

PART 1:

**Management's
Discussion
and Analysis**



INTRODUCTION

In fiscal year 2011, Treasury continued to implement the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (Dodd-Frank Act), wind down emergency financial stabilization programs that began in 2008 and 2009 in the wake of the financial crisis, and promote a better environment for investment and job creation.

Pursuant to the Dodd-Frank Act, Treasury established the Consumer Financial Protection Bureau (CFPB), the Financial Stability Oversight Council (FSOC), the Federal Insurance Office (FIO), and the Office of Financial Research (OFR); accomplished the closure of the Office of Thrift Supervision (OTS) and the integration of many of its functions into the Office of the Comptroller of the Currency (OCC); and worked with other government agencies to develop new market regulations and guidance. Over the past year, Treasury has worked tirelessly with the new regulatory bodies and other agencies to strengthen safeguards for consumers and investors and to provide better tools for limiting risk in major financial institutions and financial markets.

Treasury achieved several major milestones during the third year of the Troubled Asset Relief Program (TARP). The program's banking investments have resulted in a positive return for taxpayers, and more than three-quarters of the overall funds disbursed for TARP have been recovered. In 2011, Treasury began selling its mortgage-backed security portfolio acquired under the *Housing and Economic Recovery Act*. Although the housing market continues to face challenges, TARP's initiatives to assist struggling homeowners have provided more than 800,000 families with permanent mortgage modifications. Furthermore, Hardest Hit Fund initiatives have equipped states with the ability to tailor solutions to their unique housing challenges.

In September 2010, President Obama signed the *Small Business Jobs Act* into law to provide critical resources to help small businesses continue to drive economic recovery and create jobs. Treasury played an important role in implementing the law by initiating two programs that increase capital to small businesses: the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI). In fiscal year 2011, Treasury approved \$4

billion in funds for community banks and community development loan funds to increase lending to small businesses through the SBLF. In that same time, SSBCI disbursed \$474 million in funds that are expected to leverage approximately \$4.7 billion in new small business lending.

In fiscal year 2011, the Internal Revenue Service (IRS) received a record of more than 100 million electronic individual tax returns in a single season as a result of its electronic filing programs. The IRS also continued to increase the amount of tax information and services provided to taxpayers through IRS.gov, and received a "Best of the Web" award for performance and quality.

Treasury's financial intelligence and enforcement activities had a significant impact in combating money laundering and terrorist financing in 2011. In response to recent unrest in the Middle East and North Africa, the Department tracked the assets of regimes that violently suppressed protestors and imposed sanctions on the Syrian and Libyan governments for human rights violations. Treasury also collaborated with U.S. and Mexican counterparts to step up efforts to expose and disrupt Mexican cartels and their money laundering networks. In addition to these efforts, Treasury worked with its law enforcement and intelligence community partners to administer new sanction programs addressing Iran, North Korea, Syria, Afghanistan, Somalia, and transnational organized crime groups.

Finally, Treasury continued to take steps to reduce costs to taxpayers and operate the Department efficiently. In fiscal year 2011, the Bureau of the Public Debt ended the sale of paper payroll savings bonds and announced that the issuance of paper savings bonds sold over-the-counter at financial institutions would end by December 31, 2011. These actions, combined with other continuing efforts to increase electronic transactions, are projected to create savings of more than \$500 million and 12 million pounds of paper over the next five years. In December 2010, Treasury published a regulation requiring all businesses with a deposit liability of \$2,500 per quarter to pay taxes electronically through the Electronic Federal Tax Payment System. This initiative will eliminate the processing of approximately 20 million paper coupons annually, and will result in fewer processing errors that could result in erroneous fines or penalties for taxpayers.

ORGANIZATION

The Department of the Treasury is the executive agency responsible for promoting economic prosperity and ensuring the financial security of the United States. The Department is organized into the Departmental Offices, eight operating bureaus, and three inspectors general. The Departmental Offices are primarily responsible for policy formulation, while the bureaus are primarily the operating units of the organization.

DEPARTMENTAL OFFICES

Domestic Finance advises and assists in areas of domestic finance, banking, and other related economic matters. In addition, this office develops policies and guidance for Treasury Department responsibilities in the areas of financial institutions, federal debt finance, financial regulation, capital markets, financial management, fiscal policy, and cash management decisions. OFR and FIO, created under the Dodd-Frank Act, reside within Domestic Finance, as does the Office of Financial Stability, which is responsible for overseeing TARP programs.

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 has direct oversight over the U.S. Mint and the Bureau of Engraving and Printing, and is a key liaison with the Federal Reserve. In addition, the Treasurer serves as a senior advisor to the Secretary in the areas of community development and public engagement.

Community Development Financial Institutions (CDFI) Fund increases economic opportunity and promotes community development investments for underserved populations and in distressed communities in the United States.

Other Offices

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

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

BUREAUS

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

The Alcohol and Tobacco Tax and Trade Bureau (TTB) collects federal excise taxes on alcohol, tobacco, firearms, and ammunition and assures compliance with tobacco permitting and alcohol permitting, labeling, and marketing requirements to protect consumers.

The Bureau of Engraving and Printing (BEP) designs and manufactures high quality currency 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 administrative 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 most of the nation's gold and all of its silver.

The Office of the Comptroller of the Currency (OCC) charters, regulates, and supervises national banks and federal savings associations 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) chartered, examined, supervised, and regulated 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. OTS was closed on July 21, 2011, and its responsibilities were distributed to a number of other regulatory bodies, including OCC, FDIC, and the Federal Reserve.

THE DEPARTMENT OF THE TREASURY ORGANIZATIONAL CHART



TREASURY’S FISCAL YEARS 2007-2012 STRATEGIC FRAMEWORK

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

	Strategic Goals	Strategic Objectives	Outcomes
Financial	Goal 1: Effectively Managed U.S. Government Finances	Cash Resources are available to operate the government	<ul style="list-style-type: none"> • Revenue collected when due through a fair and uniform application of the law • 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	Goal 2: U.S. and World Economies Perform at Full Economic Potential	<p>Improved economic opportunity, mobility and security with robust, real, sustainable economic growth at home and abroad</p> <p>Trust and Confidence in U.S. currency worldwide</p>	<ul style="list-style-type: none"> • Strong U.S. economic competitiveness • Competitive capital markets • Free trade and investment • Prevented and mitigated financial and economic crises • Decreased gap in global standard of living • Commerce enabled through safe, secure U.S. notes and coins
Security	Goal 3: 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	<ul style="list-style-type: none"> • Removed or reduced threats to national security from terrorism, proliferation of weapons of mass destruction, drug 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 system
Management	Goal 4: Management and Organizational Excellence	Enabled and Effective Treasury Department	<ul style="list-style-type: none"> • A citizen-centered, results-oriented and strategically aligned organization • Exceptional accountability and transparency

TREASURY'S FISCAL YEAR 2010-2011 PRIORITY PERFORMANCE GOALS

In 2010, the Department established three Agency Priority goals to support improvements in near-term outcomes related to the strategic plan. Treasury made significant progress on these goals in 2011.

GOAL #1: REPAIR AND REFORM THE FINANCIAL SYSTEM

KEY STRATEGIES:

- Implement strong, comprehensive regulatory reform
- Restore stability and accountability to the financial system
- Manage and exit emergency financial crisis intervention programs
- Support recovery in the housing market and reduce avoidable foreclosures
- Devise long-term, solutions for our nation's system of housing finance

In fiscal year 2011, the Department coordinated with the appropriate regulators to implement additional protections passed in the Dodd-Frank Act, including writing new rules that create heightened standards for non-bank financial firms if their material financial distress could threaten financial stability; improve alignment of interests between mortgage originators, securitizers, and investors; and restrict banks' speculative activity.

The financial recovery bank programs under the investment portion of the TARP have provided a substantial positive return to the taxpayer. Moving forward, Treasury is working to exit the remaining investments and continue recovering tax payer dollars. Figure 1 depicts the income received from the TARP investments since June 2009.

In February 2011, Treasury delivered a report to Congress that provides a path forward for reforming America's housing finance market. The Administration's plan would wind down Fannie Mae and Freddie Mac and shrink the government's current footprint in housing finance on a responsible timeline. The plan also recommended reforms to continue fixing the fundamental flaws in the mortgage market through stronger consumer protection, increased transparency for

investors, improved underwriting standards, and other critical measures.

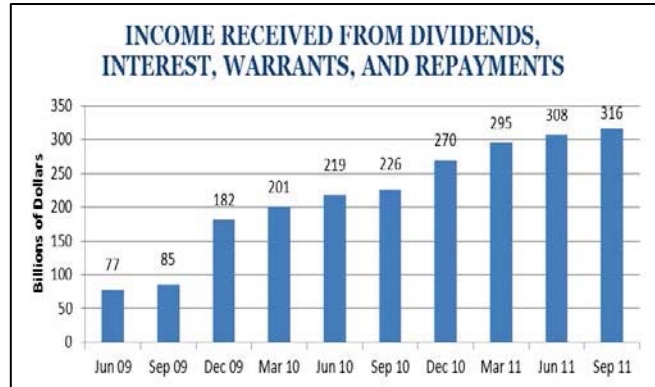


Figure 1

GOAL #2: INCREASE VOLUNTARY TAX COMPLIANCE

KEY STRATEGIES:

- Simplify the tax code by providing and improving taxpayer services to enable taxpayers to understand and meet their tax obligations
- Provide and improve enforcement to ensure that all businesses and individuals pay the tax they owe

A voluntary compliance tax system requires effective services so that taxpayers understand and meet their tax obligations. It also requires effective enforcement to ensure that all businesses and individuals pay the tax that they owe. During fiscal year 2011, the IRS continued to develop and improve on products and services such as updating forms to help taxpayers comply with filing requirements, converting forms for visually impaired taxpayers, translating more tax products into multilingual forms, reducing taxpayer telephone wait time, expanding information on IRS.gov and social media sites, and working with banks so that taxpayers without bank accounts could receive refunds on prepaid debit cards in the 2011 filing season.

In the 2011 filing season, the IRS processed more than 100 million individual tax returns electronically and completed 76.5 million phone calls through its live assistants and automated prompts and partnered with state taxing authorities, volunteer groups, and other organizations to

enhance taxpayer outreach and education. The IRS and its partners continued to provide free tax assistance to the elderly, disabled, and limited English proficient individuals and families at Volunteer Income Tax Assistance and Tax Counseling for the Elderly sites. These two programs, along with the IRS walk-in sites at the Taxpayer Assistance Centers (TACs), helped more than five million taxpayers complete their tax returns.

