscribed by 1.9 times, significantly above the previous record of 1.5 times in fiscal year 2009. The value of marketable securities issues, $8.41 trillion, was only lower than the fiscal year 2009 level of $8.87 trillion. In this strong demand environment, Treasury extended the average maturity of the debt by 5 months, back to an historic average of 58 months.

Prepared to End Paper Payroll Saving Bonds and Expanded Online Savings Bond Customer Base

In fiscal year 2010, Treasury announced an initiative to end the sale of paper savings bonds through payroll savings plans by January 2011. Throughout 2010, the BPD worked with Federal Reserve Banks, agents, and employers to encourage customers to transition to TreasuryDirect, an online system for purchasing electronic Treasury securities. Outreach efforts included direct mail, bond inserts, webcasts and other online information, and targeted print and radio advertising.

Number of Debt Auctions vs. Debt Outstanding



TreasuryDirect continued to grow, adding 99,800 new customer accounts to reach nearly one million accounts in fiscal year 2010. BPD continues to improve the system and added a streamlined process for reinvesting marketable securities.

Greater Use of Electronic Fund Transfers for Payments

During fiscal year 2010, FMS continued to expand the use of electronic fund transfers to deliver federal payments, improve service to payment recipients, and reduce government program costs. Go Direct, a campaign to motivate federal benefit recipients to use direct deposit, recently concluded a successful fifth year in which nearly 1.5 million conversions were attributed to the campaign. A total of five million conversions have occurred since the inception of the campaign in 2005. FMS has also helped unbanked federal check recipients receive electronic payments through Direct Express, a program which allows federal benefits recipients to receive payments on a pre-paid debit card. More than one million people have signed up for the card since it was introduced in April 2008. Overall, 82 percent of Treasury payments and associated information were made electronically, an increase of one percentage point from fiscal year 2009.

Challenges Forecasting Government Receipts During the Recovery

Several factors in the current climate have complicated efforts to forecast government receipts. Key economic factors such as gross domestic product and employment did not improve as much as assumed in the President's fiscal year 2011 budget. In addition, individual tax payments in April 2010 came in below forecast as liabilities for tax year 2009 were much lower than expected. Credits from the *American Recovery and Reinvestment Act of 2009* (Recovery Act) further reduced these taxes. Corporate profitability and thus corporate tax receipts also turned around, showing strong increases in fiscal year 2010. Federal Reserve Earnings, reflecting the increase in securities held by the Federal Reserve, more than doubled from their level in fiscal year 2009.

U.S. and World Economies Perform at Full Economic Potential

To achieve conditions that enable economies to perform at full economic potential, the Treasury Department must stimulate growth through the development and implementation of policies that effectively strengthen private sector growth, regulate banking and financial markets, create pro-growth tax policies, advocate free trade and investment, and foster sustained and broad-based economic development.

In fiscal year 2010, the Department focused primarily on repairing and reforming the financial system and implementing stimulus measures to restore the country's foundation for economic growth and jobs creation. The *Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010* (Dodd-Frank Act), enacted in July 2010, is the most comprehensive reform of financial regulation since the Great Depression. The Department is implementing these reforms in partnership with other federal agencies, state regulators, and international authorities. Continuing implementation of the Recovery Act and passage of the *Small Business Jobs Act of 2010* provide important support for businesses and consumers contending with a weakened economy. In addition, the Department continued to implement the Troubled Asset Relief Program (TARP) under the *Emergency Economic Stabilization Act of 2008* (EESA); manage initiatives to support the housing market under the *Housing and Economic Recovery Act of 2008* (HERA); regulate national banks and thrifts; and execute other initiatives to stabilize the financial system and support economic recovery.

Financial Regulatory Reform

On July 21, 2010, President Obama signed the Dodd-Frank Act into law, enacting historic reforms that replaced an outdated financial regulatory system with a new foundation for investment, innovation, and growth. These reforms will help ensure that risks taken by financial institutions do not threaten the health of the economy as a whole.

Monitoring and mitigating systemic risk

In the recent crisis, insufficient monitoring of emerging concentrations of risk in the financial system created the perception that some large firms were "too-big-to-fail." To eliminate this perception, the Dodd-Frank Act reformed the financial regulatory system by providing an effective system for monitoring and responding to systemic risks that could threaten financial stability; creating a single point of accountability for tougher, more consistent supervision of the largest and most interconnected institutions; and providing regulatory coverage of the full range of risks and participants in the financial system. The Act addressed these reforms in the following ways:

- ***Created a Financial Stability Oversight Council.*** The Financial Stability Oversight Council (the Council) includes the heads of the principal federal financial regulators and is chaired by the Secretary of the Treasury. The Council has primary responsibility for examining emerging threats to the financial system, facilitating the coordination of financial regulatory policy, designating firms for heightened supervision by the Federal Reserve, and making recommendations to the Federal Reserve and other federal financial regulators concerning heightened prudential standards.
- ***Created an Office of Financial Research.*** The Office of Financial Research (OFR) is a new Treasury office established to support the Council in its identification and analysis of risks in the financial system. OFR will collect and standardize financial data, develop and publish key reference databases, and conduct research on financial market activities to identify potential sources of systemic risk.
- ***Established a Federal Insurance Office.*** The Federal Insurance Office (FIO) is a new Treasury office established to advise the Secretary on insurance policy and regulatory issues; monitor the insurance industry to identify gaps in regulation that could contribute to a systemic crisis; and assist the Secretary and the U.S. Trade Representative in negotiating international insurance agreements.
- ***Improved supervision and regulation of the largest, most interconnected financial firms.*** Any financial firm which could pose a threat to financial stability through a combination of size, leverage, or interconnectedness will be subject to comprehensive supervision and regulation by the Federal Reserve. Larger, more interconnected firms will be subject to higher prudential standards requiring them to internalize the risks they impose on the system and submit to early remediation action should their capital levels decline. Through the reforms, shareholders and creditors will bear the risks, and the ultimate costs, of failure, not taxpayers.

- ***Strengthened oversight of systemically important payment, clearing, and settlement systems.*** The Council has been provided authority under the Act to designate systemically important payment, clearing, and settlement systems and activities, and subject them to risk management standards. These will generally be prescribed by the Federal Reserve, SEC, and Commodity Futures Trading Commission (CFTC) in consultation with the Council.
- ***Constrained the size of the largest firms.*** The Dodd-Frank Act prevents any financial firm from growing by acquisition to hold more than ten percent of the liabilities in the financial system, limiting the adverse effects from the failure of any single firm, and preventing further concentration within the financial system.
- ***Comprehensive oversight of the over-the-counter (OTC) derivatives markets for the first time.*** Growth and rapid innovation of credit default swaps and other OTC derivatives created new financial risks. The Dodd-Frank Act regulates OTC derivative markets for the first time, requiring standardized derivative contracts be centrally cleared and traded on regulated exchanges or other trading platforms, and establishes stronger prudential and business conduct standards for all major participants in OTC derivatives markets.
- ***Separated banking and speculative trading.*** The Dodd-Frank Act separates speculative proprietary trading from the business of banking to safeguard taxpayers and depositors. The Act further limits banks' investments in hedge funds and private equity funds.
- ***Required registration of advisors to hedge funds and other private pools of capital.*** Under the Dodd-Frank Act, hedge funds and other private pools of capital, including private equity funds, are now required to register with the SEC. Prior to the financial crisis, the government lacked the data necessary to monitor these funds' activities and assess potential risks in the market.

Requiring basic reform of capital, supervision, and resolution authority

The Dodd-Frank Act imposes higher prudential standards on the largest, most interconnected firms, including stronger capital, leverage, and liquidity requirements.

- ***Raised standards for all financial firms.*** The Dodd-Frank Act, together with the Basel III capital agreements, raised capital ratios for financial firms, as well as the standards for the quality of capital held. In addition, significant exposures between financial firms will carry added capital charges. The combination of higher capital ratios, new capital requirements, and tougher and more extensive measurement standards will help ensure that firms have sufficient resources to weather financial crises without government assistance.
- ***Enhanced resolution authority.*** Although bankruptcy is the primary solution for failing non-bank financial companies, the recent financial crisis demonstrated the need for an additional legal mechanism to wind down these firms. The Dodd-Frank Act established an emergency resolution regime, modeled on the existing system for Federal Deposit Insurance Corporation (FDIC) resolution of failed banks, to resolve any large, interconnected financial firm whose imminent failure could threaten the stability of the financial system. Under the regime, major financial firms are required to develop rapid resolution plans to be deployed in the event of their failure and Treasury possesses the authority to appoint the FDIC as receiver for any failing firm which poses a threat to the broader system.

Restoring discipline to the market

The Dodd-Frank reforms help restore market discipline by limiting regulatory arbitrage and reducing incentives for excessive risk-taking.

- ***Abolished OTS and transferred its duties to the OCC, Federal Reserve, and FDIC.*** The Dodd-Frank Act abolishes OTS, and transfers its duties to OCC, the Federal Reserve, and FDIC. This reform streamlines the regulatory system and reduces potential for regulatory arbitrage.
- ***Strengthened supervision and regulation of securitization markets.*** To better align investor and issuer interests, the Dodd-Frank Act requires that originators or issuers of certain asset-backed securities retain a five percent stake in the credit risk of the securities they sell. The Act also provides the SEC authority to require robust reporting by these originators and issuers.
- ***Strengthened credit rating agency regulation.*** The Dodd-Frank Act includes provisions expanding transparency and disclosure requirements for credit rating agencies and institutes tougher examinations of internal controls at these agencies to help ensure investors have more reliable information to assess the risks they are taking.

- ***Realigned executive compensation.*** The Dodd-Frank Act requires all publicly-traded companies hold non-binding shareholder votes on executive compensation packages and establishes greater independence for board compensation committees. The measures are intended to better align executive compensation with long-term shareholder value and prevent use of compensation incentives that could threaten a firm's safety and soundness.

Protecting consumers and investors from financial abuse

The Dodd-Frank Act contains historic reforms to protect consumers and investors from the kinds of abuse that contributed to the recent financial crisis.

- ***Created a Consumer Financial Protection Bureau.*** The Dodd-Frank Act consolidates authorities for consumer financial protection—which were fragmented across seven federal agencies—into a single, independent Consumer Financial Protection Bureau (CFPB) within the Federal Reserve System. The CFPB will protect consumers in the financial marketplace against deceptive and unscrupulous practices and ensure that they have the information needed to choose financial products wisely.
- ***Strengthened investor protections.*** The Dodd-Frank Act strengthens the SEC's authority to protect investors by establishing consistent standards of conduct and accountability for broker-dealers and investment advisors, improving the timing and quality of disclosures, and restricting "short sale" activities. The Act also creates an Investor Advocate to identify issues of concern to investors and raises the maximum cash advance amount provided by the Securities Investor Protection Corporation from $100,000 to $250,000.

Treasury's implementation of the Dodd-Frank Act

In implementing the Dodd-Frank Act, Treasury is working hard to ensure that the new rules provide necessary protections against financial excess, while preserving the benefits of financial innovation.

Guiding Principles for Implementation

- Reforms are implemented as quickly as possible to provide clarity to the public and the markets
- Full transparency and disclosure are provided in the implementation process, through publication of draft rules, available opportunities for public comment, and consultation with a broad range of groups and individuals
- Regulations are streamlined and simplified where possible to minimize duplication and eliminate rules that do not work
- Implementation is coordinated with other federal agencies to ensure that new rules across government work together and not against each other
- Every effort is made to create a more level playing field, both between banks and non-banks in the U.S., as well as between major financial institutions globally
- Freedom of innovation is protected to ensure economic growth

Treasury's support for new entities

Treasury has primary responsibility under the legislation to stand-up the CFPB, the Council, OFR, and FIO. The Secretary also has general direction over the transfer of authorities from OTS to OCC.

The Consumer Financial Protection Bureau

Under the Act, the Secretary is responsible for standing up the CFPB until the first Director is confirmed by the Senate. The Secretary has designated July 21, 2011, as the "designated transfer date" on which the CFPB will assume certain authorities from seven federal agencies. After the designated transfer date, the CFPB will implement rules for consumer financial products and services, develop supervision programs to regularly examine the most critical bank and nonbank financial services providers, operate programs to promote greater financial literacy among consumers, and establish a nationwide consumer complaint response unit. Immediate tasks include designing an organizational structure, establishing program and administrative support offices, and recruiting staff. On September 17, 2010, President Obama named Elizabeth Warren as Assistant to the President and the Secretary named her as Special Advisor on the CFPB to help stand-up the bureau.

Financial Stability Oversight Council

Prior to the Dodd-Frank Act, the regulatory framework was structured to focus regulators narrowly on individual institutions and markets, allowing loopholes, gaps and inconsistencies to emerge which weakened standards. The Council's primary role is to overcome this siloed structure and improve coordination between financial regulators. The Council also plays an important role in making regulatory decisions, including determining which major non-bank financial firms and critical financial market utilities should be subject to heightened supervision and development of prudential standards. Federal and state regulators will work together through the Council to identify risks to financial stability, respond to any emerging threats in the system, and promote market discipline. The first meeting of the Council was held on October 1, 2010.

The Office of Financial Research

OFR was established to support the Council by providing information and analysis necessary to fulfill its mission. Under the legislation, OFR has two primary divisions: a Data Center and a Research and Analysis Center. The Data Center will set standards for financial reporting and collect data to improve the quality of information that supervisors and market participants rely on to manage risk. The Data Center will also develop and publish reference databases identifying and describing financial contracts and institutions to increase market transparency and facilitate research on the financial system. The Research and Analysis Center will analyze market activities to identify possible concentrations of risk or sources of market instability and report findings to Council members and Congress. Treasury is committed to seeking advice and expertise from the private sector, academia, and Congress in standing up OFR and will make every effort to avoid duplicating existing government data collection efforts or imposing unnecessary burdens on industry participants.

