Audit Report

OIG-10-041

Audit of the Alcohol and Tobacco Tax & Trade Bureau's Fiscal Year 2009 Balance Sheet

June 16, 2010

Office of Inspector General

Department of the Treasury

Although the Alcohol and Tobacco Tax and Trade Bureau's Annual Report conforms to the requirements of Section 508 of the Rehabilitation Act, the Auditors' Reports, contained on pages 55 through 66, are not searchable as required by Section 8L. of the Inspector General Act of 1978 (5 U.S.C. App.), as amended by the Inspector General Reform Act of 2008.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

June 16, 2010

MEMORANDUM FOR **JOHN J. MANFREDA, ADMINISTRATOR**
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU

FROM: Michael Fitzgerald
Director, Financial Audits

SUBJECT: Audit of the Alcohol and Tobacco Tax and Trade Bureau's Fiscal Year 2009 Balance Sheet

I am pleased to transmit the attached audited Alcohol and Tobacco Tax and Trade Bureau (TTB) balance sheet for fiscal year 2009. Under a contract monitored by the Office of Inspector General, KPMG LLP, an independent certified public accounting firm, performed an audit of TTB's balance sheet as of September 30, 2009. The contract required that the audit be performed in accordance with generally accepted government auditing standards; applicable provisions of Office of Management and Budget Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended; and the *GAO/PCIE Financial Audit Manual*.

The following reports, prepared by KPMG LLP, are incorporated in the attachment:

- Independent Auditors' Report on Financial Statements;
- Independent Auditors' Report on Internal Control Over Financial Reporting; and
- Independent Auditors' Report on Compliance and Other Matters

In its audit, KPMG LLP found that the balance sheet was fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. However, KPMG LLP identified two significant deficiencies related to controls over (1) property capitalization; and (2) accounts payable accruals, testing and review of journal entry support, and review of allowances for accounts receivable, which were considered material weaknesses. Further, KPMG LLP found no instances of reportable noncompliance with laws and regulations tested.

In connection with the contract, we reviewed KPMG LLP's reports and related documentation and inquired of its representatives. Our review, as differentiated from an audit performed in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on TTB's balance sheet or conclusions about the effectiveness of internal control or compliance with laws and regulations. KPMG LLP is responsible for the attached auditors' reports dated May 28, 2010 and the conclusions expressed in the reports. However, our review disclosed no instances where KPMG LLP did not comply, in all material respects, with generally accepted government auditing standards.

Should you have any questions, please contact me at (202) 927-5789, or a member of your staff may contact Catherine Yi, Manager, Financial Audits, at (202) 927-5591.

Attachment

Alcohol and Tobacco Tax and Trade Bureau

ANNUAL REPORT

FISCAL YEAR 2009

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Introduction

Addressing the economic challenges we face as a Nation requires each Federal agency to apply tenets of good government and fiscal responsibility. Within the Annual Report for fiscal year (FY) 2009, the Alcohol and Tobacco Tax and Trade Bureau (TTB) combines program performance and financial data to account for how effectively the Bureau translates its program dollars into quality service, responsible management practices, consumer protection, and increased tax revenue.

TTB elects to present this data annually in an effort to communicate relevant performance and financial information. As part of the performance and budget cycle, this report grants the Bureau an opportunity to inform stakeholders of its successes and explain any shortfalls.

The report defines the Bureau's mission, strategic goals, and major programs, and summarizes its progress in meeting its objectives, as stated in TTB's five-year strategic plan. Also included is valuable financial information that discusses how TTB expended its budget on its major programs, and accounted for tax collections from the alcohol, tobacco, firearms, and ammunition industries.

This information is presented in four parts:

- **Part I – Management's Discussion and Analysis.** This section provides an overview of the Bureau including its mission and programs, highlights of program and financial operations, and a summary of TTB's program performance.

- **Part II – Program Performance Results.** In this section, the report provides a summary of results achieved for each performance measure and an overview of the Bureau's accomplishments under its Management and Organizational Excellence mission goal.