IRS enforcement activities, such as examination and collection, continued to remain a high priority. The IRS also expanded its enforcement presence in the international field, continued to pursue high net-worth noncompliant taxpayers, and initiated action to better leverage the tax return preparer community. During fiscal year 2011, as part of an overall strategy to improve offshore compliance, the IRS opened a second Offshore Voluntary Disclosure Program to encourage taxpayers with hidden offshore assets and income to voluntarily disclose. The program resulted in approximately 30,000 voluntary disclosures and resulted in approximately \$2.2 billion in additional tax, interest, and penalties.

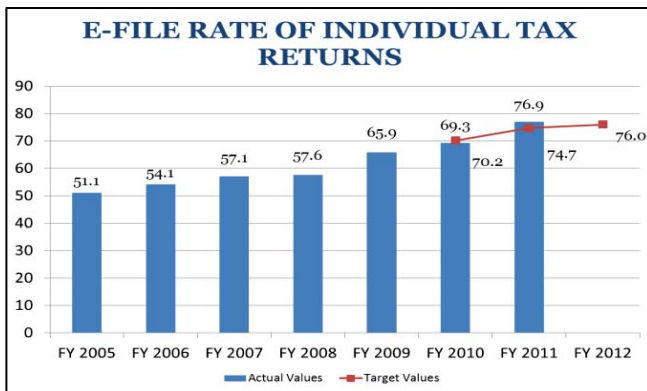


Figure 2

GOAL #3: SIGNIFICANTLY INCREASE THE NUMBER OF PAPERLESS TRANSACTIONS WITH THE PUBLIC

KEY STRATEGIES:

- Improve effectiveness and efficiency through greater use of electronic processing of documents including payments, collections, saving bonds transactions, and e-file tax returns
- Contribute to the Department’s environmental sustainability

Recognizing that paper processes are often slow, inaccurate, expensive, and wasteful, Treasury continues to reduce paper transactions with the public. The Secretary approved several initiatives to move toward electronic transactions: electronic payroll savings bonds, electronic payments to federal beneficiaries, and electronic tax collections. Treasury’s initiative to increase the number of paperless transactions it conducts with the public is expected to save more than \$500 million and 12 million pounds of paper over its first five years alone. These efforts also contribute to the Department’s environmental sustainability.

In fiscal year 2011, Treasury implemented many of the planned changes to reduce paper-based transactions. Treasury ended the issuance of all paper payroll savings bonds in January 2011, and announced that the issuance of paper savings bonds sold over-the-counter at financial institutions would end by December 31, 2011. In 2011, the IRS expanded its electronic filing program to allow businesses to pay taxes electronically. The Department also made progress moving to electronic payments, by requiring all new recipients of benefit payments to receive their payments electronically starting May 1, 2011. Treasury will continue to make progress toward electronic transactions and find opportunities to reduce costs, improve efficiency, and operate sustainably.

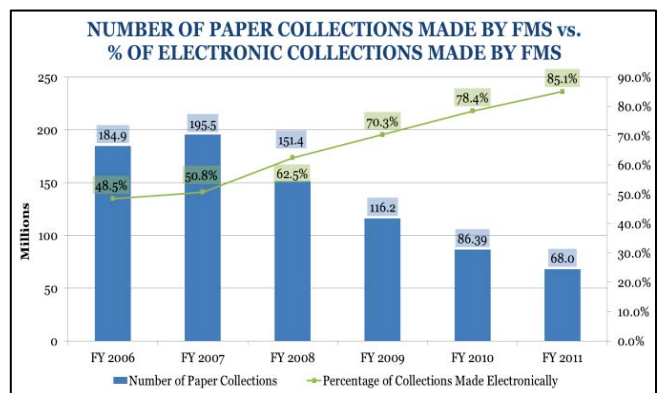


Figure 3

FISCAL YEAR 2011 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. Sound financial management practices allow the government to meet its financial obligations while minimizing borrowing costs. In pursuit of its strategic goal, Treasury led the Administration's efforts to create a tax system that is simpler, fairer, and more robust. Additionally, the Department continued initiatives to improve efficiency and lower the cost of operating the Federal Government.

DEVELOPED COMPREHENSIVE TAX PROPOSALS TO SIMPLIFY THE TAX CODE

The Department accomplished its fiscal year 2011 tax reform and simplification objectives through the legislative, regulatory, and policy efforts of the Office of Tax Policy. In 2011, Treasury released guidance on over a dozen tax provisions of the *Affordable Care Act* (ACA), including tax credits, revenue provisions, and (in collaboration with the Departments of Health and Human Services (HHS) and Labor) insurance market reforms incorporated into the Tax Code. One of the more significant projects was a proposed regulation on the refundable premium tax credit created by Code Sec. 36B, which is a centerpiece of the ACA's goal of expanding health insurance coverage. The ACA will continue to be a heavy focus in fiscal years 2012 and 2013, including the release of additional guidance to implement the ACA's core coverage provisions.

SIMPLIFIED TAX ADMINISTRATION

To enforce the law and ensure everyone meets his or her obligation to pay taxes, the IRS strives to improve its products and services to make voluntary compliance easier. In fiscal year 2011, the IRS expanded the number of automated products and services to increase tax compliance, simplify tax administration, and reduce taxpayer burden to include:

- An Interactive Tax Law Assistant (ITA) application on IRS.gov. ITA is an interactive online probe and response tool that, through a series of interview questions, provides users with answers to frequently asked questions
- Expanded transcript capability providing taxpayers with three easy and convenient options for getting copies of their tax return information, by phone, by mail, or online through a new web application on IRS.gov. Over 1.96 million taxpayers ordered transcripts in fiscal year 2011. In addition to this, the IRS Expanded e-signature pilots that allow taxpayers to use electronic signature pads and tablets instead of ink signatures for e-file, reporting agent authorizations, and requests for tax return transcripts
- Expanded Paper Check Conversion to all 401 TACs, allowing paper checks to be converted to electronic transactions. The conversion improves the payment process expediting resolution to taxpayer account issues. In fiscal year 2011, 3.6 million remittances were processed for more than \$7.8 billion
- Collaborated with US Bank (the Health Coverage Tax Credit (HCTC) check payment processing vendor) to launch the HCTC e-Payment Processing System to provide taxpayers the ability to make their payments electronically

The IRS electronic filing program is one of the most successful modernization programs in government, offering an efficient and secure way for taxpayers to file more accurate returns and get their refunds more quickly. In fiscal year 2011, the IRS received more than 100 million electronic individual tax returns in a single filing season and passed the one billion mark for individual tax returns processed since the program began in 1986. The IRS also met its performance targets for both individual and business returns processed electronically.

The IRS continued efforts to improve the clarity, accuracy, and effectiveness of correspondence sent to taxpayers who have account issues. In fiscal year 2011, the IRS had 104

redesigned/new notices in production along with corresponding webpage information to reinforce the notice, answer common questions, and provide tips to help taxpayers meet their tax obligations. The revised correspondence includes collection notices in plain language to help taxpayers more clearly understand the collection process and available payment options. For high-volume notices, the IRS included links for translation of the notice into five languages (Spanish, Chinese, Korean, Vietnamese, and Russian). The redesigned notices represent 72 percent in volume of more than 220 million notices sent each year. In recognition of this redesign work, the IRS received the 2011 grand prize ClearMark award from the Center for Plain Language, which honors the documents and websites that best succeed in clear communication.

The IRS increased the use of communications with taxpayers who may not get their information from traditional sources, such as newspapers and broadcast and cable news. By employing social media such as YouTube, Twitter, and iTunes, the IRS reaches these taxpayers with important service and compliance messages. In January 2011, the IRS unveiled IRS2Go, its first smartphone application that lets taxpayers check the status of their tax refunds, subscribe to tax season updates, and follow IRS news through a Twitter feed. There were more than 360,000 downloads of IRS2Go since January 2011. Communicating using these new technologies reflects the IRS commitment to modernizing the agency and engaging taxpayers where and when they want and increasing their rate of self-assistance. Ultimately, providing more self-assistance methods to customers will also reduce demand on more expensive customer services, such as staffing IRS phones and correspondence.

In concert with the greater use of self-assistance methods of information, the IRS answered almost 2.5 million fewer assistor calls in fiscal year 2011 compared to fiscal year 2010. However, in the past couple of years, the IRS has faced unprecedented demand for toll-free services as a result of the economic downturn, new legislation, and other events.

PRACTICED EFFECTIVE CASH MANAGEMENT AND FORECASTING

The Department of the Treasury manages the Government's central operating account and cash position to support gross

annual transactions totaling \$23 trillion. The Department's Office of Fiscal Projections (OFP) provides forecasts of federal receipts, outlays, and debt transactions to ensure that funds are available on a daily basis to cover federal payments. By increasing the accuracy of fiscal projections, the Department is able to minimize borrowing costs, which has a direct and material impact on the government's net operating cost.

To analyze the effectiveness of the cash management techniques employed, the Department measures the variance between actual and projected receipts. Notwithstanding economic uncertainties and legislative changes, the forecasts for fiscal year 2011 were better than those for fiscal year 2010. The estimated variance for fiscal year 2011 was 4.5 percent, lower than the 5.0 percent target for fiscal year 2011 and the 5.8 percent actual variance in fiscal year 2010. Fiscal year 2011 was a challenging year to forecast due to legislative changes and lingering uncertainty concerning the pace of the economic recovery.

The economic downturn and subsequent recovery in fiscal years 2010 and 2011, along with the government's policy response to these events, had a significant impact on federal revenues and on the ability to forecast federal tax receipts. Key economic factors such as Gross Domestic Product (GDP) and employment did not improve as much as expected. However, final individual tax payments in April came in well above forecast, as liability for tax year 2010 was much greater than expected. Estimates of corporate profitability and the impact of corporate tax legislation made corporate tax receipts difficult to forecast.

IMPROVED GOVERNMENT-WIDE FINANCIAL MANAGEMENT

Following the June 2010 Presidential Memorandum "Enhancing Payment Accuracy Through a "Do Not Pay List", BPD, the Office of Fiscal Policy, and the Office of Management and Budget are collaborating to implement this initiative. Now branded the GOVerify Business Center, this project will include the GOVerify Portal, Business Center, and Customer Call Center. In fiscal year 2011, BPD established agreements with select Federal Reserve Banks to help implement the program, conducted customer outreach,

obtained five data sources, and proposed legislative changes in support of the GOVerify Portal.