The Federal Insurance Office

FIO was created to provide the Federal Government dedicated expertise for the first time regarding the insurance industry. The office will monitor 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 the financial system. FIO may receive and collect data and information on and from the insurance industry and insurers; enter into information-sharing agreements; analyze and disseminate data and information; and issue reports. Treasury will work closely with the U.S. Trade Representative to effectively engage representatives from other countries on prudential insurance issues.

Transfer of OTS Authorities

Under the Dodd-Frank Act, the responsibilities of OTS are transferred to OCC, the Federal Reserve, and FDIC. The bulk of these responsibilities will be transfered to OCC. Currently, OCC and OTS staff are working together under the general direction of the Secretary to ensure a smooth transfer of authorities to OCC.

Troubled Asset Relief Program (TARP)

TARP was established by Treasury following passage of EESA on October 3, 2008. Established during the height of the financial crisis, TARP, in conjunction with other federal government actions, helped to unfreeze the markets for credit and capital, bringing down the cost of borrowing for businesses, individuals, and state and local governments, restoring confidence in the financial system, and restarting economic growth. TARP did so faster, and at a much lower cost, than many anticipated.

At the peak of the financial crisis, many banks were not making new loans to businesses, or even to one another. Many businesses could not get financing in capital markets. Numerous municipalities and state governments could not issue bonds at reasonable rates. The securitization markets — which provide financing for credit cards, student loans, auto loans and other consumer financing — had basically stopped functioning. The economy was contracting at an accelerating rate, with millions of Americans losing their jobs.

By the middle of 2009, assisted by the combined impact of the federal government's financial programs, borrowing rates had fallen sharply for businesses, individuals, and state and local governments. More companies could fund themselves in private markets by issuing equity and long-term debt. Housing prices began to stabilize. The value of the savings of American workers had begun to recover. Economic growth turned from negative to positive.

EESA provided the Secretary of the Treasury with the authority to purchase or guarantee $700 billion but it has been clear for some time that TARP will cost taxpayers substantially less than $700 billion. In December 2009, the Secretary of the Treasury announced that no more than $550 billion of the authority would be used. In July 2010, the Dodd-Frank Act reduced the cumulative authority to $475 billion, in line with expected investment amounts. Finally, many of the investments under the program, particularly those aimed at stabilizing banks, have thus far delivered positive returns for taxpayers.

As a result of improved market conditions, lower utilization of the program, and careful stewardship, the expected cost of TARP over its lifetime continues to decline. In the August 2009 Midsession Review of the President's 2010 Budget, the lifetime cost of TARP, based on budget scoring conventions, was projected to be $341 billion (assuming the full $700 billion of TARP authority was utilized). By the February 2011 President's Budget, the lifetime cost of TARP had decreased to $117 billion (assuming $546 billion of the $700 billion TARP authority was utilized).

The Department's most recent analysis of the potential lifetime cost of TARP suggests that if the proposed restructuring of AIG is completed as announced the lifetime cost of TARP could be less than $50 billion. Under the proposed restructuring of AIG, Treasury would receive 1.1 billion shares of AIG common stock in exchange for its TARP investment. While this cost is based on the October 1, 2010 market price, it should be noted that the proceeds that would actually be received by Treasury from the future sale of such stock would be based on the market price at the time of sale, which may differ materially from the October 1, 2010 market price. Of course, the final lifetime cost of TARP will depend on how financial conditions evolve in the future, including the price of AIG shares, and other common stock held by TARP.

The estimated lifetime cost of TARP reflects several factors, including the cost of the initiatives to help responsible homeowners avoid foreclosure, for which $45.1 billion is budgeted and which has not yet been spent. All funds disbursed for housing programs result in a cost because these funds will not be returned. It also reflects primarily losses on investments in the auto companies and AIG. These losses are largely offset in part by gains on TARP investments in banks and gains in other programs.

Because the restructuring has not occurred and its completion is subject to contingencies, the value of the AIG investment in the fiscal year 2010 financial statements does not reflect any potential from the restructuring.

Note that the lifetime cost of TARP, based on budget scoring conventions, differs from the cost included in the Treasury financial statements. Estimates of lifetime costs assume that all planned expenditures are made. By contrast, the TARP financial statement costs are based on transactions through September 30, 2010.

The reported cost of TARP activities from inception (October 3, 2008) through September 30, 2010 based on the Treasury financial statements was $18.5 billion. Unlike the federal budget cost estimate, this reflects only transactions through September 30, 2010. Thus, it does not include the committed but undisbursed funds for housing programs as well as other programs, all of which are included in the expected lifetime cost for budget purposes. The $18.5 billion cost consists of $23.1 billion of reported TARP net income in the Treasury financial statements for fiscal year 2010 and the $41.6 billion of reported TARP net cost for the year ended September 30, 2009. The change since last year is primarily due to the early repayment of TARP investments by the larger banks and an improvement in the financial markets and the economy.

Since its inception, TARP has disbursed $387.7 billion in direct loans and equity investments; collected $204.1 billion in repayments; and reported $16.7 billion in dividends, interest, and fees, and $10.9 billion in net proceeds from the sale and repurchase of assets in excess of cost. As of September 30, 2010, TARP had $179.2 billion in gross outstanding direct loans and equity investments, which are valued at $142.4 billion. In addition, from inception through September 30, 2010, TARP incurred costs related to Treasury Housing programs of $0.8 billion and administrative costs of $0.5 billion.

The cost estimates for budget and financial statement purposes are only estimates. They are based on current market prices where available. Because market prices change, such estimates will change. The ultimate cost of the outstanding TARP investments is therefore subject to significant uncertainty and will depend on, among other things, how the economy, financial markets and particular companies perform.

Treasury is moving quickly to recover the federal government's investments. Treasury aims to dispose of its investments as quickly as practicable, in a timely and orderly manner consistent with the duty to promote financial stability and protect taxpayers' interests.

- Treasury continues to carefully manage the TARP assets and has recovered more than 75 percent of the TARP funds provided to banks, principally through the Capital Purchase Program (CPP), and expects these capital support programs for banks to provide an overall positive return for taxpayers.

- Treasury is beginning to recover investments in the auto industry. GM has repaid the assistance it received that remained outstanding as a loan and has recently agreed to repurchase the preferred stock issued to Treasury. The ultimate loss estimate on investments in Chrysler and Ally Financial, Inc. (formerly GMAC) is expected to be less than last year as well due to financial improvements in both firms.
- The restructuring plan announced by AIG on September 30, 2010, assuming it is completed as announced, will accelerate the timeline for repaying the federal government and put taxpayers in a considerably stronger position to recoup Treasury investments in the company. As noted earlier, the AIG restructuring is not yet completed and its closing is subject to contingencies.

Treasury also expanded the Treasury Housing Programs under TARP. Treasury launched the Housing Finance Agency (HFA) Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest Hit Fund, or HHF) to help state housing finance agencies provide additional relief to homeowners in the states hit hardest by unemployment and house price declines. In addition, Treasury and the Department of Housing and Urban Development (HUD) enhanced the FHA-Refinance program to enable homeowners whose mortgages exceed the value of their homes to refinance into more affordable mortgages if their lenders agree to reduce the unpaid principal balance by at least ten percent.

Final authority to make commitments within the reduced TARP authorization expired on October 3, 2010. Servicers that participate in the Making Home Affordable Program (MHA) can continue to make mortgage modifications through the end of calendar year 2012. The HFA Hardest Hit Fund permits participating state housing agencies to provide support through their programs until as late as calendar year 2017, depending on available funding. The FHA-Refinance program is designed to enable homeowners to refinance their mortgage loans and reduce their overall mortgage debt through the end of calendar year 2012.

Treasury continues to provide detailed information about TARP to insure transparency. Treasury published a *Two-Year Retrospective Report* on TARP on October 5, 2010. This report includes information on TARP programs and the effects of TARP and other federal government actions to address the financial crisis. Readers are invited to refer to this document at *www.financialstability.gov*.

Housing and Government Sponsored Enterprise Programs

Treasury's housing initiatives have sought to assist responsible homeowners who are struggling in the aftermath of the recent financial crisis and recession. The Home Affordable Modification Program (HAMP) in TARP and tax relief for first-time home buyers provided direct assistance to homeowners. Treasury support for state HFAs, ongoing functions of the government sponsored enterprises (GSEs, in this case Fannie Mae and Freddie Mac), and stability in the mortgage-backed securities (MBS) market have sought to ensure overall stability in housing financial markets.

The HAMP program is designed to help make housing affordable to American homeowners who are strained by the double impact of high mortgage payments and a significantly reduced home value. The program has reached out to these borrowers and provided an industry-leading solution for servicers to negotiate lower mortgage payments with qualifying homeowners, allowing those homeowners to make continued mortgage payments through a trial program and remain in their homes. Through September 30, 2010, Treasury has made commitments to fund up to $29.9 billion in HAMP payments. Eighteen months into the program, Treasury under HAMP has helped more than 619,000 homeowners enter a trial modification, reducing their monthly mortgage payments to more affordable levels. This includes nearly 220,000 homeowners whose mortgage terms have been modified permanently.

Senior Preferred Stock Purchase Agreements

The *Housing and Economic Recovery Act of 2008* (HERA) authorized Treasury to purchase obligations and other securities issued by Fannie Mae, Freddie Mac or one of the 12 Federal Home Loan Banks. At the time the Federal Housing Finance Agency (FHFA) placed Fannie Mae and Freddie Mac into conservatorship in September 2008, Treasury established Senior Preferred Stock Purchase Agreements (SPSPAs) to ensure that each firm maintained a positive net worth. The maximum amount available to each GSE under this agreement was originally $100 billion and in May 2009 was raised to $200 billion. In December 2009, the Department amended the SPSPAs to replace the $200 billion per GSE funding commitment cap with a formulaic cap that will allow continued draws for three years at amounts that will automatically adjust upwards quarterly by the cumulative amount of any losses realized by either GSE and downward by the cumulative amount of any gains, but not below $200 billion, and will become fixed at the end of the three years. At the conclusion of the three year period, the remaining commitment will then be fully available to be drawn per the terms of the agreements. As of September 30, 2010, Treasury's gross investment in Fannie Mae and Freddie Mac were $85.9 billion and $63.9 billion, respectively. The losses the GSEs continue to report are largely the result of delinquencies and defaults on loans that were originated and guaranteed in 2006, 2007, and 2008. Less than one percent of losses have come from loans originated in 2009 or 2010.

The U.S. Government's investment in and support of the GSEs through the SPSPAs was structured in such a way that ensures that virtually all profits in the company revert to the Government in the form of dividends on the preferred shares in Fannie Mae and Freddie Mac. To get a true picture of the Government's exposure in the companies, it is critical to factor in those dividends and net them against the draws that the GSEs make from Treasury. For instance, while for Fiscal Year 2010 the GSEs' draws exceeded dividends by $40.5 billion, in the quarter ending September 30, 2010 the Government received more in dividend payments than the companies drew from the Treasury SPSPAs.

The GSEs are projected to have positive net operating income after 2012. However, over time their net income will be inadequate to cover the senior preferred dividend payments due to Treasury based on the balance of preferred stock outstanding and the accretion of the balance due to incremental draws over time to fund further dividends. The projections take into account that the GSEs will be gradually winding down their retained mortgage portfolios to the $250 billion cap specified in the SPSPAs and do not assume any changes to operating assumptions on the single family guarantee business.

The chart below depicts the expected gross and net draws under the existing SPSPAs, without considering the likely future fair value adjustments to the senior preferred stock liquidation preference. The net draws reflect the net payout by Treasury for each GSE to maintain positive net worth at the end of each period. As shown below, beyond 2013 the GSEs' draws under the SPSPAs are only required to cover dividend payments above the amount of anticipated positive net income. No dividend receipts are projected beyond the years when the commitment caps are reached, which is 2022 and 2031 for Fannie Mae and Freddie Mac, respectively.

GSEs Actual and Projected Draw Payments and Dividend Receipts (in millions):

	Fiscal Year Ending September 30	Draw Payments	Dividend Receipts	Net Draws (Dividends)
Beginning Balance	2009	$ 95,600	$ (4,336)	$ 91,264
Actual	2010	52,600	(12,142)	40,458
Projected[1]	2011-2013	87,600	(61,772)	25,828
Projected[2]	2014-2017	51,400	(102,781)	(51,381)
Projected[2]	2018-2022	113,000	(151,795)	(38,795)
Projected[3]	2023-2031	107,900	(139,334)	(31,434)
Net Cumulative Draws		$ 508,100	$ (472,160)	$ 35,940

1 / No cap
2 / Fannie Mae and Freddie Mac with cap
3 / Freddie Mac only with cap

The $508 billion in total gross draw payments, of which $360 billion is recorded as an accrued contingent liability as of September 30, 2010, has a counterpart increase in the projected senior preferred stock liquidation preference and this asset value would then be subject to any expected fair value adjustments. Ultimately, the cost to the Government is expected to be the valuation losses on the senior preferred stock and common stock warrants, partly offset by dividend revenues received from the GSEs, which will be received until the point in time in which the funding commitment caps are reached. Freddie Mac would reach its adjusted cap of $224 billion in 2031. While Fannie Mae is projected to begin generating positive net income in 2013, because of its greater level of credit losses (and draws) than Freddie Mac, it would reach its cap of $284 billion in 2022. As shown, the projections would imply that a total of $472 billion of dividends are received, resulting in a total net draw of $36 billion.

GSE MBS Purchase Program

The GSE MBS Purchase Program helped support the availability of mortgage credit by temporarily providing additional capital to the mortgage market. By purchasing these securities, Treasury sought to broaden access to mortgage funding for current and prospective homeowners, as well as promote market stability. In total, since inception of the program in September 2008, the Treasury Department purchased MBS worth approximately $225.5 billion, $29.9 billion of which were purchased in fiscal year 2010. In total, Treasury has received back $61.1 billion in principal and $13.9 billion in interest from MBS holdings; of those amounts, $38.9 billion in principal and $8.9 billion in interest were received in fiscal year 2010. As of September 30, 2010, the valuation of MBS held under HERA programs was $172.2 billion. The GSE MBS Purchase Program expired on December 31, 2009.