- **Part III – Financial Results, Position, Condition and Auditors' Reports.** The transactions and records that comprise TTB's financial statements are part of the consolidated financial data for the Department of the Treasury, which are annually audited at the Departmental level. For the purposes of TTB's Annual Report, the Bureau includes an audited FY 2009 balance sheet, a report on the Bureau's internal controls over financial reporting for the FY 2009 balance sheet, and a report on TTB's compliance with laws and regulations as they apply to the recording and reporting of FY 2009 balance sheet amounts. The Treasury Office of the Inspector General's audit plan for FY 2010 will include an audit of the TTB FY 2010 financial statements. This report section also includes a message from the TTB Chief Financial Officer, a discussion of budget activities for each of the Bureau's seven major programs, and supplemental information, such as a history of Federal excise tax collections for the past decade.

- **Part IV – Appendices.** This section includes a listing of TTB principal officers, an organization chart, and strategic planning information that demonstrates linkages between TTB's plan and the overall Department of the Treasury's mission and goals.

Message from the Administrator

The call to do more with less is not new in the halls of government, but it seems especially critical given the economic times in which we find ourselves. At the Alcohol and Tobacco Tax and Trade Bureau (TTB), we have taken the charge to practice better government and greater accountability as an opportunity to renew our focus on efficiency and transparency in our operations.

The Bureau's ability to respond and adapt in the face of change was tested this fiscal year with the passage of the most significant tax rate increase on tobacco products in history. In February 2009, Congress enacted the Children's Health Insurance Program Reauthorization Act (CHIPRA), effectively doubling the Bureau's collections for the tobacco commodity and bringing total annual excise tax collections to almost $21 billion.

The Bureau mobilized its staff to affect the statutory changes which, in addition to imposing significant increases in the Federal excise tax on all tobacco products and cigarette papers and tubes, levied a floor stocks tax (FST) on tobacco products held for sale as of April 1, 2009.

Nearly every TTB office was touched by provisions of the Act—from auditors conducting inventory reviews in the field to our regulations writers who were responsible for issuing industry guidance and revised regulations. Our IT staff also met the challenge, deploying the necessary updates regarding taxpayer and permit information to our consolidated tax information database within a matter of months and without additional funding. The Bureau's new Voice over Internet Protocol (VoIP) phone system also was instrumental in this massive effort, as its enhanced call management capabilities enabled our tax specialists at the National Revenue Center (NRC) to field tens of thousands of phone calls from industry. Our proactive response to preparing the requisite tax and operations forms, and timely issuance of the implementing regulations, facilitated the processing of $1.2 billion in FST receipts. Our sound operating decisions in response to this mandate resulted in a return on investment in FY 2009 of nearly $430 for every $1 TTB expended on collection activities.

Effective partnerships proved critical in meeting our mission to Collect the Revenue and Protect the Public. In implementing CHIPRA, TTB sought assistance from State governments in identifying the retailers and wholesalers of tobacco who were liable for the tobacco FST. These entities operate outside the TTB regulatory scheme, and ensuring the proper payment of FST required unprecedented levels of communication and cooperation from industry and other government agencies.

In the area of consumer protection, TTB maintained its proactive approach to preventing potential threats to the U.S. food supply by initiating collaborations with scientists from the Food Emergency Response Network, Food and Drug Administration, Centers for Disease Control and Prevention, and National Institutes of Health. The joint efforts and combined expertise will improve the effectiveness of the TTB

Alcohol Beverage Safety and Verification Program, which includes the analysis of alcohol beverages for a number of potentially harmful adulterants or contaminants. This program involves activities related to consumer complaints, imported product evaluations, and sampling for food safety issues, pesticide residue, and allergens. TTB also implemented the second cycle of its Alcohol Beverage Sampling Program to ensure marketed malt beverage products comply with TTB regulations in order to better protect consumers from inaccurate or misleading labels on products available in the marketplace.