The Office of Financial Innovation and Transformation (OFIT) was created to develop and share government-wide financial solutions to lower overall financial transaction processing costs, facilitate the resolution of audit issues, and increase transparency of financial information. In OFIT's first year of operation, the team identified key initiatives that could be implemented over the next five years to collectively deliver \$1-2 billion in annual savings upon full adoption by the Federal Government. OFIT developed an approach that will move these initiatives forward by pursuing a three pronged financial management strategy that deploys common technology solutions, expands the use of shared transactional service, and launches key enablers.

OFIT developed, in cooperation with other federal entities and FMS, business cases and project plans to launch two of the twelve key initiatives, including a portal for the electronic submission of vendor invoices and an automated way to settle intra-governmental transaction disputes. Additionally, OFIT developed data standards to support electronic invoicing. The adoption of electronic invoicing capabilities across the Federal government will reduce the cost by as much as 50 percent or \$450 million annually.

MOVING FORWARD

The IRS will continue to take actions to increase the rate of electronic filing of tax returns by individuals and businesses. While providing alternatives to telephone customer service will continue to be a high priority, the IRS will continue to properly staff all toll-free sites in order to achieve future level of service targets and ensure effective taxpayer communication.

Treasury anticipates that forecasting government receipts and outlays in fiscal year 2012 will continue to be challenging given potential changes legislative changes by Congress and the difficulty in forecasting the strength of the economy. As part of its effort to continually improve its forecasts, the Department will work to update and modify existing models and monitor new initiatives.

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

The Treasury Department develops, coordinates, and enforces the economic and financial policies that enable sustained development at home and abroad. In fiscal year 2011, Treasury programs to help strengthen and reform the financial system made substantial progress. TARP's bank programs have provided a substantial positive return to the taxpayer. Treasury also continued to work in cooperation with the Federal Housing Finance Agency (FHFA) to support the housing market and protect the taxpayers' investment in the Government Sponsored Enterprises (GSEs).

The Department also focused on spurring economic growth for local communities and American small businesses through initiatives designed to provide funding for projects that would encourage job creation and further investment. Achieving domestic goals is not possible without coordination with our international partners. On the global stage, Treasury collaborated with key partners to ensure American economic competitiveness and prosperity through stabilization of financial systems abroad and support of open trade and investment policies.

PROFITABLY MANAGED THE TROUBLED ASSET RELIEF PROGRAM

In the fall of 2008, the nation was in the midst of the worst financial crisis since the Great Depression. The U.S. financial system and economy were on the verge of catastrophic collapse. The *Emergency Economic Stabilization Act of 2008* was enacted into law to create TARP, under which the Department of the Treasury took a variety of actions to stabilize the financial system and prevent a possible second Great Depression. The authority to make new commitments to invest funds under TARP expired on October 3, 2010. Treasury is moving quickly to recover the Federal Government's investments in a manner consistent with the duty to promote financial stability and protect taxpayers' interests.

Several major developments occurred in fiscal year 2011. On March 30, Treasury announced that TARP's bank programs officially turned a profit. Moving forward, Treasury is working to exit the remaining investments and continue

recovering taxpayer dollars. Ultimately, Treasury expects that TARP's bank programs will produce a lifetime profit of more than \$20 billion. In May 2011, Chrysler repaid the remainder of its TARP loans, a full six years ahead of schedule. Treasury has now exited from its investment with Chrysler at a smaller loss than initially expected.

Additionally, the American International Group (AIG) completed a major restructuring plan, marking a major milestone in the company's remarkable turnaround and putting taxpayers in a better position to recover their investment in AIG.

As of September 30, 2011, TARP has a total estimated cost of \$70.2 billion, a fraction of the original \$700 billion amount originally authorized by Congress. Most of the program's expected costs result from assistance provided to struggling homeowners and the automobile industry.

WORKED TO STABILIZE THE HOUSING MARKET

In the face of the worst housing crisis in a generation, Treasury played an important role in the government's programs to prevent avoidable foreclosures and support the continued repair of the housing market in fiscal year 2011.

Under Treasury's Home Affordable Modification Program (HAMP), one of several critical homeownership assistance programs under the [Making Home Affordable](#) initiative, over 800,000 families received permanent mortgage modifications. By setting affordability standard procedures and providing a framework for homeowner assistance that the private sector can follow, HAMP has also driven industry improvements that resulted in two million additional modifications outside the program. Treasury continues to refine and strengthen the Department's housing programs and is taking additional steps to help ensure Americans are better served by their mortgage companies. These steps include publishing a compliance [scorecard](#) for each of the 10 largest HAMP servicers and requiring all Making Home Affordable-participating servicers to assign a single point of contact to each homeowner requesting a HAMP modification.

Another key housing priority for the Department in fiscal year 2011 was comprehensive housing finance reform. In February, the Administration laid out a plan to wind down Fannie Mae and Freddie Mac and reform the nation's

housing finance system. In February 2011, the Treasury Department and the Department of Housing and Urban Development released a report, "Reforming America's Housing Finance Market," that offered a new framework for housing finance. The report reflected Treasury's view that private capital should provide the dominant share of mortgage credit, and Fannie Mae and Freddie Mac should be wound down commensurate with the health of the housing market and the economy. The report concluded that government should have three core responsibilities in the housing finance market: consumer protection and robust supervision, targeted assistance for low and medium income homeowners and renters, and maintaining the ability to provide market stability in the event of a crisis.

Treasury is also working with FHFA on new options for selling single-family real estate owned properties held by Fannie Mae and Freddie Mac, and the Federal Housing Administration, as well as changes to the Home Affordable Refinance Program (HARP) that would help allow more Americans to refinance their mortgages at today's historically low rates.

MANAGED SENIOR PREFERRED STOCK PURCHASE AGREEMENTS

The *Housing and Economic Recovery Act of 2008* (HERA) authorized the Department 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 is currently based on a formulaic cap that allows continued draws for three years ending December 2012 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, 2011 and 2010, the Department's gross

investment in Fannie Mae and Freddie Mac were \$169.0 billion and \$148.2 billion, respectively.

The U.S. Government's investment in and support of the GSEs through the SPSPAs was structured in such a way that ensures 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, for fiscal year 2011, while the GSEs had \$20.8 billion in gross draws, this was before accounting for \$15.6 billion in dividends paid back to Treasury, resulting in a net draw of \$5.2 billion. As of September 30, 2011 and 2010, the Department's net cost for financial support provided to the GSEs under the SPSPAs after accounting for those dividends were \$136.9 billion and \$131.7 billion, respectively.

Freddie Mac is projected to have positive net operating income starting in the fiscal year 2012 and Fannie Mae is project to have positive net operating income starting in fiscal year 2013. 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 assume modest price increases on the single family guarantee business implemented gradually over time after 2013. As noted above, liabilities for gross draws under the SPSPAs do not represent the true net cost to taxpayers – since they do not include dividends paid to taxpayers on the preferred shares.

IMPLEMENTED REGULATORY REFORM

Treasury helped to coordinate the rulemaking process to implement the comprehensive reforms to the financial system passed by Congress last year in the Dodd-Frank Act, including stronger protections for consumers and tougher limits on risk-taking by banks. These reforms will help make the financial system more secure and better protect the American taxpayer.

Under the Dodd-Frank Act, the Secretary of the Treasury has responsibility for standing up the CFPB and performing certain functions until a CFPB Director is in place. The CFPB was established on July 21, 2010, to make the market for consumer financial products and services work for American consumers, responsible providers, and the economy as a whole. The CFPB has rulemaking, supervisory, enforcement, and other authorities relating to consumer financial products and services. Many of these authorities transferred from seven other federal agencies to the CFPB on July 21, 2011.

Dodd-Frank also established the OFR within the Treasury Department to provide data and analysis to the FSOC and its member agencies. OFR is working to improve the quality and transparency of financial information, conduct and sponsor research related to financial stability, and promote best practices in risk management. In fiscal year 2011, the OFR focused on the initial implementation of its institutional infrastructure and on the initial delivery of data and research-related services to FSOC.

In its first year of operation, the FSOC met nine times. Throughout these meetings, the Council worked to establish its institutional framework, adopted rules of operation, released proposed regulations establishing procedures under the *Freedom of Information Act*, and adopted a transparency policy. Throughout the year, the Council drafted several studies and reports required by the Dodd-Frank Act. On January 18, 2011, the Council released studies on implementation of the Volcker Rule, concentration limits, the economic impact of Dodd-Frank, and risk retention requirements for asset-backed securities. On July 18, 2011, the Council released a report which outlined how various secured creditors are treated in existing resolution regimes and examined whether limiting the amount a secured creditor receives after a default would be an effective means of improving market discipline and protecting U.S. taxpayers.

The Dodd-Frank bill established the FIO within the Department of the Treasury. The FIO is tasked with monitoring the insurance industry for gaps in regulations, providing guidance and recommendations to FSOC regarding insurers which may pose a systemic risk to the insurance or financial systems, monitoring the extent to which underserved communities have access to affordable

insurance, consulting with state regulators on issues of national importance, and managing the Terrorism Risk Insurance Program (TRIP). The FIO also provided expert analysis on a number of studies relating to the implementation of Dodd-Frank, including the Volcker Rule and orderly liquidation authority rule writing. The FIO staff also participated in the FSOC insurance working group.

In fiscal year 2011, Treasury created the FIO Advisory Committee which will be tasked to provide expertise and guidance to the head of the FIO. Almost half of the committee's membership has been filled by state insurance regulators because of the importance of developing an understanding of how states regulate their insurance industries. The remaining spots on the committee are filled by industry experts in a wide range of specialties (casualty, life insurance, etc.), academics, and consumer advocates.

Title III of the Dodd-Frank Act was designed to streamline banking regulation and to decrease overlap between various regulators. In furtherance of this goal, the Act abolished the Office of Thrift Supervision (OTS) and dispersed its powers among a number of other regulatory bodies, most notably the OCC, FDIC, and Federal Reserve. On July 21, 2011, the OCC assumed responsibility for the supervision of 642 federal savings associations, as well as rulemaking authority for all savings associations. The OCC and OTS management teams worked closely together to ensure a smooth transition of these functions.

Treasury continued to coordinate with various regulatory agencies to improve accountability and transparency to protect borrowers, taxpayers, the housing finance market, and the broader economy. Treasury's priorities include instituting stronger mortgage underwriting standards, requiring risk retention throughout the securitization chain, and mandating higher capital standards for banks and financial institutions involved in housing finance.

SUCCESSFULLY MANAGED THE RECOVERY ACT

The Department of the Treasury played a pivotal role in implementing the Recovery Act in fiscal years 2009 and 2010. In fiscal year 2011, the Treasury managed the transition of most Recovery Act programs to the compliance, oversight, and monitoring phase. The Department estimated

that it managed programs that have or will contribute approximately \$150 billion in direct relief to the American people.