Housing Finance Agencies Initiative

State and local HFAs are agencies or authorities created by state law charged with helping individuals and families of low or moderate income obtain affordable housing. HFAs provide mortgage financing for new homebuyers, refinancing and modification opportunities to existing homeowners at risk, loans for rehabilitation of single-family homes, and support for the development and rehabilitation of multifamily properties. In the course of the financial crisis, HFAs experienced challenges obtaining funding in private markets, limiting their ability to provide support for economically-distressed communities. The HFA Initiative provided funding to more than 90 HFAs to enable them to continue supporting housing markets. In fiscal year 2010, Treasury under the HFA New Issue Bond Purchase Program (NIBP) purchased $15.3 billion of GSE-issued securities backed by HFAs' mortgage revenue bonds. Under the HFA Temporary Credit and Liquidity Program, Treasury purchased participation interests from the GSEs in liquidity facilities supporting $8.2 billion of existing HFA variable rate demand obligations (VRDOs) single family and certain multi-family mortgage loans. Since inception of the program, Treasury's obligation has been reduced to $7.6 billion. Treasury's actions are authorized by HERA authority, which expired on December 31, 2009.

Helping those hit hardest

In February 2010, the Obama Administration announced the Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest Hit Fund, or HHF), allowing HFAs in the nation's hardest hit housing markets with high unemployment to design innovative, locally-targeted foreclosure prevention programs. States included those with average home price declines greater than 20 percent since the housing market downturn, accounting for the majority of "underwater" mortgages in the country; those with concentrated areas of economic distress due to unemployment; or those with an unemployment rate at or above the national average for the past year.

A total of $7.6 billion is being made available to 18 states and the District of Columbia. These states include Alabama, Arizona, California, Florida, Georgia, Illinois, Indiana, Kentucky, Michigan, Mississippi, Nevada, New Jersey, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, and Tennessee. As of September 30, 2010, $56.1 million has been disbursed to states participating in HHF, largely for administrative and startup expenses. Further information on the funded programs is available at *http://www.FinancialStability.gov/roadtostability/hardesthitfund.html*.

Comprehensive reform of the U.S. housing finance system

The Dodd-Frank Act includes fundamental reform of mortgage market rules, including ability-to-pay requirements and risk retention standards for mortgages, and Treasury and HUD are preparing to offer recommendations for further reform of the housing finance system. In April 2010, Treasury and the Department of Housing and Urban Development (HUD) posted seven questions for public comment and received over 300 responses from a broad cross-section of stakeholders. In August, Treasury and HUD hosted a Conference on the Future of Housing Finance, including experts from academia, consumer and community organizations, industry groups, market participants, Congressional staff, and other stakeholders. In September, the Secretary and Elizabeth Warren, Assistant to the President, held a forum on simplifying mortgage disclosure forms. To provide for long-term stability in housing markets, the Obama Administration has committed to deliver a proposal for comprehensive reform of the U.S. housing finance system to Congress in January 2011.

Supporting America's Small Businesses

Treasury and the Small Business Administration (SBA) led efforts to pass the *Small Business Jobs Act of 2010*. Enacted on September 27, 2010, the Act will strengthen the capacity of small businesses to create jobs and support economic recovery by:

- Creating a Small Business Lending Fund (SBLF) to provide $30 billion in capital to small banks
- Establishing a State Small Business Credit Initiative (SSBCI) to provide $1.5-2 billion to spur $20 billion of private sector lending through innovative state programs
- Extending and expanding key SBA loan programs
- Instituting small business tax cuts, including zero capital gains for key small business investments

Under the legislation, Treasury will manage implementation of the tax cuts and distribution of funding through the SBLF and SSBCI.

American Recovery and Reinvestment Act of 2009

The Department of the Treasury played a pivotal role in implementing the *American Recovery and Reinvestment Act of 2009* (Recovery Act). By providing targeted investments and implementing tax provisions to benefit both businesses and individuals, the Department continued to stimulate the U.S. economy, create and sustain jobs, and build the foundation for long-term economic growth. Of the $787 billion provided by the Recovery Act, Treasury is managing programs that will contribute nearly $300 billion in benefits to the American people through the year 2019. Treasury's Recovery Act programs include the following:

- **Making Work Pay Tax Credit:** In 2009 and 2010, the Making Work Pay provision of the Recovery Act provided a refundable tax credit of up to $400 for working individuals and up to $800 for married taxpayers filing joint returns. An estimated $49 billion will have been made available to taxpayers under the Making Work Pay provision through calendar year 2010.
- **American Opportunity Tax Credit:** The American Opportunity Tax Credit expanded the number of parents and students who qualify for a tax credit to pay for college expenses for 2009 and 2010. To date, 8.8 million people have benefitted from this tax credit totaling over $7 billion.
- ***Consolidated Omnibus Budget Reconciliation Act of 1985* (COBRA) health insurance continuation premium subsidy:** The Recovery Act expanded eligibility for COBRA health insurance premium assistance to longer-term unemployed workers. Nearly four million households have benefited from the COBRA premium assistance program.
- **Build America Bonds:** Build America Bonds are taxable municipal debt for which the issuer receives a direct federal subsidy equal to 35 percent of the borrowing costs. Since April 2009 there have been 1,556 issuances of Build America Bonds, which provided over $107 billion for states and local governments throughout the country to help finance projects including schools, utilities, public safety and transportation. States, counties and municipalities also received allocations of authority to issue Recovery Zone Bonds, which modified Build America Bonds with a higher subsidy rate of 45 percent of the borrowing costs, based on individual employment declines in 2008.
- **Sales tax deduction for vehicle purchases:** The Recovery Act allowed taxpayers to deduct state and local sales and excise taxes paid on the purchase of certain new cars, light trucks, motor homes, and motorcycles through calendar year 2009.
- **Economic recovery payments:** The Recovery Act provided $250 one-time economic recovery payments to eligible retirees, veterans, and other high-need recipients. FMS, in coordination with the Social Security Administration, the Railroad Retirement Board, and the Department of Veterans Affairs, issued over 55 million payments, totaling over $13.8 billion to benefit recipients. FMS processed 46.6 million of these payments electronically rather than by paper check, saving taxpayers over $17 million.
- **Community Development Financial Institutions (CDFI) awards:** The Recovery Act appropriated $98 million in grants to expand funding for the CDFI and Native American CDFI Assistance (NACA) programs, providing community banks, credit unions, loan funds, and venture capital funding to increase lending to individuals or businesses lacking access to mainstream financial institutions.
- **New Markets Tax Credit (NMTC):** The NMTC Program, administered by the CDFI Fund, facilitates investment in low-income communities by permitting credits against federal income taxes for equity investments in designated Treasury-certified Community Development Entities (CDEs). CDEs are required to use substantially all NMTC proceeds to make loans and investments in businesses and real estate developments in low-income and distressed urban and rural communities. The Recovery Act provided a total of $3 billion for the credits. A total of $3 billion was awarded to 56 organizations in 2009.
- **Health Coverage Tax Credit (HCTC):** HCTC was created by the *Trade Adjustment Assistance Reform Act of 2002* to help displaced workers and retirees who have lost their jobs due to free trade to assist eligible beneficiaries to receive affordable health care. The program originally provided a refundable tax credit for 65 percent of the cost of qualified insurance. In May 2009, the tax credit was

increased from 65 percent to 80 percent of qualified health insurance premiums, allowing participants to only pay 20 percent for health insurance each month. The increased credit will expire on December 31, 2010. The Recovery Act provisions have assisted 32,000 additional taxpayers with enrolling in HCTC.

- **Payments for Specified Energy Property in Lieu of Tax Credits:** This program responded to the devaluation of after-market tax credits as a result of the credit crisis and recession by converting an existing tax credit for investments in renewable energy production to a cash payment of equivalent value. As of the end of fiscal year 2010, Treasury has awarded $4.3 billion in cash assistance to over 3,000 eligible applicants. Treasury estimates that $16 billion in financial support will be distributed over the life of the program to thousands of renewable energy production facilities.
- **Payments for Low-Income Housing Projects in Lieu of Tax Credits:** The Recovery Act gives state housing credit agencies the choice to receive cash payments for all or part of their 2009 low-income housing tax credit allocation. As of the end of fiscal year 2010, 55 state housing agencies have applied for funds, and $4.9 billion in awards have been made to those agencies. State agencies used these funds to finance nearly 1,100 affordable housing projects that will add over 67,000 units of affordable housing to the housing supply and create approximately 105,000 jobs.
- **First-Time Homebuyer Credit Expansion:** The Recovery Act allowed eligible first-time homebuyers to claim a refundable credit up to $8,000 without a payback requirement. Nearly 2.4 million taxpayers claimed over $17 billion in First Time Homebuyer credits for houses purchased in 2009.
- **Indian Tribal Economic Development Bonds:** The Recovery Act added $2 billion in bond-issuing authority for Indian Tribal Governments. The new bond program gives Indian Tribal Governments the same broad flexibility afforded to state and local governments to use tax-exempt bonds to finance economic development projects. Certain gaming facilities are excluded from participation. Two award rounds of $1 billion each were conducted in 2009 to 76 Indian tribal governments
- **Qualified School Construction Bond Allocation:** The Recovery Act established an allocation cap of $11 billion for Qualified School Construction Bonds in 2009, and another $11 billion in 2010, totaling $22 billion over two years. The Act provides a federal subsidy for school construction financing to states and the 100 largest educational agencies based on school funding data. The bonds provide a federal tax credit to investors designed to cover 100 percent of the interest. Over $7.4 billion in Qualified School Construction Bonds were issued through September 2010.
- **Qualified Energy Conservation Bonds and Clean Renewable Energy Bonds:** Qualified Energy Conservation Bonds provide a subsidy for energy conservation-oriented repair and rehabilitation of public schools through a federal tax credit to investors covering 70 percent of the interest on the bonds. The Recovery Act established a cap of $3.2 billion for these bonds. New Clean Renewable Energy Bonds ("New CREBs") provide incentives for entities not eligible for renewable energy tax credits, such as public power providers, government bodies, and cooperative electric companies, to invest in renewable electricity generation. A total of $2.4 billion of Clean Renewable Energy Bonds (CREBs) was allocated to 1,067 applicants through September 30, 2010.
- **Net Operating Loss Carry Back:** The Recovery Act extended the period for business taxpayers to carry back a 2008 net operating loss (NOL) to offset taxable income in preceding taxable years from two to five years. Over $3.5 billion in NOL Carryback Adjustments were claimed by businesses to offset taxable income for the preceding three to five years.

Strengthened International Economic Coordination

Treasury protects and supports economic prosperity at home by encouraging financial stability and sound economic policies abroad. In fiscal year 2010, Treasury pursued this agenda by focusing on restarting economic growth following the financial crisis, encouraging open trade and investment policies, supporting multilateral and bilateral engagements, reforming the international financial system by addressing international financial regulatory reform and the role and responsibilities of the international financial institutions (IFIs), and by continuing to encourage broad-based, sustainable economic growth around the world to create new engines of growth in the global economy.

Demonstrated U.S. leadership at G-20 meetings

The G-20 is a multilateral forum that includes the leaders from the 20 largest economies in the world, accounting for 85 percent of world output. Beginning with the G-20 Summit in London, when President Obama joined other G-20 leaders to develop collaborative and coordinated responses to the economic crisis, the Obama Administration and Treasury have actively engaged with the G-20 nations, and through other multilateral and bilateral forums, to foster economic growth and address challenges, including the need for international financial regulatory reform and transnational issues, such as food security and climate change.

Participated in development of new global capital standards for banks

One of the lessons of the financial crisis was that more robust capital standards must be at the heart of efforts to make the financial system stronger and more secure. Treasury has played a key role with global partners in strengthening capital standards. In September 2010, new global capital standards—Basel III— were announced, which will require banks to hold enough capital so they can withstands losses similar to those witnessed during the depths of the financial crisis without turning to the taxpayer for help. The standards require banks to hold significantly more capital against risky trade-related assets and obligations, hold a higher percentage of their capital reserves in common equity and other less risky assets, and hold an additional 2.5 percent capital conservation buffer on top of an eight percent reserve, which if breached would trigger restrictions on a firm's ability to pay dividends or buy back stock. Through the G-20 process, the Financial Stability Board, and engagement with international standard setting bodies, Treasury led efforts to ensure that reforms in the international financial system matched domestic regulatory reform initiatives.

Worked with global partners to avert regional economic instability

The IFIs responded quickly to meet their members' needs for financial support and policy advice during the global economic and financial crisis. U.S. support for the International Monetary Fund (IMF)—including the IMF's recent lending commitments to Europe—were critical to restoring market confidence and stability, promoting global growth and recovery, and protecting U.S. jobs.

Similarly, U.S. support for and continued engagement in the multilateral development banks (MDBs) has also been vital. The MDBs acted with speed and force to protect the poorest around the world from the worst impacts of the crisis, and continued U.S. leadership in these institutions will help further strengthen the global economy, reduce poverty and help fragile nations. For example, in July, following passage of the *2010 Supplemental Appropriations Act*, the Treasury Department announced that the United States, the IFIs, and other donors had achieved the goal of eliminating Haiti debt owed to the IFIs at the time of the January earthquake. The announcement marked one of the fastest multilateral debt reductions in history. In September 2010, Treasury delivered U.S. funds allowing the Inter-American Development Bank (IDB) to cancel $447 million in debt and initiate the provision of $2.5 billion in grants which will extend over the next decade.

National Export Initiative and support for free trade and investment

Treasury, with other agencies, helped launch and implement the President's National Export Initiative (NEI). President Obama underscored the importance of trade as a catalyst for American jobs and set the goal to "double our exports over the next five years, an increase that will support two million jobs in America." Treasury's primary role in the NEI focuses on macroeconomic rebalancing. Treasury works to promote free trade and investment as part of the Obama Administration's broader economic agenda, and partners with G-20 nations and other countries to achieve these objectives.