Cooperation with U.S. foreign trading partners through the TTB Trade Facilitation Program has been another primary focus in FY 2009. Our work in this area helps to strengthen the U.S. economy by facilitating import and export trade in alcohol and tobacco products, while balancing consumer protection standards. During this fiscal year, TTB made progress on international agreements with multiple counterpart agencies in Brazil, Italy, the Republic of Georgia, and France. These agreements facilitate trade by increasing mutual understanding of each country's alcohol and tobacco production requirements, and labeling and licensing standards.

The risk to the revenue posed by the diversion of alcohol and tobacco products from the legal chain of commerce is another paramount concern for TTB, and is one that we are addressing through interagency partnerships. At the direction of Congress, TTB was tasked to conduct a study to determine the magnitude of tobacco smuggling in the United States and to make recommendations on how to combat the illicit tobacco trade. TTB made significant progress in developing its study methodology to determine the Federal revenue loss from tobacco smuggling, and coordinated this effort with 32 Federal and State agencies and several industry members. TTB findings and recommendations to address the illegal tobacco market, due to Congress in FY 2010, will become a cornerstone of TTB's enforcement efforts to prevent diversion.

In monitoring the operations of the legitimate industry, educational outreach remained a core TTB strategy in sustaining the high rate of compliance displayed by our taxpayers. Building on the success of last year's event, TTB sponsored TTB Expo 2009 to ensure industry has the necessary information to comply with Federal requirements related to alcohol, tobacco, firearms, and ammunition. Under the tagline "Compliance through Education," the event attracted 700 industry members, and offered 78 instructional sessions and more than 30 exhibition booths. Attendees also received hands-on demonstrations of our electronic filing options in the e-Gov Hall—including a preview of the upcoming Formulas Online system.

Reducing taxpayer burden and improving service through technology is a strategic priority at TTB, with the ultimate goal of enabling industry members to file all payments, returns, reports, and applications online. In FY 2009, TTB invested in technology that will automate the permit application and authorization process, moving the Bureau from a paper-intensive, repetitive system to a simplified and secure Web-based filing solution. TTB expects this shift in operations to achieve efficiencies and performance improvements of measurable value to industry applicants and the Bureau.

The combined efforts and personal initiative displayed by TTB employees resulted in the accomplishments described in this annual report. We've never been more focused as an agency, with employees committed to the mission and showing high rates of job satisfaction. TTB improved three positions in the standings on the 2009 Best Places to Work survey, ranking 7th out of 216 Federal organizations polled by the

Partnership for Public Service. TTB ranked first for Family-Friendly Culture and Benefits and third for Strategic Management.

Further, as the performance data in this report indicates, we were able to execute our mission effectively, even under difficult fiscal constraints and despite new mandates and increased workloads. This report also holds the Bureau to a new standard in its presentation of financial information. In past years our financial statements were consolidated with those of the Department of the Treasury. In FY 2009, an independent accounting firm conducted an audit of TTB's FY 2009 balance sheet. In FY 2010, TTB will undergo an independent audit of its FY 2010 financial statements. In the year ahead, we will continue to pursue greater accountability and transparency in all areas of our operations and to leverage our resources through effective partnerships and technology enhancements to better meet our mission.

John J. Manfreda

Administrator

Vision, Mission, and Values

Vision

Our vision is to maintain an organization of people who value each other and who treat each other and their customers with the respect that they deserve. We intend to uphold the laws, for which we are responsible, in a fair, equitable, and appropriate manner, affording all an opportunity to have their opinions heard without prejudice. We intend to carry out our mission without imposing inappropriate or undue burden on those from which TTB collects taxes and those TTB regulates.

Mission

The mission of TTB is to:

- Collect alcohol, tobacco, firearms, and ammunition excise taxes that are rightfully due;
- Protect the consumer of alcohol beverages through compliance programs that are based upon education and enforcement of the industry to ensure an effectively regulated marketplace; and
- Assist industry members to understand and comply with Federal tax, product, and marketing requirements associated with the commodities we regulate.