Treasury continued to manage several Recovery Act programs in fiscal year 2011, including several bond programs and grants in lieu of tax credit programs. Some of the programs expired on December 31, 2010, while others operate under authority that has continued.

Build America Bonds were taxable municipal bonds that provided special tax credits and federal subsidies for either the bond issuer or the bondholder. Through the life of the program until its expiration on December 31, 2010, Build America Bonds were an important source of financing to help state and local governments undertake much-needed infrastructure projects. State and local governments issued more than \$181 billion of Build America Bonds and saved billions of dollars in financing costs as a result of the program. Market reception for Build America Bonds was very positive; during the program, Build America Bonds constituted about 21 percent of the municipal bonds market. There was a total of 2,275 separate issues of Build America Bonds by local or state governments in all 50 states, the District of Columbia, and two territories.

The Recovery Act also provided the option for state housing credit agencies to receive cash payments instead of tax credits. This program also expired on December 31, 2010. Through the end of fiscal year 2011, 55 state housing agencies applied for funds, and \$5.6 billion in awards were made to those agencies. State agencies used these funds to finance 1,496 affordable housing projects that will add 86,230 units of affordable housing and create approximately 116,405 jobs.

The Recovery Act provided a total of \$22.4 billion in new issuing authority for Qualified School Construction Bonds (QSCBs), which provide federal tax credits to investors in school construction projects that are designed to cover 100 percent of the interest payments for the project. From 2009 through the end of fiscal year 2011, there were 943 issuances of QSCBs, raising approximately \$13.5 billion in financing.

The Recovery Act provided a maximum of \$3.2 billion for Qualified Energy Conservation Bonds, which provide a subsidy for energy conservation-oriented repair and

rehabilitation to public power providers, government bodies, and cooperative electric companies through a federal tax credit to investors which covers 70 percent of the interest on the bonds. The Treasury Department allocated this bond authority among the states pursuant to a population-based statutory formula for further local allocation and use for projects within the states.

In fiscal year 2011, \$2.4 billion was allocated for Clean Renewable Energy Bonds in the Recovery Act. Clean Renewable Energy Bonds provide a federal tax credit to investors of clean, renewable energy capital projects that cover 70 percent of the interest on the bonds. The Treasury Department allocated nearly \$3 billion of this bond authority to applicants for 818 projects.

Treasury provided awards to support investment in renewable energy projects under the Recovery Act Section 1603 program (extended for one year by Section 707 of the *Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010*). Through the end of fiscal year 2011, the Department awarded \$9.1 billion under the program to support nearly 20,500 projects. These projects are located in every state and the District of Columbia and have added over 13.6 gigawatts of renewable energy generation capacity in the United States.

ENABLED DOMESTIC ECONOMIC GROWTH

Supporting Distressed Communities

In fiscal year 2011, the CDFI Fund's core program awarded \$167.3 million in funding to 167 CDFIs to provide loans, investments, financial services, and technical assistance to underserved populations and low-income communities (LICs). The CDFI Program awardees provided funds for projects that created or maintained 25,199 jobs and leveraged \$1.5 billion in private investment. In addition, the Native American CDFI Assistance Program awarded \$11.85 million in financial and technical assistance to 35 Native CDFIs and other Native entities seeking to become or create Native CDFIs. The Bank Enterprise Award Program, which provides monetary awards to CDFIs and banks for increasing their investments in LICs, received 82 eligible applications requesting a total of approximately \$78 million.

The New Markets Tax Credit Program, which provides tax credit allocation authority to Community Development Entities for targeted investments in LICs, competitively awarded \$3.5 billion based on 2010 tax credit allocation authority. Allocatees estimate the funds will create 67,744 jobs, including 37,669 construction-related jobs. The Capital Magnet Fund (CMF) provided \$80 million in competitively awarded grants to 23 CDFIs and qualified nonprofit housing organizations serving 38 states. CMF awards can be used to finance affordable housing activities as well as related economic development activities and community service facilities.

Strengthening America's Small Businesses

Since the enactment of the *Small Business Jobs Act* on September 27, 2010, the SBLF has initiated and executed a billion-dollar national program. Overall, Treasury approved funding for 332 institutions totaling more than \$4.0 billion. All closings were completed by September 27, 2011.

The State Small Business Credit Initiative (SSBCI) was established in September 2010 to provide \$1.5 billion in federal funds to support state programs that provide financing to small businesses and small manufacturers. In fiscal year 2011, SSBCI received applications from eligible applicants from all 50 states, territories, and the District of Columbia. To date, 46 states and the District of Columbia have been approved for nearly \$1.3 billion in SSBCI funds that is expected to leverage almost \$13 billion in new small business lending.

ENCOURAGED INTERNATIONAL ECONOMIC GROWTH AND STABILITY

Promoting Free Trade and Investment

The Department works with other agencies to implement U.S. trade laws and policy, enforce international trade rules and agreements to reduce and eliminate foreign trade barriers, and to create jobs and protect U.S. companies and workers consistent with our international agreements. In fiscal year 2011, Treasury was involved in over 80 specific trade actions, including initiation of trade disputes, review of country eligibility for preference programs, intellectual property enforcement, and review of specific trade petitions and recommendations. Treasury is particularly engaged with other agencies in the implementation of trading rules as they

affect financial services, including ensuring that (1) regulations implementing the Dodd-Frank Act are consistent with U.S. international commitments and (2) other governments comply with trading rules where Treasury equities are involved.

Treasury initiated and continued efforts to resist trade and investment protectionism, in particular through continued monitoring of trade and investment measures through [the G-20 Standstill Declaration](#), where the heads of the 19 largest economies and the European Union (EU) agreed to avoid trade protectionism. Treasury also plays a central role in pursuing a level playing field through engagement with China on priority trade and investment issues, particularly through its leadership in the Strategic and Economic Dialogue. The Department has persistently urged China to move away from policies that distort international competition and disadvantage U.S. workers, firms, and investors as part of a broader effort to integrate China as an equal partner in the world economy.

Treasury also supported the Administration in completing the negotiations of amendments to the Korea-U.S. Free Trade Agreement, and in readying the free trade agreements with Columbia and Panama for Congressional approval.

Strengthening Global Economic Cooperation

At the G-20 Leaders' summit in Seoul in November 2010, it was recognized that insufficient progress was being made to rebalance global demand. Essentially, countries like the U.S., with large, persistent current account deficits needed to boost national saving and reorient their economies at the margin away from domestic consumption to greater exports, while countries with large current account surpluses, like China, Germany, and Japan, needed to do the opposite by boosting domestic demand to offset the loss of demand in deficit countries. Leaders agreed in Seoul to a process to assess the root causes of large and persistent imbalances and the impediments to rebalancing global demand.

In February 2011, the Finance Ministers of the G-20 agreed on the indicators by which the imbalances of all G-20 countries would be assessed (i.e., trade and current account imbalances, public and private sector debt ratios, and public and private sector saving ratios). By April, Finance Ministers

agreed on the statistical approaches, or indicative guidelines by which the indicators of each G-20 member country would be assessed. In the event, it was determined that seven countries warranted further in-depth assessments of the causes of their persistent imbalances and the appropriate policy responses. The assessments were completed in the fall of 2011 and the conclusions were a direct input to the development of an Action Plan for Leaders at the Cannes Summit, addressing both near-term vulnerabilities to the global economy and the rebalancing of global demand. Key commitments in the Action Plan were faster exchange rate liberalization and capital account convertibility by China, increased domestic demand relative to GDP by China, Germany, and Japan; and a more comprehensive plan from the EU on ways to address and contain sovereign debt and financial market stresses in Europe.

To further address global economic challenges, Secretary Geithner led the Economic Track of the annual Strategic and Economic Dialogue with China in May 2011. The meetings focused on addressing China's need to increase domestic consumption, strengthening cooperation on financial regulations and supervision, and reducing trade and investment barriers faced by U.S. firms and workers—all of which promote increased U.S. exports and jobs.

Leading International Efforts on Development and Food Security

In fiscal year 2011, the Department played a key role in negotiating landmark international financing agreements to replenish capital and increase funding for the [Multilateral Development Banks](#) (MDBs). These agreements included new commitments to better orient the MDBs' internal resources toward the poorest countries. As part of the general capital increase for the Inter-American Development Bank (IDB), Treasury secured a commitment to dedicate over \$2 billion of IDB income to grants for Haiti over the next decade. Treasury also secured landmark commitments on transparency and accountability across the MDBs. The World Bank's new disclosure policy represents a dramatic shift in how the institution approaches transparency and sets a standard for regional development banks and other multilateral institutions to follow.

The Department continued to work closely with the MDBs to ensure that they are engaged in regions and countries that are vital to U.S. interests. In the past year, the Department has been intensively engaged with MDBs to ensure a rapid and robust response to the historic changes associated with the Arab Spring. The mobilization of World Bank and African Development Bank resources and programming for Egypt, Tunisia, and elsewhere in the region demonstrated the tremendous and timely leverage and expertise that these institutions are able to provide.

Treasury also plays an important role in addressing global food insecurity through its leadership in the Global Agriculture and Food Security Program (GAFSP)—a multi-donor trust fund called for by G-20 leaders with the goal of helping accelerate progress towards halving the proportion of people living in extreme poverty and suffering from hunger by 2015. Treasury is currently the Chair of GAFSP’s Steering Committee.

To date, seven donors have pledged \$971 million to GAFSP. Of the \$971 million pledged, \$581 million has been received, and GAFSP has awarded \$481 million to 12 low-income countries in Africa, Asia, and Latin America. The \$481 million is expected to raise the incomes of 1.5 million direct beneficiaries (and six million indirect beneficiaries) and provide aggregate economic returns on the order of 20 percent. A results measurement framework has been approved to ensure timely reporting and monitoring during project implementation and following project completion.

Delivering Financial Technical Assistance to U.S. Foreign Policy Priority Countries

In fiscal year 2011, Treasury’s Office of Technical Assistance worked across five continents and delivered 115 separate technical assistance projects to 51 countries to help finance ministries and central banks of developing countries, such as Guatemala, Kenya, Paraguay, and Zambia, and recovering countries, such as Afghanistan, Haiti, and Iraq, strengthen their capacity to manage public finances. Treasury project assistance stimulates economic growth, builds institutional capacity of governments to establish and maintain stable and effective financial institutions, develops better policies and public services to serve citizens, provides a stronger basis for U.S. trade and commerce, enhances capacity to address

national and international financial crime, and fosters U.S. partnerships overseas to promote security and mutual economic interests.