U.S.-China Strategic and Economic Dialogue

The U.S.-China Strategic and Economic Dialogue (S&ED) was established by President Obama and Chinese President Hu in April 2009 and represents the highest-level bilateral forum to discuss a broad range of issues between the two nations. Treasury Secretary Geithner and Secretary of State Clinton, as special representatives of President Obama, and Vice Premier Wang and State Councilor Dai, as special representatives of President Hu, co-chair the Dialogue, which includes Strategic and Economic tracks and takes place annually in alternating capitals. The second meeting of the S&ED took place in Beijing in late May 2010. Secretary Geithner led ten heads of U.S. Government agencies for discussions with Chinese President Hu, Premier Wen, Vice Premier Wang, and a delegation comprised of key Chinese economic ministries and agency heads. Discussions focused on creating new opportunities for

U.S. workers and firms; promoting strong recovery and more balanced growth; promoting more resilient, open, and market-oriented financial systems; and strengthening the international financial architecture. Significant progress was made on top Obama Administration priorities, including encouraging China to move towards a more market-based exchange rate, agreeing to launch expert and high-level bilateral innovation discussions to ensure innovation policies encourage the best ideas wherever they originate, and strengthening opportunities for U.S. firms and workers by reducing barriers to foreign investment in services, high-technology goods, high-end manufacturing, and energy saving products. Economic policy cooperation between the United States and China, including mutual efforts to boost domestic demand through decisive monetary and fiscal policy actions, has been one of the most important elements of the international effort to bring about a global economic recovery. The U.S. will host the next round of the Strategic and Economic Dialogue in 2011.

Global Agricultural and Food Security Program

Treasury led efforts to establish the Global Agriculture and Food Security Program (GAFSP) , a food security trust fund that is administered by the World Bank and is an integral part of the Obama Administration's broader "Feed the Future" initiative. The GAFSP seeks to improve food security and reduce poverty by delivering rapid and predictable financing for agriculture sectors in low-income countries. Launched in April 2010 with $880 million in commitments from the United States, Canada, South Korea, Spain, and the Bill & Melinda Gates Foundation, GAFSP represents a global effort to aid vulnerable populations afflicted by hunger and poverty and is a key element of the Obama Administration's initiative to enhance food security in poor countries. The fund was created in response to a call by G-20 leaders at the Pittsburgh Summit in 2009 for nations to address the food security challenge in order to foster economic growth over time.

Supported global agreement on climate change

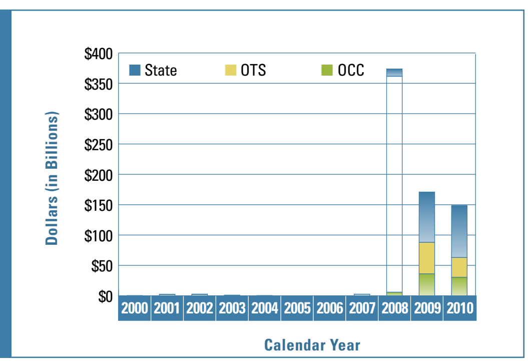
Treasury supports U.S. efforts to address climate change by managing U.S. engagement in the multilateral climate finance funds, the Global Environment Facility (GEF) and Climate Investment Funds (CIF). The GEF provides partial funding, mostly in grants, for projects that provide global environmental benefits, such as reducing greenhouse gas emissions and conserving bio diversity. CIF are comprised of the Clean Technology Fund (CTF) and Strategic Climate Fund (SCF). The CTF seeks to reduce the growth of greenhouse gas emissions in developing countries through financing the additional costs of deploying commercially available cleaner technologies over dirtier, conventional alternatives. The SCF supports three targeted programs: the Pilot Program for Climate Resilience, the Forest Investment Program, and the Program for Scaling-Up Renewable Energy in Low-Income Countries. Each program seeks to pilot new approaches and scaled-up activities to address climate change challenges in developing countries, while promoting low-carbon, climate-resilient economic growth.

Regulation of Banks and Thrifts

OCC and OTS are the primary regulators of national banks, savings associations, and savings and loan holding companies. Given the weak economy, fiscal year 2010 activity focused on monitoring and responding to adverse conditions in credit and financial markets, improving credit risk management at supervised institutions, and monitoring loan portfolios. To streamline the regulatory system, the Dodd-Frank Act provides for the abolishment of OTS and transfer of its duties to OCC, the Federal Reserve, and FDIC. OCC and OTS are currently working with other agencies to ensure a smooth transition.

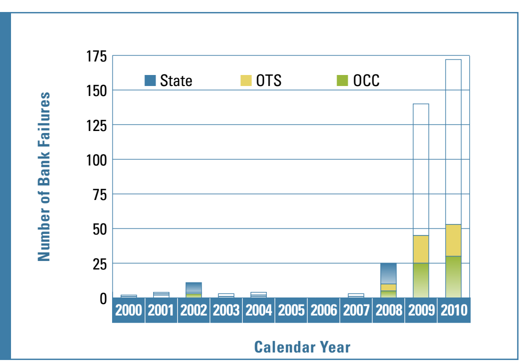
Assets of Failed Banks by Primary Regulator by Year

(through 9/30/2010)



Number of Bank Failures by Primary Regulator by Year

(through 9/30/2010)



Despite efforts to identify and correct issues at an early stage, federal regulators closed a number of national banks and thrifts in fiscal year 2010. In total, 172 insured depository institutions insured by FDIC with $121.7 billion in deposits were resolved by the FDIC over the year. Of these, 30 were national banks regulated by OCC with $25.7 billion in deposits, 23 were federal thrifts regulated by OTS with $25.1 billion in deposits, and 119 were state banks with $70.9 billion in deposits. Work-out solutions, whereby some or all deposits and assets were assumed by another existing bank, were arranged by FDIC and regulators for almost all failed institutions.

OCC's and OTS's on-site supervisory assessments focused on the quality of credit risk management practices (including effective credit risk rating systems and problem loan identification), adequacy of loan-loss reserves, and effective loan work-out strategies. Primary emphasis was placed on ensuring the strength of capital buffers to weather earnings pressures and asset quality deterioration. Other critical areas included sound liquidity risk management through diversified funding sources and realistic contingency funding plans, and maintenance of consistent underwriting standards regardless of intent to hold or sell a loan. For troubled institutions, OCC and OTS employed a number of remedial measures, including Prompt Corrective Action determinations when institution capital deteriorated below specified thresholds, requirements to increase available capital and liquidity, required changes in bank management, and required approval for changes in business plans. To combat mismanagement, formal enforcement actions such as cease-and-desist orders, removal or prohibition orders, civil money penalties, and formal agreements were utilized. In severe cases, financial institutions were required to enter into sales, mergers, or liquidation or enter FDIC receivership. Through the first half of fiscal year 2010, the OCC issued 207 enforcement actions against national banks and 82 against institution-affiliated parties. OTS issued a total of 170 formal enforcement actions against institutions and 68 formal enforcement actions against individuals.

In addition to individual bank examinations, the OCC conducted 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 the banking system. OCC examiners and Credit Risk staff completed the Annual Survey of Credit Underwriting Practices, assessing standards at the 51 largest national banks with assets of $3 billion or more. OCC and OTS issued industry guidance related to concentration risks and meeting the credit needs of small businesses. OCC, OTS, and the Federal Reserve, and FDIC continued their Shared National Credit Review of large syndicated loans held by multiple banks. The 2010 review covered 8,700 credit facilities with commitments totaling $2.7 trillion. OCC, OTS, and other federal banking agencies also warned financial institutions of the risks that were accumulating in many banks' commercial real estate (CRE) loan portfolios. OCC developed several diagnostic tools to help assess risks in CRE portfolios and conducted asset quality reviews of all community and mid-size banks that have significant CRE concentrations to assess the adequacy of credit underwriting, problem loan identification, and loan-loss reserves for these portfolios. OCC also provided additional supervisory guidance on accounting and classification issues associated with residential mortgage modifications and CRE work-outs. Monitoring banks with significant CRE concentrations will continue to be a primary focus of OCC supervisory strategies in 2011 and 2012.

In an effort to make key aspects of mortgage loan data more transparent and publicly available, the OCC and OTS publish joint quarterly reports on loan performance, delinquencies, and foreclosures. The *Mortgage Metrics Report* presents data from nine national banks and thrifts with the largest mortgage portfolios (about 65 percent of all first-lien mortgages in the country). The report can be used by examiners to assess emerging trends, evaluate asset quality and loan-loss reserve needs, identify anomalies, and evaluate loss mitigation actions among federally-regulated banks and thrifts. OCC and OTS continue to encourage bankers to work with creditworthy borrowers who may be facing financial difficulties.

OCC and OTS are also working closely with other domestic and international supervisors, including members of the Council, the Basel Committee on Bank Supervision, the Financial Stability Board (FSB), and the Senior Supervisors' Group (SSG), to identify and coordinate actions aimed at both restoring functioning markets and strengthening risk management practices.

Key initiatives related to these efforts are the following:

- ***Enhanced capital standards.*** The financial crisis highlighted areas where the Basel II capital framework required strengthening. The OCC worked together with other Basel Committee members to revise and publish the new Basel III rules to improve capital standards. The OCC and other U.S. banking agencies will implement the new Basel standards through the U.S. notice and rulemaking process.

- ***Enhanced liquidity risk management and liquidity buffers.*** In March 2010, the OCC, with Federal Financial Institutions Examination Council (FFIEC) member agencies and the Conference of State Banking Supervisors, issued Interagency Guidance on Funding and Liquidity Risk Management.
- ***Correspondent banking concentrations.*** In April 2010, the OCC and other federal banking agencies issued guidance to address risks associated with funding and credit concentrations arising from correspondent relationships.
- ***Interest rate risk.*** In January 2010, the OCC, the other federal banking agencies, and the Conference of State Banking Supervisors issued a joint advisory statement reminding institutions of supervisory expectations regarding sound practices for managing interest rate risk. The advisory statement reminds institutions of the importance of maintaining processes for measuring and, where necessary, mitigating exposure to unexpected or substantial increases in rates.
- ***Incentive compensation structures.*** OCC participated with the Federal Reserve in a horizontal review of incentive compensation structures and practices across the largest financial institutions. Follow-up work is being conducted by the agencies' examination teams and will continue into 2011. As announced in June 2010, the OCC along with the Federal Reserve, the FDIC, and OTS, issued guidance on incentive compensation policies to ensure that these policies take into account risk and are consistent with safe and sound practices.
- ***Addressing off-balance sheet risks.*** In January 2010, the OCC and other federal banking agencies amended their risk-based capital rules to include certain consolidated asset-backed commercial paper in their list of risk-weighted assets. In addition, new regulations were issued requiring banking organizations to include all of their entities in their calculations of risk-based capital needs, including those they typically do not report in their financial statements. This rule is in response to changes in the accounting for certain off-balance sheet structures that went into effect in January 2010.
- ***Accounting and financial disclosure issues.*** The OCC and other federal banking agencies continue to work closely with the SEC, Financial Accounting Standards Board, and International Accounting Standards Board to improve financial disclosure rules.

As a participant in the Council, OCC will be actively involved in promoting measures to improve coordination among federal regulators to help identify and address systemic risks.

Provided Assistance to Low-Income and Underserved Communities

The CDFI Fund provides grants, loans, and tax credits to CDFIs, which provide capital, credit, and financial services to underserved populations and economically distressed communities in the United States. The CDFI Fund awards funds through an annual competitive application process. Since its inception, the CDFI Fund has awarded over $932 million through its largest program, the CDFI Program. The CDFI Program competitively awarded $104.8 million in fiscal year 2010 to 179 CDFIs and organizations.

Managed Currency and Coin Manufacturing

Planned productivity improvements for printing and engraving currency notes

At the BEP, the production of newly-redesigned $100 currency notes led to a 8.8 percent decrease in productivity due to high spoilage and slower operating speeds. To improve productivity and efficiency, the BEP is undertaking a multi-year project to install new equipment to enable production of 50 currency notes per printed note sheet, which is expected to increase productivity by 40 to 50 percent. This project is slated for completion in fiscal year 2013.

Improved supply management for bullion coin production

As financial market volatility continued, investors increased their holdings of precious metals. Throughout fiscal year 2010, the United States Mint made significant efforts to expand raw materials supply and enhance productivity to meet demand. Revenue from the sale of gold and silver bullion coins increased from $1.7 billion in fiscal year 2009 to $2.9 billion in fiscal year 2010, a 70.6 percent increase. The U.S. Mint expanded average monthly gold and silver blank supply by 1.5 million ounces (a 56 percent increase from fiscal year 2009 to 2010) by working with fabricators and identifying a new supplier. The production facility in West Point, New York realized higher output without incurring significant costs by automating processes, shifting employees where they were needed, and maintaining continuous assaying, inspection, and coin production. Output per labor hour increased 23 percent from 175 ounces per hour in fiscal year 2009 to 215 ounces per hour in fiscal year 2010.

In fiscal year 2010, the U.S. Mint fully satisfied demand for American Eagle gold bullion products and sufficiently expanded silver blank supply to remove ordering limits on silver bullion coins in August 2010. By the close of fiscal year 2010, expanded supply reached levels sufficient to allow the U.S. Mint to redirect a portion of both gold and silver blanks to numismatic production, enabling the Mint to launch previously suspended American Eagle proof numismatic products late in calendar year 2010.

Explored cost-reduction options related to the penny, nickel, and other coin denominations

For the fifth year in a row, the penny and nickel cost more to produce than their face value. Global prices for copper, nickel, and zinc (the metals used to produce the penny and nickel) remain high, elevating per-unit production costs. The United States Mint and the Department of the Treasury are developing options for more cost-effective ways to produce circulating coins.

Prevented Terrorism and Promoted the Nation's Security Through Strengthened International Financial Systems

While promoting financial and economic growth at home and abroad, the Treasury Department performs a unique role in preserving national security. In fiscal year 2010, Treasury continued to disrupt the financial networks of terrorists, drug traffickers, and weapons of mass destruction (WMD) proliferators. Treasury safeguarded the nation's financial security and carried out critical law enforcement responsibilities pertaining to predatory lending practices.