Values

We value each other and those we serve. This Bureau:

- Upholds the highest standards of excellence and integrity;
- Provides quality service and promotes strong external partnerships;
- Develops a diverse, innovative, and well-trained workforce in order to achieve our goals;
- Embraces learning and change in order to meet the challenges of the future.

TTB Mission Goals

Goals for Collect the Revenue

- ### Voluntary Compliance:
  Provide high quality service, while imposing the least regulatory burden.

- ### Tax Verification and Validation:
  Promote voluntary compliance and eliminate or prevent tax evasion and other criminal conduct.

- ### Effective and Efficient Tax Collection Systems:
  Provide the most effective and efficient system for the collection of all revenue that is rightfully due.

Goals for Protect the Public

- ### Business Integrity:
  Assure that only persons who carry permits as authorized by statute operate within the industries TTB regulates.

- ### Product Integrity:
  Help industry members comply with all Federal labeling and advertising requirements for their products.

- ### Market Integrity:
  Assure the alcohol marketplace is free from anti-competitive practices.

- ### Effective and Efficient Systems to Promote Economic Opportunity:
  Facilitate economic opportunity and growth by maximizing TTB Protect the Public systems' effectiveness and efficiencies.

Goal for Management and Organizational Excellence

- ### Management-Supported Optimum Program Effectiveness and Efficiency:
  Ensure that all TTB programs operate at optimum efficiency and effectiveness and with full accountability, by providing high-quality management and administrative support.

Part I:
Management's Discussion and Analysis

Profile of a Bureau

The mission of the Alcohol and Tobacco Tax and Trade Bureau (TTB) is to collect alcohol, tobacco, firearms, and ammunition excises taxes that are rightfully due and to protect the consumer of alcohol beverages from unsafe or improperly labeled products and from unfair competitive practices in the trade of alcohol. Put simply, TTB "Collects the Revenue" and "Protects the Public" through seven major regulatory and compliance programs.

The Bureau was formed in January 2003, under the Homeland Security Act of 2002, but its history began more than 200 years ago as one of the earliest Federal tax collection agencies. Today, TTB operates under the authorities of the Internal Revenue Code of 1986 and the Federal Alcohol Administration Act (FAA Act), including the Alcoholic Beverage Labeling Act of 1988 and the Webb-Kenyon Act.

Collect the Revenue

TTB is the third largest tax collection agency in the U.S. Government (behind the Internal Revenue Service and U.S. Customs and Border Protection), and its collections duties help to ensure that the Federal Government has the cash resources needed to operate.

Since FY 2000, tax receipts for TTB and its predecessor agency, the Bureau of Alcohol, Tobacco, and Firearms (ATF), totaled between $14 billion and $15 billion annually. In this fiscal year, TTB collected $20.6 billion in alcohol, tobacco, and firearms and ammunition excise taxes—an increase of 41 percent over FY 2008.

The $6 billion increase in revenue collections in FY 2009 is mostly attributable to increased receipts from the tobacco industry. With the passage of the Children's Health Insurance Program Reauthorization Act (CHIPRA) in February 2009, Congress imposed significantly increased tax rates on tobacco products and introduced requirements for permits and taxes on products which had not previously been taxed or regulated. The statutory provisions include a new permit requirement for processed tobacco manufacturers and importers. The Act also expands the definition of "roll-your-own" tobacco to include cigar materials.

CHIPRA also levied a floor stocks tax (FST), a one-time excise tax placed on a commodity undergoing a tax increase, on all tobacco products held for sale as of April 1, 2009. TTB ensured collection of FST from tobacco wholesalers and retailers by working closely with State agencies and some of the largest tobacco manufacturers and distributors to identify industry members and retailers most likely to have substantial quantities of tobacco products in inventory. In FY 2009, TTB processed more than 133,000 receipts and collected a record $1.2 billion of FST.