IMPROVING CURRENCY AND COIN MANUFACTURING

In fiscal year 2011, the Bureau of Engraving and Printing (BEP) continued progress in developing tactile features that will enable the blind and visually impaired to denominate currency. Testing and refinement of various tactile features were conducted during the year to determine which processes and features work best at the production volumes needed for U.S. currency. BEP continued testing and development of counterfeit deterrent features for possible use in the Nation’s currency. BEP also worked closely with its currency paper supplier and the Federal Reserve Board to resolve a creasing problem in the redesigned \$100 note. BEP expects to resume production of the new notes in early fiscal year 2012. BEP also embarked on a multiyear effort to improve its currency quality assurance system and reduce spoilage.

In fiscal year 2011, the United States Mint took initial steps toward transforming coin production. For example, the Mint hired an independent contractor to conduct research for a Congressionally-mandated review of metallic materials, the largest portion of circulating production cost, for the nation’s circulating coins. In addition, the U.S. Mint undertook implementation of incremental manufacturing improvements to make operations more efficient as well as more environmentally sustainable. These sustainability efforts included the Denver Mint purchasing 100 percent of its electricity from renewable sources, the San Francisco Mint installing a “cool roof,” and the Washington, D.C. headquarters building obtaining Energy Star certification in fiscal year 2011.

MOVING FORWARD

Moving forward, Treasury continues to help implement comprehensive reforms to the financial system passed by Congress last year in the Dodd-Frank Act, including stronger protections for consumers and tougher limits on risk-taking by banks. Treasury is also coordinating with the appropriate regulators to implement additional protections passed in Dodd-Frank, including writing new rules that will subject non-bank financial firms to heightened standards if their material financial distress could threaten financial stability.

Treasury's other key priorities in this area include winding down government programs that were established to address the financial crisis, while ensuring policies and programs still necessary for financial and economic recovery are maintained and well executed; developing longer-term reforms for our nation's system of housing finance; and implementing new programs that will help small businesses access credit in order to grow and create jobs.

The Department will continue to pursue policies that will foster American prosperity at home and abroad. To achieve conditions that will enable domestic economic stability and growth, the Department plans to continue expanding access to capital for distressed markets and communities through the CDFI Fund, SBLF, and SSBCI. On the international stage, the Department will continue to advocate free trade and investment policies to stimulate new engines of growth for the global economy, particularly for U.S. exports, while ensuring enforcement of existing trade laws and policy to promote U.S. competitiveness and balanced, sustained economic development.

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

Treasury continued to play a unique role in preserving national security by leveraging financial intelligence, law enforcement, sanctions, regulatory, and diplomatic tools. Treasury's Office of Terrorism and Financial Intelligence (TFI) worked to keep U.S. and international financial systems accessible to legitimate users while also disrupting the financial networks of terrorists, drug traffickers, and weapons of mass destruction (WMD) proliferators. TFI includes the Office of Terrorist Financing and Financial Crimes (TFFC), the Office of Foreign Assets Control (OFAC), the Office of Intelligence Analysis (OIA), the Treasury Executive Office for Asset Forfeiture (TEOAF), and the Financial Crimes Enforcement Network (FinCEN).

DISRUPTED MONEY LAUNDERING EFFORTS AND DRUG TRAFFICKING IN MEXICO

In collaboration with U.S. and Mexican counterparts, TFI disrupted and exposed Mexican drug cartels and their money laundering networks using designations authorized by the *Foreign Narcotics Kingpin Designation Act* (Kingpin Act). TFI provided investigative training to Mexican law enforcement counterparts and expanded critical information sharing and collaborative investigative work between Mexican and U.S. law enforcement agencies. TFI's efforts enhanced the effectiveness of financial and asset forfeiture investigations in Mexico. Mexican law enforcement exposed, isolated, disrupted, and incapacitated drug traffickers' financial infrastructure and commercial operations.

In September 2010, the Mexican government limited the deposit and exchange of U.S. cash in Mexican banks to mitigate risks of laundering proceeds from narcotics trafficking and organized crime. FinCEN worked to identify whether Mexican cartels and associated criminal organizations employed other methods for laundering money in the financial system. As part of this effort, FinCEN expanded analysis of Bank Secrecy Act (BSA) and money transfer data and increased outreach to law enforcement and financial industry partners. In March 2011, FinCEN issued an advisory to law enforcement that outlined the potential methods to circumvent the cash restrictions and documented significant changes in U.S. dollar cash activity near the Southwest Border and in Mexico.

EMPLOYED SANCTIONS AND INTELLIGENCE ANALYSIS TO COMBAT ILLICIT FINANCE AND NATIONAL SECURITY THREATS

Throughout fiscal year 2011, TFI worked across a broad range of areas focusing on specific anti-money laundering/countering the financing of terrorism (AML/CFT) issues and illicit finance networks. TFI currently administers and enforces 33 major economic and trade sanctions programs based on U.S. foreign policy and national security goals. OFAC, under Executive Order 13382, continued to target individuals and entities facilitating Iranian proliferation activity. OFAC developed and increased the number and variety of sanction designations and property identifications in Iran related sanction programs. Treasury officials actively engaged foreign partners to encourage them to implement similar restrictions on Iran. Additionally, a fiscal year 2010 Executive Order enabled Treasury to target

sanctions on individuals and entities engaging with North Korea or North Korean entities in arms trafficking, procurement of luxury goods, and illicit finance activities.

Within the intelligence community, TFI worked to consolidate government-wide efforts to conduct counterterrorist financing intelligence research, which resulted in all-source, fused, coordinated intelligence products. In fiscal year 2011, OIA surged analytical resources to track regime assets in the Middle East, focusing on those regimes which violently suppressed protestors, such as Libya and Syria.

COLLECTED MAJOR ASSET FORFEITURES

The Treasury Forfeiture Fund, administered by TEOAF, collected \$868 million in forfeiture revenue during fiscal year 2011. The Fund's major forfeitures in fiscal year 2011 can be attributed to cases pursued by the IRS's Criminal Investigation (CI) division. Deutsche Bank forfeited \$404 million and paid an additional \$149 million penalty for running fraudulent tax shelters that allowed clients to avoid paying billions of dollars in U.S. taxes. Barclays Bank PLC agreed to forfeit \$149 million to the Department of Justice (DOJ) Assets Forfeiture Fund and \$149 million to the New York County District Attorney's Office for violations of the International Emergency Economic Powers Act (IEEPA) and the Trading with the Enemy Act (TWEA). The DOJ equitably shared \$74.5 million with the Fund for the IRS's contribution to the case.

SUPPORTED HEALTH CARE FRAUD CASES WITH BANK SECRECY ACT (BSA) DATA AND ANALYSIS

FinCEN worked closely with the DOJ and the HHS Health Care Fraud Prevention and Enforcement Action Team (HEAT) to identify complex large-scale fraud schemes. Through analysis of BSA data, FinCEN provided investigators and prosecutors with an overall health care fraud assessment of targeted geographic areas. FinCEN also identified sophisticated and complex criminal organizations and individuals participating in health care fraud. FinCEN identified and analyzed over 175,000 BSA records to support 67 cases from HHS-Office of the Inspector General field offices and to support several state level Medicaid Fraud Control Units. FinCEN contributed to over a dozen DOJ

cases, which resulted in a takedown of \$295 million of false Medicare billings.

SHARED INFORMATION ON HOUSING FRAUD ACTIVITIES

FinCEN continued its regulatory efforts to combat mortgage fraud, foreclosure rescue scams, and loan modification fraud. FinCEN issued a Notice of Proposed Rulemaking in November 2010 to require non-bank residential mortgage lenders and originators to implement anti-money laundering programs and report on suspicious activity. FinCEN also issued an advisory for financial institutions with examples of common commercial real estate fraud schemes. FinCEN published reports on commercial real estate financing fraud, mortgage loan fraud, and loan modification fraud based on analysis of suspicious activity reports (SARs). In addition, FinCEN studied suspicious activities which involve title and escrow companies to assess potential vulnerabilities in this industry. FinCEN also made publicly available online [datasets](#) on mortgage fraud hotspots on hundreds of previously unavailable geographies and historical filings, based on SAR data.

MOVING FORWARD

TFI will continue to combat illicit financial activity through a variety of means. TFFC will review mutual evaluations and offer training and other technical assistance to counterparts abroad to create effective AML/CFT frameworks. OIA will focus its analytical resources on transnational organized crime and its illicit finance networks. TEOAF will continue to target cases and investigations that result in high impact forfeitures. FinCEN will continue to coordinate and support federal, state, and local efforts to combat fraud.

MANAGEMENT AND ORGANIZATIONAL EXCELLENCE

The Department of the Treasury is committed achieving management and organizational excellence. The Department demonstrates prudent management of taxpayer resources through its paperless initiatives, information technology (IT) cloud and consolidation initiatives, procurement savings and high risk contracts reductions, environmental achievements, and other savings initiatives. In addition, Treasury strives to

achieve organizational excellence by improving Human Capital management and performance.

REDUCED PAPER PROCESSES

Treasury's major paperless initiatives include: paying benefits and collecting government receipts electronically and discontinuing paper savings bonds. These initiatives improve organizational efficiency, enhance customer service, and minimize the Federal Government's environmental impact.

Pay Benefits Electronically

As of May 1, 2011, newly enrolled federal beneficiaries and retirees were mandated to receive payments electronically. By March 1, 2013, existing beneficiaries and retirees who were receiving payment by check prior to May 1, 2011, will also be required to receive payments electronically. The increased use of electronic funds transfer to deliver federal payments will continue to improve service to payment recipients and reduce government program costs by minimizing the costs associated with postage and the re-issuance of lost or stolen checks. Consistent with this effort, the Financial Management Service (FMS) exceeded its target with 84 percent of payments being processed electronically in fiscal year 2011.

Collect Government Receipts Electronically

FMS encourages businesses and individuals to pay their taxes through the Electronic Federal Tax Payment System (EFTPS). To date, FMS has collected more than \$3.06 trillion, with 96 percent of those funds received electronically. Effective January 1, 2011, businesses with quarterly tax payments greater than \$2,500 that previously used paper Federal Tax Deposit (FTD) coupons must make deposits through EFTPS. This initiative eliminated the processing of approximately 20 million paper coupons annually. In fiscal year 2011, EFTPS processed nearly 130 million payments, an increase of over 19 percent in transaction volume, and a 2.9 percent increase in the tax revenue collected in comparison to totals from 2010. The new change also benefits taxpayers; IRS research showed that businesses using EFTPS are 31 times less likely to make an error that results in a fine or penalty than those who paid via coupon.