Combated Iran's Efforts to Acquire Proliferation-Related Materials

In June 2010, the United Nations (UN) adopted United Nations Security Council Resolution (UNSCR) 1929, broadening the existing UN sanctions on Iran. Shortly thereafter, Treasury announced new designations under Executive Order (EO) 13382 targeting individuals and entities that facilitate Iranian proliferation activities. Most prominently, Treasury designated Post Bank, an Iranian state-owned bank, for providing support to and acting on behalf of UNSCR 1929 designee Bank Sepah. Treasury also designated five Islamic Republic of Iran Shipping Lines (IRISL) front companies and blocked 27 vessels due to their connection to IRISL. In August, Treasury announced a set of designations targeting the Government of Iran's support for terrorism and terrorist organizations, including Hizballah, Hamas, Palestinian Islamic Jihad, the Popular Front for the Liberation of Palestine-General Command, and the Taliban.

The European Union (EU), Australia, Canada, Norway, Japan, and South Korea have implemented sanctions to press Iran to resume negotiations on its nuclear program and meet its international obligations. The financial measures the U.S. and others have implemented are imposing serious costs and constraints on Iran. Iran is effectively unable to access financial services from reputable banks, conduct major transactions in dollars or euros, or secure needed foreign investment, financing, and technology to modernize its aging energy infrastructure. These financial measures threaten Iran's oil and gas production and export capacity.

Prevented North Korean Proliferation and Other Illicit Activities

A new sanctions program, established by President Obama on August 30, targets North Korean arms trafficking, luxury goods procurement, and illicit economic activities. These sanctions enhance U.S. implementation of UNSCR 1718 and 1874 on North Korea, address threats to U.S. national security, and protect the international financial system. The Treasury Department continues to implement sanctions targeting North Korean proliferation activities.

Supported Counterterrorism Efforts in Afghanistan

Treasury served a leading role in establishing the Afghanistan Threat Finance Cell (ATFC). The ATFC is a Kabul-based task force charged with collection, analysis, and dissemination of intelligence to disrupt funding and support for the Taliban and other terrorist and insurgent networks in Afghanistan. The ATFC provides threat finance expertise to U.S. civilian and military leaders and assists Afghan authorities in investigations of insurgent finance, narcotics trafficking, and government corruption. Through this assistance, the ATFC has helped build the capacity of Afghan authorities to operate independently, a key U.S. policy goal in Afghanistan.

In June 2010, the Financial Transactions and Reports Analysis Center of Afghanistan (FinTRACA) formally entered the Egmont Group under Treasury sponsorship. The Egmont Group is the world's organization of financial intelligence units (FIUs), which share financial intelligence to improve global law enforcement. FinTRACA can now engage with the other 119 FIUs that form this global network.

Treasury will continue to investigate bulk cash movements and illicit financial flows into and out of Afghanistan. To support these efforts, Treasury is planning to deploy additional personnel to the Attaché Office in Kabul to bolster the regulatory and investigative capacity of the Afghan government.

Finalized Terrorist Finance Tracking Program Agreement

Treasury, in conjunction with the Departments of Justice (DOJ) and State, successfully led negotiations for a new Terrorist Finance Tracking Program Agreement (TFTP) with the EU. The new agreement which came into effect on August 1, allows Treasury to subpoena financial payment messaging data stored in the EU for use in U.S. counterterrorism investigations. The TFTP was initiated by Treasury to identify, track, and pursue terrorists and their networks. Since the start of the program, the TFTP has provided thousands of valuable leads to U.S. Government agencies and other governments to investigate and prevent terrorist attacks.

Supported Efforts to Combat Money Laundering and Drug Trafficking in Mexico

Over the past year, Treasury and its Mexican counterparts increased efforts to combat money laundering and target the financial underpinnings of criminal organizations in Mexico. Treasury provided technical assistance to Mexico through training on forensic accounting, financial investigations, and financial sector supervision to address money laundering. In August 2010, the Director of the Office of Foreign Assests Control (OFAC) met with private and public sector officials in Mexico City to strengthen coordination between Treasury and Mexican actions against cartels. During the year, Treasury has designated 49 individuals and 25 entities associated with Mexican drug cartels, enhanced information exchange with the Mexican FIU, and improved coordination on a variety of counter narcotics initiatives.

Treasury continued to leverage partnerships with U.S. law enforcement and the Mexican FIU to support the detection, interdiction, and investigation of the flow of illicit proceeds from narcotics and human smuggling into U.S. and Mexican banks. In support of these efforts, Treasury completed a joint study with the Mexican FIU to more accurately baseline U.S. dollar currency activity in Mexico. The study will allow both countries to more effectively measure the scope of bulk cash smuggling into Mexico and the effectiveness of future anti-money laundering (AML) and cash interdiction efforts. Treasury and the Mexican FIU produced a joint intelligence advisory with the National

Drug Intelligence Center (NDIC) on trends in trade-based money laundering and black market peso exchange. Further, Treasury initiated support for a newly-created Southwest Border Anti-Money Laundering Alliance through analysis of wire remittance data; issued an advisory on a new Mexican regulation that may precipitate a significant change in recent cash smuggling trends; and identified and referred Mexican cartel money laundering suspects to U.S. and Mexican law enforcement.

Major Asset Seizures and Forfeitures

The Treasury Forfeiture Fund collected over $1 billion in forfeitures and recoveries. The ABN AMRO Bank signed a Deferred Prosecution Agreement with the U.S. Government and agreed to forfeit $500 million to the Treasury Forfeiture Fund in connection with a conspiracy to defraud the United States, violate the International Emergency Economic Powers Act (IEEPA), violate the Trading with the Enemy Act (TWEA), and violate the Bank Secrecy Act (BSA). Of this amount, $250 million was shared with the Justice Forfeiture Fund. In another case jointly managed by Treasury and the DOJ, Credit Suisse Bank signed a Deferred Prosecution Agreement and agreed to a total forfeiture of $536 million. The District Attorney of the County of New York received half, $268 million, the Treasury Forfeiture Fund received $134 million in equitable sharing from the Justice Forfeiture Fund, and the balance of $134 million was retained by DOJ as the lead Agency. In both cases, these banks permitted illegal transactions on behalf of customers and other countries sanctioned in programs administered by the Department of the Treasury.

Enhanced Mechanisms to Combat Mortgage and Loan Modification Fraud

Treasury continued to combat mortgage fraud, foreclosure rescue scams, and loan modification fraud, an activity begun in prior years. Treasury developed a notice of proposed rulemaking that would require non-bank residential mortgage lenders and originators to guard against and report on illicit financial transactions. FinCEN published an advisory to financial institutions on fraud related to home equity conversion mortgages (HECMs) in April 2010 and an updated advisory to financial institutions on loan modification fraud in June 2010.

FinCEN released a report specifically describing trends found in depository institution Suspicious Activity Reports (SARs) on loan modification and foreclosure rescue scams in June 2010. The relevant SARs increased from 28 reports filed by depository institutions and money services businesses in 2004, to over 3,000 SARs filed in 2009. The SARs in the sample dataset revealed that in the eight months between the issuance of an April 2009 FinCEN Advisory requesting filers report loan modifications and foreclosure rescue fraud activity in SARs, filers increased reporting by over 100 percent In addition, FinCEN published its latest mortgage fraud report in July 2010, which provided analysis of depository institution SARs and described filing trends, evolving patterns, and emerging typologies. The report is intended to benefit law enforcement, regulators, and financial industries.

FinCEN was recognized by the DOJ for playing an important role in Operation Stolen Dreams, an effort over 3.5 months to take down mortgage fraud schemes across the country. The operation involved 1,215 criminal defendants nationwide who were allegedly responsible for more than $2.3 billion in losses.

Collaborated to Detect Health Care Fraud

Treasury is working with the Health Care Fraud Prevention and Enforcement Action Team (HEAT), which brings investigators and prosecutors together in selected geographical areas to target individuals and organizations who are defrauding the health care system. Treasury is working closely with HHS, DOJ, and other federal and state law enforcement agencies to identify increasingly complex health care fraud schemes. Treasury developed an initiative to use the Bank Secrecy Act (BSA) analytical assessments to identify the most egregious individual perpetrators and organized groups in these schemes. Through this analytical process, Treasury will be able to provide the investigators with an overall assessment of the targeted jurisdictions, as well as the organizations and individuals that are suspected of being engaged in health care fraud.

Management and Organizational Excellence

The Department of the Treasury strives to achieve excellence in the design and execution of its management processes, enabling it to better accomplish its mission. Continual improvement in the effectiveness and efficiency of these processes through institutionalized performance reviews and relentless follow-up will drive improved results. Some of the highlights of these areas follow.

Performance Management

In fiscal year 2010, the Department began to conduct quarterly formal performance reviews of its bureaus and policy offices. Meetings are held with the Deputy Secretary, the Assistant Secretary for Management, and bureau and policy officials. The intent is to utilize performance information to drive improved results and improve the performance culture of the organization. The first session in 2010 reviewed existing bureau missions, goals, and measures. The second session focused on the fiscal year 2012 budget formulation. The third session reviewed 2010 performance and plans for 2011.

Improved Management of Human Capital

Attention in fiscal year 2010 focused on Employee Viewpoint Survey (now called the FedView Survey) scores, the Best Places to Work rankings, and revisions to the Senior Executive Service (SES) rating system. By targeting key areas for improvement, the Department moved from 17th to 12th on the Best Places to Work in Government Survey, making Treasury one of the most improved agencies across the Federal Government. The Department also improved its scores in all four key areas of the Employee Viewpoint Survey: leadership and knowledge management, results-oriented performance culture, talent management, and job satisfaction. See *http://bestplacestowork.org/BPTW/rankings/overall/large* for survey rankings.

Treasury implemented several changes to the SES performance management process to clarify performance expectations and support more meaningful distinctions in ratings and rewards. Because SES reform has been identified as a major priority of the President's Management Council, Treasury plans to pursue additional initiatives in fiscal year 2011 related to performance, hiring, and executive development.

Modernized Information Technology

With an annual IT budget of over $3 billion dollars, the Department is focused on enabling innovation in support of its expanding financial and economic missions, while increasing the operational efficiency and effectiveness of existing IT assets. Primary examples of this innovation include Enterprise Content Management, the IRS's Customer Account Data Engine II, FinCEN's IT Modernization, IT projects central to Treasury's duties under the Dodd-Frank Act, Data Center Consolidation, and increasing the amount of data that is readily accessible to the public through the Obama Administration's Open Government effort. To track performance, Treasury utilizes the Federal IT Dashboard to monitor and assess its key programs. Treasury had two high risk investments in fiscal year 2010.

For the Department's first high risk investment related to its network, "TNet," the following actions were taken during fiscal year 2010:

- Treasury officials met with the Federal CIO, Vivek Kundra, on September 29, 2010, to discuss the investment
- Treasury and OMB finalized a plan on actions to improve performance
- In fiscal year 2011 Treasury's legacy wide area network will be fully decommissioned and Treasury will complete its data transition to GSA's network realizing a cost savings of $40 million per year
- Treasury will corporatize the decision making related to the investment and appointed a new program manager

For the Department's second high risk investment, Treasury Enterprise Identity, Credential and Access Management (TEICAM), the following actions were taken during fiscal year 2010:

- Treasury officials met with the Federal CIO on October 25, 2010 to discuss the investment
- An improvement plan is in development but is not yet finalized

The Department continues to implement effective information security tools to thwart attacks and keep key information safe. Two of Treasury's Department-wide strategic security objectives include use of Homeland Security Presidential Directive-12 credentials for access to business applications and use of data-loss prevention tools to prevent the accidental leakage of information. Treasury is also enhancing its capability to monitor the use of illegal and unauthorized software in its networks and systems. This capability will help prevent software piracy and the introduction of hostile software which would put Treasury's IT-based business processes and information at risk of theft, compromise, or disruption.

Increased Use of Electronic Transactions

In 2010, Treasury began implementing a "paperless" initiative to increase the use of electronic transactions with the public. The largest effort involves migrating Social Security, Supplemental Security Income, Veterans, Railroad Retirement, and Office of Personnel Management payments to electronic transactions. Individuals will be able to receive benefits either through direct deposit or Treasury's Direct Express debit card. Today, one million Americans are receiving their benefit payments through Direct Express. Beginning March 1, 2011, Treasury will require that new enrollees receive payments electronically. All recipients will be required to receive payments electronically by March 1, 2013. Currently, 85 percent of federal benefit recipients receive their payments electronically. Moving all recipients of these benefits to electronic payments is expected to save upwards of $300 million in the first five years.

Currently, nearly 98 percent of all business tax dollars are paid electronically through Treasury's free Electronic Federal Tax Payment System (EFTPS). IRS research has shown that businesses using EFTPS are 31 times less likely to make an error. For tax collection, businesses with $2,500 or more in quarterly tax liabilities that are permitted to use paper Federal Tax Deposit coupons will have to make those deposits electronically beginning in 2011. This change will save an estimated $65 million in the first five years.

Finally, Treasury will eliminate the option to purchase paper savings bonds through payroll deductions for federal employees on September 30, 2010 and for the private sector by January 1, 2011. Individuals will still be able to purchase paper savings bonds at financial institutions for themselves and as gifts. Payroll savers will be encouraged to continue their purchases through TreasuryDirect, a web-based system that allows investors to buy and hold electronic Treasury securities. This change is estimated to save nearly $50 million in the first five years.

Achieved Acquisition Savings

The Department executed its fiscal year 2010 plan to meet the OMB acquisition improvement mandate to deliver 3.5 percent in procurement savings in fiscal year 2010 and achieve a ten percent reduction in high risk contracting in fiscal year 2010. As of September 30, Treasury had exceeded both goals, realizing over $241.9 million in savings versus the goal of $158.4 million, and $129.4 million in high risk contracting reduction versus the goal of $48.8 million.