Another contributing factor to the spike in excise tax collections was the rise in Firearms and Ammunition Excise Tax (FAET) collections. In early October 2009, collections were up 45 percent compared to the prior fiscal year, the greatest annual increase in FAET collections in the history of this agency. In comparison, the average annual increase for fiscal years 1993 to 2008 was 6 percent. A recent surge in firearms sales influenced the increased collections, but the work of specialists at the National Revenue Center (NRC) also played a part in ensuring that industry remitted the taxes that are lawfully due to the Government.

The NRC is responsible for collecting and accounting for the alcohol, tobacco, firearms, and ammunition excise taxes due to TTB. These functions, and the Bureau's other collection activities, are administered under two primary programs—the Alcohol and Tobacco Program and the FAET Program. TTB directs a majority share of its Collect the Revenue budget resources to the Alcohol and Tobacco Program, as these industries constitute more than 98 percent of the Bureau's revenue collections. Both of these Collect the Revenue programs require that TTB perform the necessary tax processing, verification, audit, and investigation activities to calculate and collect the excise taxes due.

Before the Bureau can determine tax liability, a tax class must be assigned to alcohol and tobacco products based on regulatory standards. For alcohol beverages, classification requires that the Bureau review the formula of certain products, like flavored malt beverages (FMB), before they enter the market. For example, if a review of the formula were to disclose that the finished FMB product would derive more than 49 percent of its alcohol by volume from added flavors containing alcohol, the product would be reclassified and taxed as a distilled spirit, rather than a malt beverage. In FY 2009, TTB processed nearly 6,300 formulas, lab analysis reports, and pre-import evaluations to ensure Federal production standards were met.

Tobacco barns were once an essential component of the air-curing process for tobacco in the United States. As technology advanced, and industry grew to rely on more efficient curing techniques and equipment, tobacco barns became little more than remnants of the past. Because of their historic significance to colonial American life, the tobacco barns of Southern Maryland were listed in the 11 Most Endangered Historic Places in 2004 by the National Trust for Historic Preservation.

TTB also conducts post-market product evaluations to check for proper tax classification. As an example, TTB receives numerous samples of cigar products from manufacturers and importers seeking verification that the product is a cigar rather than a cigarette. The samples are submitted not only for Federal excise tax purposes, but because some States defer to TTB for such determinations. In classifying such a product under the Internal Revenue Code, TTB evaluates the product's wrapper, the type of tobacco used in the filler, the product's appearance, and its packaging and labeling. Misclassification of such products would have a significant consequence on revenue collection, as small cigars are taxed at a fraction of the cigarette tax rate.

Accomplishing the Collect the Revenue mission also requires the Bureau's auditors, investigators, and tax specialists to work in concert to verify and validate that industry members pay the proper amount of tax on the regulated commodity. At the NRC, tax specialists reconcile the tax returns against the industry members' operational reports to verify the proper payment of tax. The NRC also processes claims, computes penalties and interest, and issues notice and demand letters to taxpayers who missed or are late in filing payments. In cases where an industry member fails to comply with various laws and regulations, TTB negotiates Offers-in-Compromise to recover lost tax revenue, plus interest and penalties.

Working on taxpayer premises, TTB field personnel audit production records and returns to ensure compliance with Federal requirements. To conserve and more efficiently use its resources, TTB uses a risk-based selection model for determining audit targets. In FY 2009, the Bureau completed audits for 171 industry members, and completed the audit fieldwork for 94 percent of its audit plan. Though traditional on-premises audit work was down slightly compared to FY 2008, TTB also conducted more than 200 field visits associated with the collection of the tobacco FST enacted under CHIPRA. Completing these inventory reviews and implementing other CHIPRA requirements required TTB to redeploy resources in the second fiscal quarter to better manage workloads.

The CHIPRA legislation also required a major information campaign. The NRC developed and mailed information packets to more than 475,000 businesses, and the specialists handled almost 50,000 phone calls related to the FST. Specialists also developed Frequently Asked Questions on CHIPRA and the FST for the TTB Web site, and later updated the information to include Frequently Made Mistakes to address and offer guidance on how to complete the required tax forms. These efforts were instrumental in the processing of tax returns and payments that amounted to $1.2 billion in FST and $20.6 billion in excise taxes.