Another important program that promotes the use of electronic transactions to collect revenues needed to operate the Federal Government is Pay.gov, an innovative system that allows individuals and businesses to make non-tax payments to federal agencies over the internet. Pay.gov has been implemented with 160 federal agencies representing 770 cash flows, and collected over \$87 billion and processed over 76 million transactions in fiscal year 2011.

Eliminate New Issues of Paper Savings Bonds

In fiscal year 2011, the Bureau of the Public Debt (BPD) ended the sale of paper payroll savings bonds and announced it will stop issuing paper savings bonds sold over-the-counter at financial institutions by December 31, 2011. The web-based TreasuryDirect portal will become the primary retail system for investors to buy savings bonds and marketable securities and conduct business electronically. The initiative will produce savings on agent fees, postage, printing, and a reduction in the number of customer service transactions.

CONSOLIDATED IT SERVICES

Cloud Computing

In fiscal year 2011, Treasury worked to save on IT costs by switching from a traditional hosting environment to a cloud environment in which computing resources are accessed through shared resources. For example, the Department recently moved the Treasury.gov website and four other Treasury websites (SIGTARP.gov, MyMoney.gov, TIGTA.gov, and IRSOversightBoard.treasury.gov) to a cloud hosting environment, saving over 13 percent in monthly costs versus the legacy hosting solution. Finally, by moving to a cloud environment, BEP estimates it will save over 50 percent in operating and maintenance costs while also automating processes for manufacturing, financial management, acquisition, and supply chains.

Data Center Consolidation Initiative

Treasury is working to increase the utilization and efficiency of combined IT assets while reducing technology costs through its Data Center Consolidation Initiative. For example, under the Fiscal IT initiative, FMS and BPD are partnering to close three data centers by December 31, 2011, and are in the process of consolidating IT common services by September 30, 2012. The Fiscal IT consolidation will

reduce spending on energy consumption, equipment, hardware, software, personnel, and contractor support.

REALIZED PROCUREMENT SAVINGS AND REDUCED HIGH RISK CONTRACTS

Treasury has taken a multi-faceted approach to achieve procurement savings. In March 2011, Treasury consolidated its headquarters procurement organization with IRS procurement. The consolidation will provide greater economies of scale and deeper capabilities, including enhanced access to strategic sourcing, which is a collaborative and structured process of critically analyzing spending and using this information to make business decisions about acquiring commodities and services more effectively and efficiently. In addition to participating in government-wide efforts to leverage basic commodity buying, Treasury significantly advanced its Department-wide strategic sourcing program through commodity management initiatives led by senior managers. The Department exceeded its fiscal year 2011 goals for acquisition-related savings mandated by the Office of Management and Budget (OMB), and realized a 21 percent aggregate reduction in high risk contract obligations. Overall, in fiscal year 2011, Treasury achieved \$325.9 million in acquisition savings based on OMB's definitions.

ENVIRONMENTAL ACHIEVEMENTS

Treasury set a Department-wide priority to improve energy efficiency and reduce greenhouse gas emissions. In addition to the reduced energy and paper consumption from the paperless initiatives, Treasury saves energy by improving data center energy efficiency, completing energy efficiency upgrades, and increasing space utilization. Other examples include improved emission control over the currency printing process at BEP; implementing water reuse strategies at the Mint; and converting the water heating system from steam to electric at the Main Treasury complex.

IMPLEMENTED INTERNET PAYMENT PLATFORM

Treasury issued a mandate requiring all bureaus and offices to adopt the use of the Internet Payment Platform (IPP), a centralized web portal for vendors to submit invoices and request payments, by September 30, 2012. Treasury was only the second agency in the Federal Government to do this.

In fiscal year 2013, the Department will also require commercial vendors to submit their invoices using IPP. Adoption of IPP is projected to reduce the cost of entering invoices and responding to invoice inquiries by as much as 50 percent, which is estimated to save the Treasury \$7 million annually. IPP will eliminate the need to manually input, file, and store paper invoices; shift the responsibility for invoice entry to the vendor; and reduce the time required to answer payment status questions. Moreover, vendors who use IPP will collect quicker payments for their services, receive greater assurances that their invoices are received and processed accurately, and have immediate online access to their invoice status for all agencies using IPP. The IPP initiative is estimated to produce approximately \$450 million in government-wide savings annually.

MANAGED THE TREASURY FLEET

In fiscal year 2010, Treasury converted expiring commercial leased vehicle requirements for several of its bureaus to General Service Administration (GSA) leases, which include the cost of vehicle maintenance and fuel. This conversion saves \$1 million in rental cost per year. Similarly, in fiscal year 2011, Treasury saved approximately \$1.6 million in additional annual rental costs by converting expiring commercial leased vehicle requirements for 111 pick-up trucks from the IRS Fuel Compliance Program to GSA leases.

REDUCED REAL ESTATE PROPERTY COSTS

In response to the June 10, 2010, Presidential Memorandum on "Disposing of Unneeded Federal Real Estate," Treasury identified a \$20 million contribution towards the President's \$3 billion cost saving goal. For example, Treasury is consolidating warehouse requirements for leases expiring in fiscal year 2012 through fiscal year 2014 within the National Capital Region. Requirements for the Departmental Offices (DO), FMS, and IRS-CI will be moved to BEP's warehouse space to achieve about \$445,000 in annual rental cost savings.

STRENGTHENED ORGANIZATIONAL EXCELLENCE

Treasury seeks to create an organization with exemplary leadership; innovative and collaborative processes; sustainable operations; and a culture of excellence, integrity, and teamwork. Accordingly, Treasury continually strives to

improve Human Capital performance by focusing on hiring the best talent; respecting and engaging the workforce; expecting the best from employees; and striving to be the best place to work in the Federal Government.

In addition, during fiscal year 2011, the Department of the Treasury deployed resources to successfully stand up several new organizations, as provided by the Dodd-Frank Wall Street Reform and Consumer Protection Act. Treasury Human Resources (HR) staff quickly benchmarked other financial regulatory organizations, and worked in concert with program staff and the Office of Personnel Management to develop and establish interim hiring, classification, compensation, and benefits policies and systems for the new organizations. In addition, the HR staff began the recruitment and hiring to staff these new organizations, in order to meet the mandates of the new legislation.

MOVING FORWARD

In fiscal year 2012, Treasury will continue to work to achieve management and organizational excellence. Treasury will continue to reduce the amount of paper transactions with the public by encouraging federal beneficiaries to receive payments electronically, promote the purchase of bonds electronically via TreasuryDirect, and expand the use of IPP across the Department and throughout the Federal Government. In addition, FMS will continue to expand the use of electronic collection mechanisms that use the most advanced and secure collection technologies that are flexible enough to accommodate the varying needs and technical sophistication of all taxpayers and federal program agencies. Furthermore, Treasury will continue to pursue aggressive targets to save on procurement and real estate and improve energy efficiency and reduce greenhouse gas emissions. Finally, Treasury will work to improve organizational excellence by improving performance in Human Capital programs.

DEPARTMENT'S KEY PERFORMANCE MEASURES FOR 2011

The following table contains key performance metrics providing a representative overview of the Department's performance for 2011. 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	2011 Target	2011 Actual
Percentage Collected Electronically of Total Dollar Amount of Federal Government Receipts (%)	FMS	80.0	79.0	79.0	80.0	80.0	84.0	80.0	85.0	82.0	96.0
Percentage of Treasury Payments and Associated Information Made Electronically (%)	FMS	78.0	78.0	79.0	79.0	80.0	81.0	81.0	82.0	83.0	84.0
Customer Service Representative Level of Service (%)	IRS	82.0	82.1	82.0	52.8	70.0	70.0	71.0	74.0	71.0	70.1
Taxpayer Self-Assistance Rate	IRS	48.6	49.5	51.5	66.8	64.7	69.3	61.3	64.4	68.7	70.1
Percent of Business Returns Processed Electronically (%)	IRS	19.5	19.1	20.8	19.4	21.6	22.8	24.3	25.5	27.0	31.8
Percent of Individual Returns Processed Electronically (%)	IRS	57.0	57.1	61.8	57.6	64.0	65.9	70.2	69.3	74.0	76.9
Affordable Housing Units Created by CDFI Fund Programs	CDFI Fund	-	-	-	-	-	-	-	-	Baseline	19,083
Clean Audit Opinion on TARP Financial Statements	DO	-	-	-	-	Baseline	Met	Met	Met	Met	Met
OTA Scope and Intensity of Engagement (Traction)	DO	-	-	Baseline	3.6	3.6	3.7	3.6	3.5	3.6	3.7
Impact of TFI Programs and Activities	DO	-	-	-	-	Baseline	7.81	7.4	7.4	7.6	8.4*

Note: Performance measures were not audited.

*Estimated value.

On December 7, 2010, Treasury published a regulation that required businesses with an annual tax liability of at least \$10,000 to pay their taxes electronically. The new requirement, combined with FMS's efforts to transition taxpayers to electronic payments, resulted in FMS processing nearly 130 million payments electronically during fiscal year 2011. Accordingly, Treasury significantly exceeded its performance target on the measure: "Percentage collected electronically of total dollar amount of Federal government receipts." With continued emphasis on the All Electronic Treasury initiative, the percentage of funds collected via EFTPS will continue to grow.

In support of the All Electronic Treasury initiative, FMS also continued to expand and market the use of electronic funds transfer to deliver federal payments, improve service to payment recipients, and reduce government program costs. In fiscal year 2011, FMS made 84 percent of payments electronically, slightly exceeding its performance goal. FMS attributes the performance outcome to considerable success in implementing its nationwide "GO Direct" campaign to encourage current check recipients to switch to direct deposit.

In fiscal year 2011, the IRS achieved 70.1 percent on its metric, "Customer Service Representative Level of Service." The IRS attributes the slight performance shortfall to unexpectedly high telephone customer service demand. Moving forward, the IRS will staff telephone service as effectively as possible to meet anticipated telephone demand.

The IRS met its performance target and achieved a 70.1 percent "Taxpayer Self Assistance Rate," as a result of the increased popularity of IRS web-based applications. The self-assistance rate is expected to increase in future years as more taxpayers choose automated customer service methods over more traditional methods such as telephone and paper correspondence.

The IRS achieved an electronic-filing rate of 31.8 percent for business returns, exceeding its performance target by almost four percentage points. The IRS also exceeded the target on its electronic filing metric, "Percentage of Individual Returns Processed Electronically." Performance in this area continues to be driven by increased demand for the overall benefits of e-file, such as its accuracy; quick

acknowledgement of receipt; the ability to file amended, superseded, and prior year returns; and year-round filing capabilities.