The Department has taken steps to achieve 3.5 percent savings in fiscal year 2011 ($158 million) and reduce the use of high risk contracting authorities. Treasury will continue to actively transition to lower risk contracting strategies. Treasury will achieve its targets through active management of acquisition operations and increased examination of high dollar/risk contracts.

Improved Transparency and Accountability

In April 2010, the Department of Treasury published its first Open Government plan in line with the Obama Administration's Open Government Directive. An Open Government Steering Committee with representatives from each of Treasury's bureaus was established to develop guidance and lead activities across the Department. In executing the plan, Treasury released 84 data sets, increased stakeholder outreach efforts, and began a more focused approach to tracking reductions in the Freedom of Information Act (FOIA) request backlog. In addition, the Department identified costs savings from Open Government initiatives such as tracking the impact of proactive disclosure through *FinancialStability.gov* on FOIA requests to the Office of Financial Stability (OFS). Using this data, Treasury developed a cost-benefit matrix to assess open government initiatives.

The Department of the Treasury received a Leading Practices Award for Participation and Collaboration for achievement above and beyond the requirements of the Directive. This award recognized Treasury as an agency that outlined the best and most innovative strategies for promoting open government over the next two years. Treasury was only one of eight agencies to receive an award.

Provided Effective Oversight of Treasury Programs

The Treasury Inspector General chairs the Council of Inspectors General on Financial Oversight (CIGFO), which was established by the Dodd-Frank Act. CIGFO facilitates information sharing among inspectors general with a focus on concerns that may apply to the broader financial sector and on ways to improve financial oversight. The Treasury Inspector General also serves as a statutory member of the Recovery Accountability and Transparency Board which was established in 2009 to coordinate and conduct oversight of Recovery Act funds to prevent fraud, waste, and abuse.

The OIG committed nearly all audit resources to mandated work primarily related to material loss reviews of failed banks during the fiscal year. Due to the unprecedented number of Treasury-regulated bank failures requiring review, the OIG was unable to meet its performance goal of completing 100 percent of audits by the statutory deadline. During fiscal year 2010, 53 Treasury-regulated banks failed. By comparison, 27 Treasury-regulated banks failed during fiscal year 2009. For fiscal year 2010, OIG had 18 required material loss reviews in progress at the start of the year; initiated 20 new material loss reviews during the year; and completed ten. During fiscal year 2010, material loss reviews were required when the bank failure caused a loss to the Deposit Insurance Fund of $25 million or more. This threshold was recently increased to $200 million. In addition, the Office of Investigations initiated four criminal investigations of failed Treasury banks as a result the Office of Audit's findings. During fiscal year 2010, the OIG Office of Audit completed 50 percent of statutory audits by their required deadline and completed 68 products overall.

TIGTA is responsible for successful investigations of entities and individuals who threaten the U.S. tax system. TIGTA estimates approximately $11.46 billion in potential financial benefits could be realized through implementation of its audit recommendations in fiscal year 2010 and $230 million in potential savings could be realized from investigative recoveries from embezzlements, thefts, court order fines, penalties, and restitution. These benefits included $2.8 billion in cost savings recommendations, $8.6 billion in potential increased revenue/revenue protected recommendations, $0.2 million in taxpayer rights and entitlement recommendations, and $36 million in recommendations related to inefficient use of resources. These reports also included recommendations impacting over two million taxpayer accounts.

SIGTARP promotes efficiency and effectiveness in Treasury's management of the TARP through transparency, coordinated oversight, and robust enforcement against those who waste, steal, or abuse TARP funds. SIGTARP's primary tools for informing taxpayers about TARP are audit and quarterly reports, which are available for inspection at *www.sigtarp.gov*. Since its inception, SIGTARP has conducted 22 distinct audits and issued 11 audit reports on topics such as use of TARP funds, external influences on program decision-making, oversight of AIG's executive compensation, and Treasury's role in the decision to reduce the number of GM and Chrysler dealerships. SIGTARP's investigations division has over 104 ongoing major criminal and civil investigations. SIGTARP closely coordinates its oversight activities with other TARP oversight bodies to ensure maximum coverage while avoiding redundancy and undue burden.

DEPARTMENT OF THE TREASURY KEY PERFORMANCE MEASURES FOR 2010

The following table contains ten key performance metrics providing a representative overview of the Department's performance for 2010. Discussion of the factors contributing to each measure's performance results, and plans to improve the measures' results in future years, follows the table.

Performance Measure Official Title	Bureau	2007 Target	2007 Actual	2008 Target	2008 Actual	2009 Target	2009 Actual	2010 Target	2010 Actual	Percent Target Achieved 2010	2010 Actual vs. Target	4-year Target Trend	4-year Actual Trend
Percentage collected electronically of total dollar amount of Federal government receipts (%)	FMS	80	79	79	80	80	84	80	85	106%	Exceeded	▶	▲
Customer Service Representative (CSR) Level of Service (%)	IRS	82	82.1	82	52.8	70	70	71	74	104%	Exceeded	▼	▼
Percent of Business Returns Processed Electronically (%)	IRS	19.5	19.1	20.8	19.4	21.6	22.8	24.3	25.5	105%	Exceeded	▲	▲
Percent of Individual Returns Processed Electronically (%)	IRS	57	57.1	61.8	57.6	64	65.9	70.2	69.3	99%	Unmet	▲	▲
Number of full-time equivalent jobs created or maintained in underserved communities by businesses financed by CDFI program awardees	CDFI	34,009	35,022	28,676	29,539	30,000	70,260	85,000	80,796	95%	Unmet	▲	▲
Rehabilitated national banks as a percentage of problem national banks one year ago (CAMELS 3, 4 or 5) (%)	OCC	40	52	40	47	40	29	40	23	58%	Unmet	▶	▼
Clean audit opinion on TARP financial statements	DO					Baseline	Met	1	1	100%	Met	▶	▶
Percent of customers satisfied with Financial Stability.gov (%)	DO					Baseline	65	70	63	90%	Unmet	▲	▼
Percent of timely completed Planned Corrective Actions (%)	DO	85	71.7	85	82.5	85	85.6	87.5	88.4	101%	Exceeded	▲	▲
Impact of TFI programs and activities	DO					Baseline	7.81	7.4	8.1	109%	Exceeded	▶	▲

Note: Performance measures were not audited.

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

In fiscal year 2010, FMS collected nearly $2.94 trillion through approximately 9,000 financial institutions, with 85.3 percent of the dollars collected electronically. FMS's metric "Percentage collected electronically of total dollar amount of Federal government receipts" exceeded its performance target by five percentage points and showed a one percentage point improvement over 2009. More than 108 million payments were processed through EFTPS, an increase in transaction volume of seven percent, despite only a 3.5 percent growth in tax revenue collected. FMS regularly reaches out to the banking community to promote electronic collection and is implementing marketing programs to encourage migration of paper-based collections to electronic collection systems and Pay.gov.

The IRS metric "Customer Service Representative (CSR) Level of Service" exceeded its performance target by four percent in fiscal year 2010 and improved on the prior fiscal year's result by four percentage points. The IRS is addressing demand through improved self-service options. Twenty-one percent more automated calls were completed compared to fiscal year 2009, reaching 35.1 million calls. The number of assistor answered calls was 36.7 million, lower than the 39 million assistor calls answered in fiscal year 2009.

IRS electronic filing metric "Percent of Business Returns Processed Electronically" exceeded its performance target by five percent, a 12 percent increase over fiscal year 2009. The "Percent of Individual Returns Processed Electronically" came within one percent of meeting its target. Increased electronic filing can be attributed to changes in filing patterns, economic and demographic trends, legislative requirements, and IRS administrative processes. IRS expects the percentage of both business and individual returns filed electronically to increase in fiscal year 2011 based on recent experience, historical growth trends, increased marketing, and expanded programs aimed at boosting electronic filing. IRS will continue to pursue additional legislative mandates to increase electronic filing for businesses taxpayers, such as a 2011 provision requiring taxpayers filing more than ten individual returns during a calendar year to file electronically.

The CDFI Fund's metric "Number of full-time equivalent jobs created or maintained in underserved communities by businesses financed by CDFI Program awardees" achieved 80,796, a 15 percent increase over the prior year and within five percent of the target. This target was unmet primarily due to the effects of the economic downturn. The CDFI Program in fiscal year 2010 competitively awarded $104.8 million in funding to 179 CDFIs and organizations for providing loans, investments, financial services, and technical assistance to underserved populations and low-income communities. The amount of money CDFIs were able to attract from private investment reached nearly $2 billion, more than triple the 2010 target of $600 million, largely due to higher program funding provided in legislation passed after the target was set.

During fiscal year 2010, OCC's metric "Rehabilitated national banks as a percentage of problem national banks one year ago (CAMELS 3, 4 or 5)" achieved 58 percent of its performance target, dropping by 21 percent compared with fiscal year 2009. National banks continued to operate in a highly challenging and volatile environment. The impact of the past and current economic climates on these banks requires longer term rehabilitation efforts. Given the weak economy, OCC focused on monitoring and responding to adverse conditions in credit and financial markets, improving credit risk management at supervised institutions, and monitoring loan portfolios. For all national banks, OCC is continuing to focus on quick responses to deteriorating bank credit quality and on ensuring banks maintain adequate liquidity, loan-loss reserves, and capital buffers. Because of changing conditions, OCC should consider changing their target setting methodology.

For fiscal year 2010, the Office of Financial Stability (OFS) received a clean audit opinion on TARP financial statements. This is a significant accomplishment, and OFS will continue to strive for accuracy and transparency in its financial statements. However, the metric "Percent of customers satisfied with FinancialStability.gov" fell short of its 70 percent target by seven percentage points and was also two percentage points lower than fiscal year 2009. OFS is using survey analysis results to identify opportunities for implementing new webpage layouts.

During fiscal year 2010, the Department achieved 88.4 percent of timely completed Planned Corrective Actions (PCAs), which exceeded its target of 87.5 percent. Throughout fiscal year 2011, the Department will continue to monitor progress on the timely completion of PCAs and continue to provide valuable information on various aspects of audit follow-up. In addition, the target completion rate has been raised to 90 percent for fiscal year 2011.

TFI's performance metric "Impact of TFI programs and activities" exceeded its performance target and improved on the fiscal year 2009 results by nine percent. This metric consists of four overall focus areas, with additional detailed focus area components. These components align to performance goals established by TFI. The external review process for this measure still needs to be developed, but the implementation of this measure is a large step in the effort to measure performance for a policy office that also has operational responsibilities.

SUMMARY OF MANAGEMENT AND PERFORMANCE CHALLENGES AND HIGH-RISK AREAS

Annually, in accordance with the *Reports Consolidation Act of 2000*, the Treasury Office of Inspector General (OIG) and the Treasury Inspector General for Tax Administration (TIGTA) identify the most significant management and performance challenges facing the Department. The Government Accountability Office (GAO) identifies high-risk areas biennially. These challenges do not necessarily indicate deficiencies in performance; rather, some represent inherent risks that must be monitored continuously. Treasury made much progress on these issues in fiscal year 2010, and will continue to focus on resolving them during fiscal year 2011.

Summaries of the IG-identified management challenges and GAO-identified high-risk areas are below. For details, refer to Appendix C for this year's OIG and TIGTA memoranda identifying major management and performance challenges, and the Secretary's responses.

Treasury-wide Management Challenges – As Identified by OIG

Management Challenge	Summary of Major Issues
Transformation of Financial Regulation	• Implement and enforce the provisions of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* and other federal consumer financial laws consistently • Identify risks to financial stability that could arise from the activities of large, interconnected financial companies; respond to emerging threats to the financial system; and promote market discipline • Assess and report on systemic risks • Monitor the insurance industry • Streamline and improve supervision of depository institutions and holding companies

Management of Treasury's Authorities Intended to Support and Improve the Economy	• Protection of the taxpayer from unnecessary risk associated with the implementation and administration of programs intended to support and improve the economy, including the provisions of:
	  • *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*

Anti-Money Laundering and Terrorist Financing/ Bank Secrecy Act Reporting	• Prevent and detect money laundering and terrorist financing • U.S. and international financial systems that are safe and transparent • Efficient management, safeguarding, and use of Bank Secrecy Act information
Management of Capital Investments	• Effective use of taxpayer funds for large capital investments

IRS Management Challenges – As Identified by TIGTA

Management Challenge	Summary of Major Issues
Security	Appropriate physical security and protection of financial, personal, and other information
Modernization	Improve taxpayer service and efficiency of operations
Tax Compliance Initiatives	Improve compliance and fairness in the application of the tax laws
Implementing Health Care and Other Tax Law Changes	Responsiveness to new tax provisions, including tax-related health care provisions of the *Patient Protection and Affordable Care Act*, the Recovery Act, and adjusting to expiring provisions
Providing Quality Taxpayer Service Operations	Improve taxpayer service
Human Capital	Enable the IRS to achieve its mission
Erroneous and Improper Payments and Credits	Effective use of taxpayer funds
Globalization	Increase outreach efforts to foreign governments on cross-border transactions
Taxpayer Protection and Rights	Apply the tax laws fairly
Leveraging Data to Improve Program Effectiveness and Reduce Costs	Use resources to focus on producing the best value for stakeholders

High-Risk Areas – As Identified by GAO

Enforcement of the Tax Laws

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

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

Challenges and Actions Taken/Planned:

Reduce the opportunity for evasion

- During fiscal year 2010, the IRS continued to focus on the many taxpayers that shift income abroad and engage in offshore tax evasion schemes in order to hide their wealth and avoid paying taxes. With cross-border transactions on the rise, the IRS more than doubled offshore presence by opening new offices in Asia and Central America, placing additional personnel at its existing offices throughout the world, and expanding its interaction with key international organizations involved in tax and financial law compliance.
- In fiscal year 2010, the IRS began mining the information from participants of its offshore voluntary disclosure program started in 2009, to identify financial institutions, advisors, and others who promoted or otherwise helped U.S. taxpayers hide assets and income offshore. The IRS also used audit results and intelligence from ongoing offshore initiatives to refine case identification and selection methods and to identify promoters, facilitators, and participants in abusive offshore arrangements.
- In fiscal year 2011, the IRS will use mined data from the offshore voluntary disclosure program to develop additional strategies to prohibit promoters and facilitators from soliciting new clients.

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

- The IRS continued to focus examinations on high-net worth individuals, flow-through entities, and large corporations (assets > $10 million). In fiscal year 2010, the IRS conducted over 153,000 high-net worth audits, an increase of 5.5 percent. Audits of large corporations increased by 8.1 percent, a significant achievement given the size (more than $10 million in assets) and complexity of these corporate entities. The number of flow through audits totaled more than 29,000.
- During fiscal year 2010, the IRS began laying the groundwork to ensure the quality and integrity of professional tax return preparation, which most taxpayers rely on in one form or another. The IRS successfully implemented an application process to comply with the mandate that all paid tax return preparers obtain a preparer tax identification number.
- In fiscal year 2010, the IRS released the Research Community Strategic Plan. The plan focuses on research efforts aimed at effectively determining ways to address taxpayer compliance.
- In fiscal year 2011, the IRS will continue to expand its efforts to address international tax evasion, expand the focus on corporate and high net-worth returns to integrate significant new information reporting authorities into compliance programs, and proceed with additional mandates for paid tax preparers. The mandates include the requirement that all paid tax return preparers except attorneys, certified public accountants, and enrolled agents pass a competency test and complete continuing professional education of 15 hours per year. The IRS also plans to conduct research to enhance compliance and use analytically-based technologies to provide tools for detecting and reducing noncompliance.

IRS Business Systems Modernization

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

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

Challenges and Actions Taken/Planned:

Fully implement all projects and programs for the BSM program

- In fiscal year 2010, IRS modernization efforts continued to focus on core tax administration systems designed to provide more sophisticated tools to taxpayers and to IRS employees. The Customer Account Data Engine (CADE), Modernized e-File (MeF), and Account Management Services (AMS) modernization projects delivered the changes necessary for a successful filing season, and continued to support implementation of Recovery Act tax provisions.
- The IRS revised its CADE strategy (CADE 2) to implement a new taxpayer account database for the 2012 filing season that provides for daily updating of individual taxpayer accounts to improve taxpayer service and accuracy, reduce interest paid on late refunds, improve data security, and allow the development of new tools to combat fraud and improve enforcement activities. Completion of the taxpayer account database is the prerequisite for other major initiatives, including significant expansion of online services and transactions and next generation of enforcement technologies.
- The IRS also deployed an additional release of MeF that enabled acceptance of the forms and schedules to reach 61 percent of the e-file population, and with enhanced disaster recovery capabilities to manage operational risk. In addition, the IRS deployed the final release of AMS, enabling users to view correspondence images online, eliminating manual processing and reducing case cycle time from 10-14 days to zero days. AMS also facilitated the identification of unallowable or fraudulent claims for First-Time Home Buyer Credits claimed by taxpayers filing amended returns.
- In fiscal year 2011, the IRS will continue to focus on modernization of the tax administration systems to provide additional benefits to taxpayers. The IRS will further develop CADE 2 to accommodate tax law changes in the 2012 filing season.

Modernizing the Outdated U.S. Regulatory System

Issue/Goal: Efficient and effective implementation of financial regulatory reform legislation.

Challenges and Actions Taken/Planned:

Actions related to this high-risk area are provided on page 15 (Financial Regulatory Reform), page 24 (Strengthened International Economic Coordination), and page 26 (Regulation of Banks and Thrifts).

ANALYSIS OF FINANCIAL STATEMENTS

CONDENSED BALANCE SHEET (in millions):	2010	2009
Due From the General Fund	$ 13,655,637	$ 11,992,719
Other Intra-governmental Assets	1,025,169	923,457
Cash, Foreign Currency, and Other Monetary Assets	375,282	341,308
Gold and Silver Reserve	11,062	11,062
TARP Direct Loans and Equity Investments, Net and Asset Guarantee Program	144,692	239,657
Investments in Government Sponsored Enterprises	109,216	64,679
Investments and Related Interest	12,639	13,565
Credit Program Receivables and Direct Loans, Net	186,396	184,460
Tax, Other Related Interest Receivables, Net	36,976	30,408
Beneficial Interest in Trust	20,805	23,472
Other Assets	21,383	21,814
Total Assets	**$ 15,599,257**	**$ 13,846,601**
Federal Debt and Interest Payable	$ 13,623,731	$ 11,962,385
Other Intra-governmental Liabilities	1,424,976	1,275,613
Liabilities to Government Sponsored Enterprises	359,900	91,937
Other Liabilities	89,554	88,610
Total Liabilities	**15,498,161**	**13,418,545**
Unexpended Appropriations	400,557	455,144
Cumulative Results of Operations	(299,461)	(27,088)
Total Net Position	**101,096**	**428,056**
Total Liabilities and Net Position	**$ 15,599,257**	**$ 13,846,601**

CONDENSED STATEMENT OF NET COST (in millions):	2010	2009
Net Financial Program Cost	$ 13,243	$ 13,055
Net Economic Program (Revenue)/Cost	297,234	195,705
Net Security Program Cost	340	322
Net Management Program Cost	526	509
Total Program Cost before Assumption Changes	**311,343**	**209,591**
(Gains)/Losses Due To Changes in Actuarial Assumptions	820	0
Total Net Cost of Treasury Operations	**$ 312,163**	**$ 209,591**
Net Federal Costs (primarily interest on the Federal Debt)	**$ 346,678**	**$ 313,341**

CONDENSED STATEMENT OF CHANGES IN NET POSITION (in millions):	2010	2009
Beginning Balance	$ (27,088)	$ 37,743
Budgetary Financing Sources	503,042	668,894
Other Financing Sources (Uses)	(116,574)	(210,793)
Total Financing Sources	386,468	458,101
Net Cost of Operations	(658,841)	(522,932)
Net Change	(272,373)	(64,831)
Cumulative Results of Operations	**$ (299,461)**	**$ (27,088)**
Beginning Balance	$455,144	$271,968
Appropriations Received	456,970	855,762
Appropriations Used	(502,439)	(668,153)
Other	(9,118)	(4,433)
Total Budgetary Financing Sources	(54,587)	183,176
Total Unexpended Appropriations	**400,557**	**455,144**
Net Position - Year End	**$ 101,096**	**$ 428,056**

CONDENSED STATEMENT OF BUDGETARY RESOURCES (in millions):	2010	2009
Unobligated Balances, Brought Forward	$ 457,588	$ 284,630
Recoveries of Prior Year Obligations	42,349	8,096
Budget Authority	929,687	1,814,086
Other Budget Authority	(236,543)	(271,778)
Total Budgetary Resources	**$ 1,193,081**	**$ 1,835,034**
Obligations Incurred	$ 820,838	$ 1,387,195
Unobligated Balance	301,811	413,998
Unobligated Balance, Not Available	70,432	33,841
Total Status of Budgetary Resources	**$ 1,193,081**	**$ 1,835,034**
Total Unpaid Obligated Balances, Net	$ 158,323	$ 56,977
Obligations Incurred, Net	820,838	1,387,195
Gross Outlays	(733,710)	(1,248,916)
Recoveries of Prior Year Unpaid Obligations, Actual	(42,349)	(8,096)
Changes in Uncollected Customer Payments Federal	5,087	(28,748)
Total Unpaid Obligated Balance, Net, End of Year	**$ 208,189**	**$ 158,412**
Net Outlays	$ 340,510	$ 922,165

CONDENSED STATEMENT OF CUSTODIAL ACTIVITY (in millions):	2010	2009
Individual Income and FICA Taxes	$ 1,988,760	$ 2,036,557
Corporate Income Taxes	277,937	225,482
Other Revenues	179,613	139,648
Total Cash Revenue Received	**2,446,310**	**2,401,687**
Less Refunds	(469,937)	(437,972)
Net Cash Revenue Received	**1,976,373**	**1,963,715**
Beneficial Interest in Trust	(2,666)	23,472
Accrual Adjustment	6,539	(1,097)
Total Custodial Revenue	**1,980,246**	**1,986,090**
Amounts Provided to Fund the Federal Government	1,975,986	1,963,228
Amounts Provided to Fund Non-Federal Entities	387	487
Non-cash Revenue - Beneficial Interest in Trust	(2,666)	23,472
Accrual Adjustment	6,539	(1,097)
Total Disposition of Custodial Revenue	**1,980,246**	**1,986,090**
Net Custodial Revenue Activity	**$ 0**	**$ 0**

Summary of Auditor's Report on the Treasury Department's Financial Statements

The Department received an unqualified audit opinion on its fiscal year 2010 financial statements. As summarized in the table below, the auditor reported one open material weakness as of September 30, 2010. During the fiscal year 2010 financial audit, the auditors downgraded the material weakness they identified in the fiscal year 2009 audit, "Financial Management Practices at the Departmental Level," to a significant deficiency. The Office of Accounting and Internal Control (AIC) and the Office of Performance Budgeting (OPB) worked diligently during the year to close many of the planned corrective actions to improve its financial management practices and made significant progress. The auditor also reported significant deficiencies related to financial reporting at the Office of Financial Stability and information system controls at the Financial Management Service. In addition, the auditor reported an instance of noncompliance with laws and regulations related to Section 6325 of the Internal Revenue Code (release of federal tax liens), and that the Department's financial management systems did not substantially comply with the requirements of the *Federal Financial Management Improvement Act of 1996*.

SUMMARY OF FINANCIAL STATEMENT AUDIT

Audit Opinion	Unqualified				
Restatement	No				
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Financial Systems and Reporting at the IRS	1	0	0	0	1
Financial Management Practices at the Departmental level	1	0	1	0	0
Totals	2	0	1	0	1

Limitations on the Principal Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Department of the Treasury, pursuant to the requirements of 31 U.S.C. 3515 (b). While the statements have been prepared from the books and records of the Department of the Treasury, in accordance with GAAP for federal entities and the formats prescribed by OMB, the statements are, in addition to the financial reports, used to monitor and control budgetary resources which are prepared from the same books and records.

The financial statements should be read with the realization that they are for a component of a sovereign entity, that liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the sovereign entity.

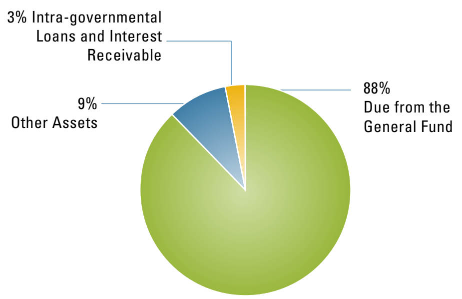
Major Highlights

The following provides the major highlights of the Department's financial position and results of operations for fiscal year 2010.

Assets. Total assets increased from $13.9 trillion at September 30, 2009 to $15.6 trillion at September 30, 2010. The primary reason for the increase is the rise in the federal debt, which causes a corresponding rise in the "Due from the General Fund of the U.S. Government" account ($13.7 trillion.) This account represents future funds required from the General Fund of the U.S. Government to pay borrowings from the public and other federal agencies.

The majority of loans and interest receivable ($552.9 billion) included in "Intra-governmental" assets are the loans issued by the Bureau of the Public Debt to other federal agencies for their own use or to private sector borrowers, whose loans are guaranteed by the federal agencies.

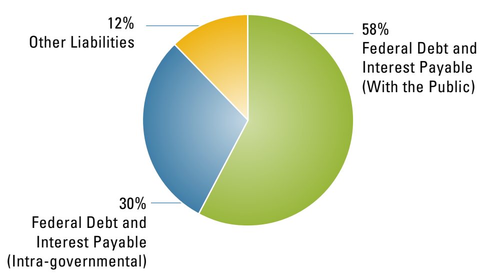
Total Assets



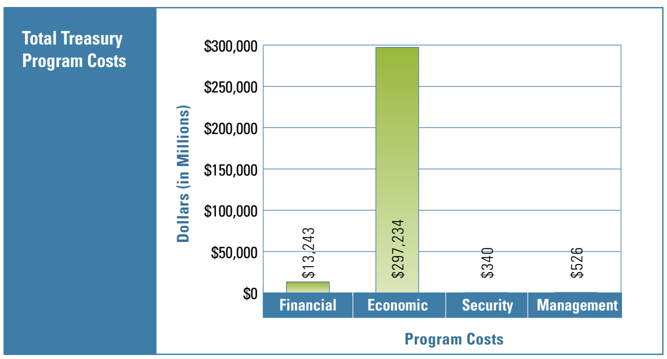
Liabilities. Intra-governmental liabilities totaled $6 trillion, and include $4.6 trillion of principal and interest payable to various federal agencies, such as the Social Security Trust Fund. These borrowings do not include debt issued separately by other governmental agencies, such as the Tennessee Valley Authority or the Department of Housing and Urban Development.

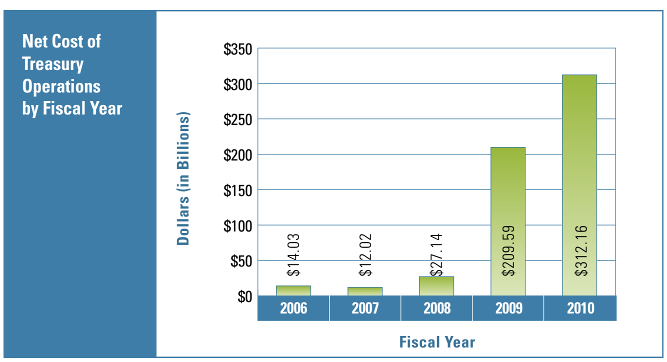
Liabilities also include federal debt held by the public, including interest, of $9 trillion; this debt was mainly issued as Treasury Notes. The increase in total liabilities in fiscal year 2010 over fiscal year 2009 ($2.1 trillion and 15.5 percent), is the result of increases in borrowings from various federal agencies ($184.7 billion), and federal debt held by the public, including interest, ($1.5 trillion). Debt held by the public increased primarily because of the need to finance budget deficits.