In fiscal year 2011, the CDFI Fund collected baseline performance data on its revised measure, "Number of Affordable Housing Units Developed or Produced by CDFI Fund Programs." The CDFI Fund programs developed or produced 19,083 housing units across all programs, reflecting the impact of Recovery Act investments in 2011.

The Government Accountability Office (GAO) rendered an unqualified, clean audit opinion on OFS's financial statements for the third year in a row. OFS will continue to strive for accuracy and transparency in its financial statements so that TARP programs continue to receive clean audit opinions in the future.

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

TFI created a composite measure that consists of four overall focus areas related to its mission and strategic goals. TFI estimated that it exceeded its performance target on its composite measure, "Impact of TFI Programs and Activities." Note that the fiscal year 2011 outcome is an estimate as of the publication of this report because a customer service survey that contributes to the composite score has not been fully completed.

HIGHLIGHTS OF MANAGEMENT AND PERFORMANCE CHALLENGES

Annually, in accordance with the *Reports Consolidation Act of 2000*, OIG and TIGTA identify the most significant management and performance challenges facing the Department. These challenges do not necessarily indicate deficiencies in performance; rather, some represent inherent risks that must be monitored continuously. Treasury made much progress on these issues in fiscal year 2011, and will

continue to focus on resolving them during fiscal year 2012 and beyond. Refer to Appendix C, of Part 3, Other Accompanying Information, for a detailed discussion of these challenges, listed below.

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

TREASURY-WIDE MANAGEMENT CHALLENGES – AS IDENTIFIED BY OIG

- Transformation of Financial Regulation
- Management of Treasury’s Authorities Intended to Support and Improve the Economy
- Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement
- Management of Capital Investments

IRS MANAGEMENT CHALLENGES – AS IDENTIFIED BY TIGTA

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

FINANCIAL OVERVIEW

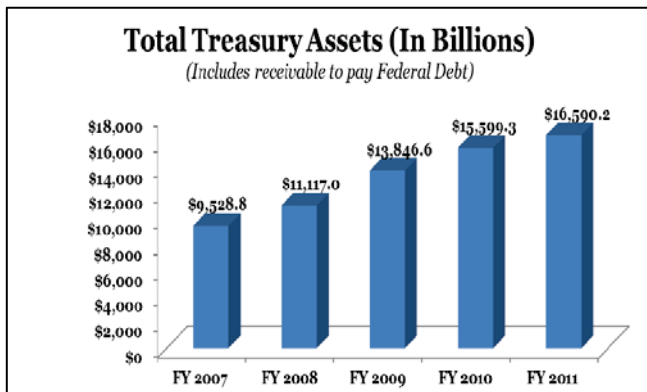


Figure 4

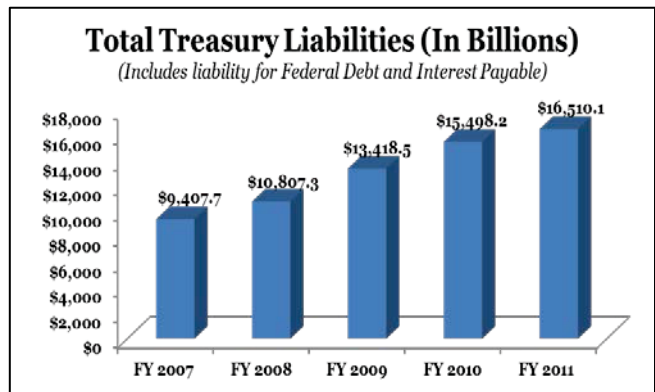


Figure 5

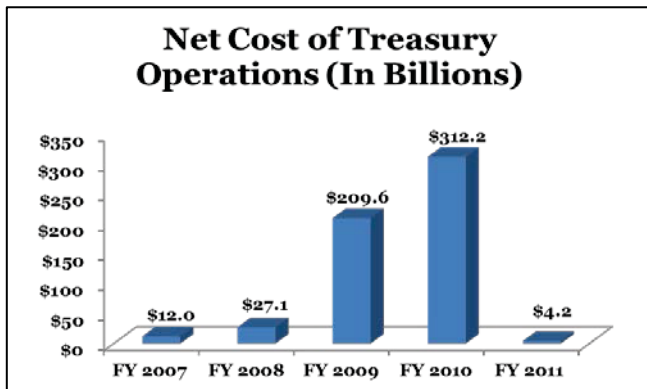


Figure 6

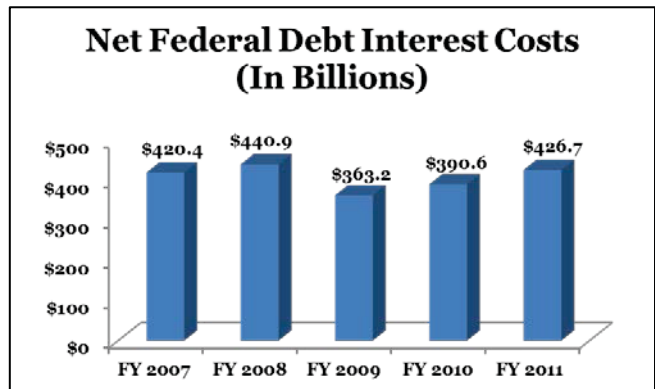


Figure 7

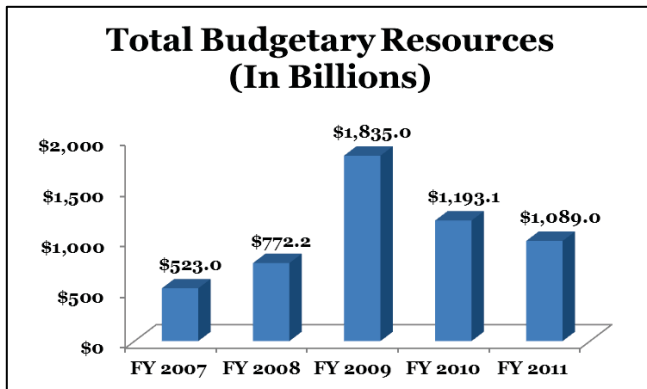


Figure 8

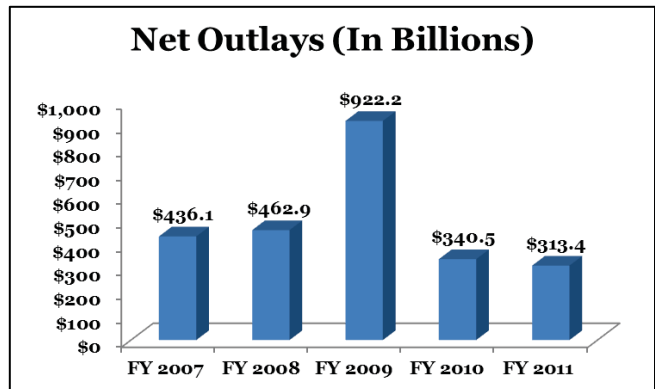


Figure 9

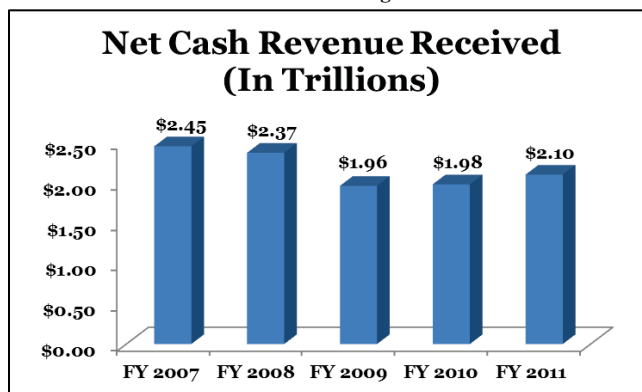


Figure 10

Total Assets. Total assets increased from \$15.6 trillion at September 30, 2010, to \$16.6 trillion at September 30, 2011 (Figure 4). The nearly \$1 trillion increase in 2011 is due to the rise in the federal debt, which causes a corresponding rise in the “Due from the General Fund of the U.S. Government” account (\$14.9 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. Included in “Intra-governmental” assets (Figure 11) are loans and interest receivable (\$728.7 billion in 2011), the majority of which are loans issued by the BPD to other federal agencies for their own use or to private sector borrowers, whose loans are guaranteed by the federal agencies.

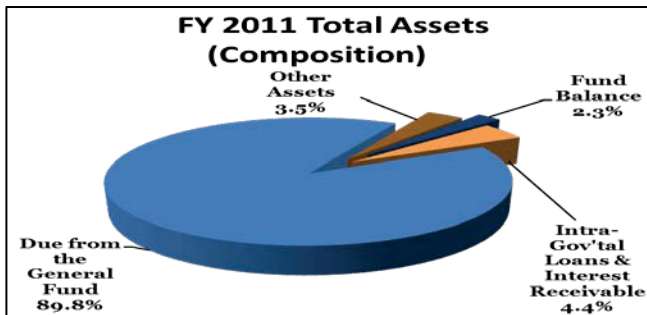


Figure 11

Total Liabilities. Liabilities principally include federal debt held by the public, including interest, of \$10.1 trillion which were mainly issued as Treasury Notes. Liabilities also include intra-governmental liabilities totaling \$6.0 trillion, of which \$4.7 trillion represents principal and interest payable to various federal agencies, such as the Social Security Administration Trust Fund (Figure 12). The \$1.0 trillion increase in total liabilities in fiscal year 2011 over 2010 (Figure 5) is the result of increased federal debt held by the public, including interest, needed to finance budget deficits.

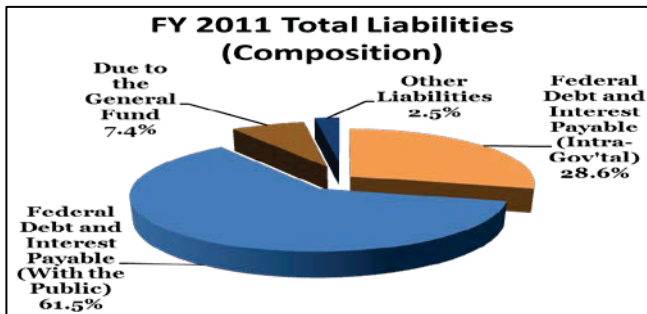


Figure 12

Net Cost of Treasury Operations. The Consolidated Statements of Net Cost present the Department’s gross and net costs by strategic programs which fall into four main categories: financial, economic, security, and management. The net cost associated with financial and economic programs together accounted for almost 75 percent of the Department’s total consolidated net cost of \$4.2 billion for fiscal year 2011 (Figure 6). The net cost of financial programs of \$13.0 billion for 2011 was partially offset by economic programs which generated net revenue of \$9.9 billion (Figure 13). The \$13.0 billion of financial program net costs remained relatively unchanged from the prior year, and primarily reflect Treasury’s role as the primary fiscal agent for managing the nation’s finances by collecting revenue and making federal payments.