Total Liabilities

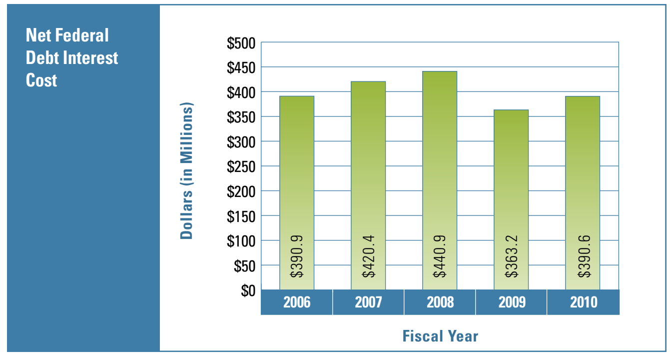


Net Cost of Treasury Operations. The Consolidated Statement of Net Cost presents the Department's gross and net cost for its four strategic missions: financial program, economic program, security program, and management program. The majority of the Net Cost of Treasury Operations is in the economic program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

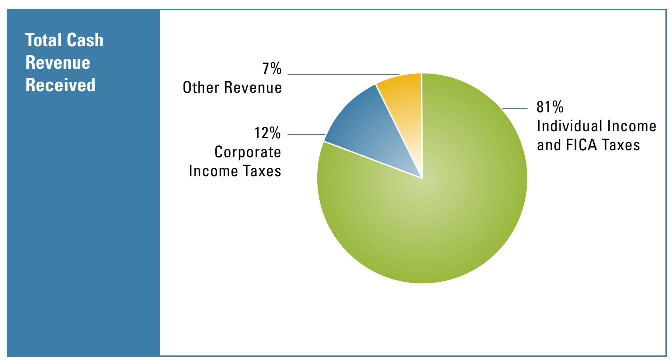


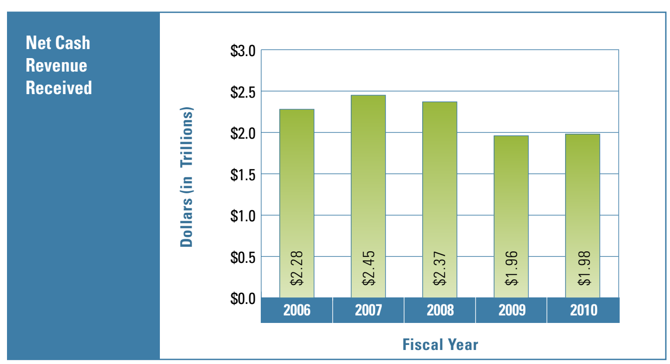


Net Federal Debt Interest Costs. The increase of $27.4 billion in net interest paid on the federal debt is due to the increase in the debt.



Custodial Revenue. Total net cash revenue collected by Treasury on behalf of the Federal Government includes various taxes, primarily income taxes, user fees, fines and penalties, and other revenue. Over 92.7 percent of the revenues are from income and social security taxes.





IMPROPER PAYMENTS INFORMATION ACT AND RECOVERY AUDITING ACT

Improper Payments Information Act

Background

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

However, some federal programs are so complex that developing an annual error rate is not feasible. The government-wide Chief Financial Officers Council developed an alternative for such programs to assist them in meeting the IPIA requirements. Agencies may establish an annual estimate for a high-risk component of a complex program (e.g., a specific program population) with OMB approval. Agencies must also perform trend analyses to update the program's baseline error rate in the interim years between detailed program studies. When development of a statistically valid error rate is possible, the reduction targets are revised and become the basis for future trend analyses.

Treasury's Risk Assessment Methodology and Results for Fiscal Year 2010

Each year, Treasury develops a comprehensive inventory of all funding sources and conducts a risk assessment for improper payments on all of its programs and activities. The risk assessment performed on all of Treasury's programs and activities in fiscal year 2010 resulted in low and medium risk susceptibility for improper payments except for the Internal Revenue Service's (IRS) Earned Income Tax Credit (EITC) program. The high-risk status of this program is well-documented. OMB has deemed the EITC a complex program for the purposes of the IPIA.

Earned Income Tax Credit

The EITC is a refundable tax credit that offsets income tax owed by low-income taxpayers and, if the credit exceeds the amount of taxes due, provides a lump-sum payment in the form of a refund to those who qualify. The fiscal year 2010 estimate is that a maximum of 28.7 percent ($18.4 billion) and a minimum of 23.9 percent ($15.3 billion) of the EITC total program payments are overclaims.

The IRS has a robust base enforcement program for the EITC which consists of examinations (audits), math error notices, and document matching. In fiscal year 2010, the IRS expanded its approach to decrease improper payments.

Executive Order 13520 - Reducing Improper Payments and Eliminating Waste in Federal Programs

On November 20, 2009, President Barack Obama issued Executive Order 13520 - *Reducing Improper Payments and Eliminating Waste in Federal Programs* (EO 13520). According to EO 13520, the purpose of the order is to *"reduce improper payments by intensifying efforts to eliminate payment error, waste, fraud, and abuse in the major programs administered by the Federal Government, while continuing to ensure that Federal programs serve and provide access to their intended beneficiaries."*

Section 2 of the order, "Transparency and Public Participation," directed OMB "to identify Federal programs in which the highest dollar value or majority of Government-wide improper payments occur." OMB identified the EITC as a "high-priority program" under EO 13520. The requirements of the high-priority programs are described in Appendix B.

Recovery Auditing Act

Background

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

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

Results for Fiscal Year 2010

During fiscal year 2010, Treasury issued $6.4 billion in contracts (defined as issued and obligated contracts, modifications, task orders, and delivery orders). The Department identified improper payments in the amount of $467,000 from recovery auditing efforts, and recovered $518,000, including prior year recoveries, with $58,000 outstanding as accounts receivable on September 30, 2010.

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

MANAGEMENT ASSURANCES

The Secretary's Letter of Assurance

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

Treasury provides assurance that the objectives of the *Federal Managers' Financial Integrity Act* over operations have been achieved, except for the material weaknesses noted below. In accordance with OMB Circular A-123, Appendix A, we provide qualified assurance that internal control over financial reporting was operating effectively based on the results of the assessment as of June 30, 2010. Treasury is not in substantial compliance with the *Federal Financial Management Improvement Act* due to the material weakness related to revenue accounting systems.

As of September 30, 2010, Treasury has four material weaknesses as follows (with origination/resolution timeframes indicated):

Operations:

Internal Revenue Service

- Improve Modernization Management Controls and Processes (fiscal year 1995/2011)
- Computer Security (fiscal year 2001/2012)

Financial Management Service

- Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements (fiscal year 2001/2014)

Financial Reporting:

Internal Revenue Service

- Unpaid Assessments (remaining portions of Financial Accounting of Revenue – Custodial) (fiscal year 1995/2015)

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

Timothy F. Geithner

November 15, 2010

MATERIAL WEAKNESSES, AUDIT FOLLOW-UP, AND FINANCIAL SYSTEMS

Summary of Management Assurances

Summary of Material Weaknesses						
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
IRS – Unpaid Assessments (remaining portions of Financial Accounting of Revenue – Custodial)	1	0	0	0	0	1
IRS – Improve Modernization Management Controls and Processes	1	0	0	0	0	1
IRS – Computer Security	1	0	0	0	0	1
FMS – Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements	1	0	0	0	0	1
DO – Financial Management Practices	1	0	1	0	0	0
Total Material Weaknesses	5	0	1	0	0	4

As of September 30, 2010, Treasury has four material weaknesses under Section 2 of the *Federal Managers' Financial Improvement Act* as shown in the tables below.

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	**Qualified**					
Material Weaknesses	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
IRS – Unpaid Assessments (remaining portions of Financial Accounting for Revenue – Custodial) (See Appendix D)	1	0	0	0	0	1
DO – Financial Management Practices	1	0	1	0	0	0
Total Material Weaknesses	2	0	1	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 – Improve Modernization Management Controls and Processes	1	0	0	0	0	1
IRS – Computer Security	1	0	0	0	0	1
FMS – Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements	1	0	0	0	0	1
Total Material Weaknesses	3	0	0	0	0	3

Conformance with Financial Management System Requirements (FMFIA § 4)						
Statement of Assurance	**Systems conform to financial management system requirements**					
Non-Conformances	**Beginning Balance**	**New**	**Resolved**	**Consolidated**	**Reassessed**	**Ending Balance**
Total Non-conformances	0	0	0	0	0	0

Compliance with Federal Financial Management Improvement Act (FFMIA)		
	Agency	**Auditor**
Overall Substantial Compliance	**No**	**No**
1. System Requirements	No	
2. Accounting Standards	No	
3. USSGL at Transaction Level	Yes	

Federal Managers' Financial Integrity Act (FMFIA)

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

- Programs achieve their intended results
- Resources are used consistent with overall mission
- Programs and resources are free from waste, fraud, and mismanagement
- Laws and regulations are followed
- Controls are sufficient to minimize any improper or erroneous payments
- Performance information is reliable
- System security is in substantial compliance with all relevant requirements
- Continuity of operations planning in critical areas is sufficient to reduce risk to reasonable levels
- Financial management systems are in compliance with federal financial systems standards

Deficiencies that seriously affect an agency's ability to meet these objectives are deemed "material weaknesses." Treasury can provide assurance that the objectives of the FMFIA have been achieved, except for the material weaknesses noted in the Secretary's Letter of Assurance. During fiscal year 2010, Treasury downgraded or closed one material weakness. Although the last open material weakness is targeted to be closed in fiscal year 2015, Treasury is focusing on making sufficient progress to downgrade the weakness sooner.

Each year, material weaknesses, both the resolution of existing ones and the prevention of new ones, receive special attention from management. In fiscal year 2010, Treasury continued to make resolution of material weaknesses a performance requirement for every executive, manager, and supervisor.

Office of Management and Budget Circular A-123, Appendix A

The Department continues to strengthen and improve the execution of the Treasury mission through the application of sound internal controls over financial reporting. In response to Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, Appendix A, *Internal Control over Financial Reporting*, Treasury developed and implemented an extensive annual testing and assessment methodology that identified and documented internal controls over financial reporting at the transaction level integrated with the Government Accountability Office's *Standards for Internal Control*. The testing and assessment were completed across all material Treasury bureaus and offices by June 30, 2010. Treasury provides qualified assurance that internal controls over financial reporting are effective as of June 30, 2010, due in large part to the unpaid assessment weakness (remaining portions of the financial accounting of revenue - custodial weaknesses) at the Internal Revenue Service (IRS).

Audit Follow-Up

During fiscal year 2010, Treasury continued its efforts to improve both the general administration of management control issues throughout the Department and the timeliness of the resolution of all findings and recommendations identified by the Office of the Inspector General (OIG), the Treasury Inspector General for Tax Administration (TIGTA), the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), the Government Accountability Office (GAO), and external auditors.

Treasury management at every level will maintain the momentum on accomplishing planned corrective actions (PCAs) to resolve and implement sound solutions for all audit recommendations. Treasury has made considerable progress by focusing on achieving a high rate of timely implementation of planned corrective actions (PCAs). In fiscal year 2010, Treasury's offices and bureaus completed 88.4 percent of PCAs on time or early.

Federal Financial Management Improvement Act (FFMIA)

The *Federal Financial Management Improvement Act* (FFMIA) of 1996 mandates that agencies "... implement and maintain financial management systems that comply substantially with federal financial management systems requirements, applicable federal accounting standards, and the United States Government Standard General Ledger at the transaction level." FFMIA also requires that remediation plans be developed for any entity that is unable to report substantial compliance with these requirements.

During fiscal year 2010, the Department issued revised FFMIA guidance and procedures based on federal guidance issued by the Office of Management and Budget (OMB). OMB requires agencies to use a risk-based approach to assess their financial management systems' compliance with FFMIA. In compliance with the revised guidance, Treasury's bureaus and offices conducted a self-assessment to determine their risk level.

With the exception of the Internal Revenue Service (IRS), all Treasury bureaus and offices are in compliance with FFMIA. As required, the IRS has a remediation plan in place to correct the identified deficiencies. For each identified deficiency, the remediation plan provides specific remedies, target dates, responsible officials, and estimated resources required to correct the deficiencies. This plan is reviewed and updated quarterly. (Refer to Appendix D for detailed information.)

Financial Management Systems Framework

The Department's overall financial management systems framework consists of a Treasury-wide financial data warehouse, supported by a financial reporting tool, and separate bureau core financial systems. Bureaus submit their monthly financial data to the data warehouse within three business days of the month-end. The Department then produces monthly financial statements and reports for management analysis. This framework satisfies both the bureaus' diverse financial operational and reporting needs, as well as the Department's internal and external reporting requirements. The financial data warehouse is part of the overarching Treasury-wide Financial Analysis and Reporting System (FARS), which also includes applications for the bureaus to report the status of their planned audit corrective actions. In addition to the existing FARS applications, the Department is reviewing existing government owned and operated systems for the implementation of a Department-wide fleet management information system, which would streamline and enhance management controls and reporting and improve fleet management planning and decision making.

Treasury's FARS applications operate at a contractor operated hosting facility. In accordance with the guidance contained in the American Institute of Certified Public Accountants' Statement of Auditing Standards (SAS) No. 70, *Service Organizations*, the service provider's independent auditors examined the controls for the dedicated hosting service. In the opinion of the auditors, the description of the controls presents fairly, in all material respects, the relevant aspects of the provider's controls that had been placed in operation as of September 30, 2010.

Fourteen Treasury bureaus and offices use the financial operations services and systems support from the Bureau of the Public Debt's Administrative Resource Center. Utilizing these services reduces the need for Treasury to maintain duplicative financial management systems; enhances the quality, timeliness, and accuracy of financial management processes; and achieves a more efficient and cost-effective business model. Treasury continues to work with the bureaus to evaluate plans for continuous improvement to their financial management systems structure.