Economic programs generated net revenue of \$9.9 billion in fiscal year 2011 compared to a net cost of \$297.2 billion in 2010, a change of \$307.1 billion, primarily driven by the GSE SPSPA program. In fiscal year 2010, the Department increased its future funded contingent liability related to the GSE program by \$320.6 billion. This liability represents the projected total cost payable to the GSEs over the life of the program. The significant increase in this liability in 2010 was due primarily to the increased availability of GSE projection data, coupled with the effect of a 2009 amendment to the liquidity cap for each GSE. The projection data enabled the Department, for the first time, to estimate and accrue its total future contingent liability to the program. In fiscal year 2011, the Department reduced its contingent liability by \$22.9 billion, recorded as a reduction in expense, due to updated projections that reflect lower expected future losses at the GSEs.

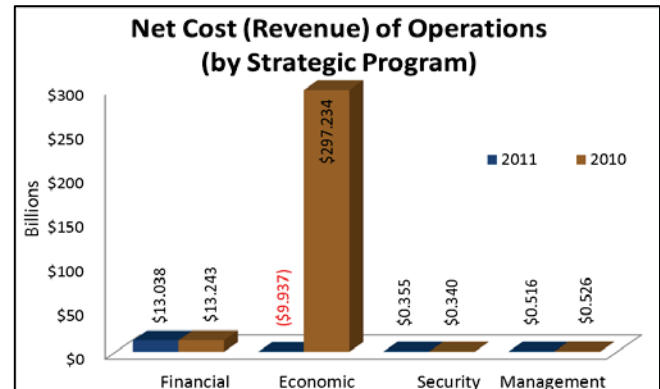


Figure 13

Net Federal Costs and Net Federal Debt Interest

Costs. The majority of these costs is the interest expense on the federal debt. The increase of \$36.1 billion in net interest paid on the federal debt is due to the increase in the debt (Figure 7).

Total Budgetary Resources. The majority of the net \$104.1 billion decrease for fiscal year 2011 (Figure 8) was related to the TARP and GSEs. TARP had a significant decrease of \$33 billion resulting from the Dodd-Frank Act that capped TARP at \$475 billion. Additionally, the budgetary resources required in fiscal year 2011 for the GSE MBS and HFA program decreased by \$54 billion and \$27 billion, respectively, due to the expiration of the program authority under HERA in fiscal year 2010. With the expiration of that authority, new purchases ended and the need for borrowing authority reduced significantly.

Net Outlays. The majority of the \$27.2 billion decrease in net outlays was due to fewer TARP equity and loan disbursements coupled with continued collections from repayments for the TARP investments and loans. In addition, there were fewer GSE SPSPA draw disbursements in fiscal year 2011 than in fiscal year 2010 (Figure 9).

Custodial Revenue. Net revenue received on behalf of the U.S. Government increased by \$128.9 billion for fiscal year 2011 (Figure 10). This increase can be attributed mainly to an overall improvement in individual tax collections. Total net revenue collected by Treasury on behalf of the U.S. Government includes various taxes, primarily income taxes, user fees, fines and penalties, and other revenue. Approximately 99 percent of the revenues are from income and social security taxes.

SUMMARY OF AUDITORS’ REPORT ON THE TREASURY DEPARTMENT’S FINANCIAL STATEMENTS

The Department received an unqualified audit opinion on its fiscal year 2011 financial statements. As summarized in the table below, the auditor reported one open material weakness as of September 30, 2011. During the fiscal year 2011 financial audit, the auditor reported a significant deficiency related to financial reporting practices at the Departmental level. The auditor also reported significant deficiencies related to financial reporting at OFS and information system controls at FMS. 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* (FFMIA).

SUMMARY OF FINANCIAL STATEMENT AUDIT

Audit Opinion	Unqualified				
	No				
Restatement	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Material Weakness					
Financial Systems and Reporting at the IRS	1	0	0	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 USC 3515 (b). While the statements have been prepared from the books and records of the Department of the Treasury in accordance with generally accepted accounting principles (GAAP) for federal entities and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

MANAGEMENT ASSURANCES

THE SECRETARY'S ASSURANCE STATEMENT

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

Treasury provides assurance that the objectives of the FMFIA with respect to operations have been achieved, except for the material weaknesses noted below. Also, in accordance with Office of Management and Budget Circular No. A-123, *Management's Responsibility for Internal Control, Appendix A, Internal Control over Financial Reporting*, Treasury provides qualified assurance that internal control over financial reporting was operating effectively based on the results of the assessment as of June 30, 2011. Treasury's financial management systems are not in substantial compliance with the *Federal Financial Management Improvement Act* due to the Internal Revenue Service's (IRS's) material weaknesses related to unpaid tax assessments and information security.

During fiscal year 2011, Treasury closed the material weakness on the IRS's Modernization Management Controls and Processes. As of September 30, 2011, Treasury had three material weaknesses as follows (with origination/planned resolution timeframes indicated):

Operations:

- IRS – 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:

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

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



Timothy F. Geithner
Secretary of the Treasury
November 15, 2011

SUMMARY OF MANAGEMENT ASSURANCES

Summary of Material Weaknesses						
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS – Unpaid Tax Assessments	1	0	0	0	0	1
IRS – Improve Modernization Management Controls and Processes	1	0	1	0	0	0
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	4	0	1	0	0	3

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	Qualified					
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS – Unpaid Tax Assessments	1	0	0	0	0	1

Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Qualified					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS – Improve Modernization Management Controls and Processes	1	0	1	0	0	0
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	1	0	0	2

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

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

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

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

In fiscal year 2011, Treasury closed one of its material weaknesses and continued to make progress on closing its remaining three, as listed in the Secretary's Assurance Statement. Treasury includes resolution of material weaknesses as a performance requirement for every executive, manager, and supervisor. Additional information on Treasury's material weaknesses and progress can be found in Appendix D of Part 3, Other Accompanying Information.

OMB CIRCULAR NO. A-123, MANAGEMENT'S RESPONSIBILITY FOR INTERNAL CONTROL, APPENDIX A, INTERNAL CONTROL OVER FINANCIAL REPORTING

The Department continues to strengthen and improve the execution of the Treasury mission through the application of sound internal controls over financial reporting. In compliance with OMB Circular No. A-123, Appendix A, Treasury uses an extensive annual testing and assessment methodology that identifies and documents internal controls

over financial reporting at the transaction level integrated with Government Accountability Office's *Standards for Internal Control*. Treasury's bureaus and offices completed their testing and assessment of internal controls for material transactions as of June 30, 2011. Treasury provides qualified assurance that internal control over financial reporting was effective as of June 30, 2011, due primarily to the IRS's unpaid tax assessments material weakness.

FFMIA AND FINANCIAL MANAGEMENT SYSTEMS FRAMEWORK

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

During fiscal year 2011, Treasury bureaus and offices used a risk-based approach to assess their financial management systems' compliance with FFMIA, as required by OMB. The bureaus and offices conducted self-assessments to determine their risk levels. With the exception of the IRS, all Treasury bureaus' and offices' financial management systems are in compliance with FFMIA. As required, the IRS has a remediation plan in place to correct the identified deficiencies. IRS management updates this plan quarterly and Treasury management reviews it. In addition, TIGTA audits the plan annually.

The IRS made significant progress in fiscal year 2011 toward attaining FFMIA compliance by implementing programming changes in the IRS sub-ledger for unpaid tax assessments (i.e., Custodial Detail Data Base) that enabled reporting one balance for unpaid payroll taxes or Trust Fund Recovery Penalty assessments, where previously, they were not separately distinguished.

FINANCIAL MANAGEMENT SYSTEMS FRAMEWORK

Treasury'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.

Fourteen Treasury bureaus and offices use centralized financial operations services and systems support provided by the BPD's Administrative Resource Center (ARC). This cross-servicing enables the bureaus to have access to core financial systems without having to maintain the necessary technical and systems architectures. Using these services reduces the need for Treasury to maintain duplicative financial management systems; enhances the quality, timeliness, and accuracy of financial management processes; and achieves a more efficient and cost-effective business model. Additional information on Treasury's financial systems framework can be found in Appendix D of Part 3, Other Accompanying Information.

IMPROPER PAYMENTS

On July 22, 2010, President Obama signed into law the *Improper Payments Elimination and Recovery Act of 2010* (IPERA, Pub. L. 111-204). IPERA amends the *Improper Payments Information Act of 2002* (IPIA) and requires agencies to review their programs and activities annually to identify those susceptible to significant improper payments. IPERA significantly increases agency payment recapture efforts by expanding the types of payments to be reviewed by agencies and lowering the threshold of annual payments that are subject to payment recapture audit programs from \$10 million to \$1 million, if cost effective. IPERA requires agencies to report information on their improper payments and recapture audit programs to the President and Congress annually.

In fiscal year 2011, Treasury completed a full program inventory and performed risk assessments to identify programs that have a significant risk of improper payments,

per the methodology in OMB Circular No. A-123, Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments*. The risk assessments performed on Treasury's programs and activities in fiscal year 2011 resulted in low and medium risk susceptibility for improper payments, except for the IRS's Earned Income Tax Credit (EITC) program.

Treasury also performed the payment recapture activities required in A-123, Appendix C during fiscal year 2011. Details on Treasury's improper payments and payment recapture program activities and results can be found in Appendix B of Part 3, Other Accompanying Information.

EITC PROGRAM

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. Treasury estimates that for fiscal year 2011, a maximum of 25.8 percent (\$16.7 billion) and a minimum of 21.2 percent (\$13.7 billion) of the total EITC program payments of \$64.7 billion were overclaims.

The IRS has a robust base enforcement program for the EITC which consists of examinations (audits), math error notices, and document matching. Details on the IRS's EITC program can be found in Appendix B of Part 3, Other Accompanying Information.

AUDIT FOLLOW-UP PROGRAM

During fiscal year 2011, Treasury continued its efforts to improve both the general administration of internal control issues throughout the Department and the timeliness of the resolution of all findings and recommendations identified by the Treasury OIG, TIGTA, SIGTARP, GAO, and external auditors.

Treasury has made considerable progress by focusing on achieving a high rate of timely implementation of planned corrective actions (PCAs). In fiscal year 2011, Treasury's offices and bureaus completed 92 percent of PCAs on time or early, exceeding the goal of 90 percent.

Additional information on Treasury's audit follow-up activities can be found in Appendix D of Part 3, Other Accompanying Information.