Protect the Public

TTB facilitates growth in the U.S. economy by enabling qualified applicants to enter business as an alcohol producer, wholesaler or importer, or as a tobacco products manufacturer, importer or exporter. Since 2004, the number of applicants filing for an original permit or registration with TTB has grown 53 percent to more than 5,500 in FY 2009. Today, the Bureau regulates 49,600 industry members, an increase of 29 percent over the same five-year period.

Under its FAA Act authority, TTB conducts a comprehensive screening of each applicant prior to issuing a permit to determine his or her eligibility to operate within the regulated industries. Through this process, and other activities under its Permits and Business Assurance Program, TTB prevents prohibited persons—including organized crime groups and terrorist networks—from commencing operations and potentially diverting products from legitimate commercial channels in order to fund illicit activity.

In addition to field work to ensure those operating within the regulated industries are properly permitted, TTB monitors compliance with Federal permit requirements among importers by comparing the import records in the U.S. Customs and Border Protection's International Trade Data System to the permit records on file in the TTB Integrated Revenue Information System (IRIS). TTB intelligence analysts are able to identify entities importing product illegally through this comparison and respond by issuing cease and desist letters to the individuals. These efforts to address detected violations have proven effective, as all of the persons notified by TTB have come into compliance or ceased operations.

Efficiency in permit processing is equally critical to the Department of the Treasury's goals of improved economic opportunity. Improving turnaround time for permit application processing enables alcohol and tobacco permit holders to begin operating businesses sooner, facilitating U.S. economic growth. Due to strategic improvements in the application investigation process, TTB was able to maintain the 64-day turnaround time achieved in FY 2008 despite a 4 percent increase in the number of original permits processed.

TTB is also charged with assuring that the alcohol marketplace is free from practices that would stifle competition. As part of the Trade Facilitation Program, TTB has reinvigorated FAA trade practices activities to investigate acts that violate Federal law relating to alcohol beverage marketing practices. TTB also works to address barriers in the international marketplace by partnering with other Federal agencies and participating in the negotiation of international trade agreements related to alcohol and tobacco products. In FY 2009, TTB made significant progress on international agreements with multiple counterpart agencies in Brazil, Italy, the Republic of Georgia, and France. These agreements facilitate trade by increasing mutual understanding of each country's alcohol and tobacco production, labeling, and licensing requirements,

A winery informs consumers of the geographic pedigree of its grape wine by using an appellation of origin on its product label. An American Viticultural Area (AVA) is a specific type of appellation, and represents a delimited grape growing area in the United States with distinguishable features that would effect growing conditions, such as climate and soil. The approved AVAs, and descriptions of the established boundaries, are published in the Code of Federal Regulations under Part 9 of Title 27, Chapter I.

and by providing a process for the exchange of regulatory information that has the potential to impact trade, compliance, and product safety.

Consumer confidence is essential to ensuring that U.S. and world economies perform at their full economic potential. To ensure the integrity of foreign and domestic alcohol beverage products for sale in the U.S. marketplace, TTB investigates consumer complaints, suspected cases of product adulteration or contamination, and reports of unsafe imported products as part of the Bureau's Advertising, Labeling, and Product Safety Program. The program also includes the routine analysis of sampled alcohol beverages for limited and prohibited ingredients, such as thujone, methanol, and toxic heavy metals. In addition, wines are analyzed to ensure safe levels of pesticides and ochratoxin-A, and malt beverages are tested for mycotoxins. As appropriate, the Bureau shares the results of the laboratory's analyses with TTB investigators and representatives from other regulatory and enforcement agencies. For example, analytical testing performed by TTB's Beverage Alcohol Laboratory found that a Jamaican roots wine product violated Food and Drug Administration (FDA) regulations. This information was shared with FDA and U.S. customs officials at the port of entry, and resulted in the interception of a shipment of the adulterated product by an unlicensed importer. Hundreds of bottles of adulterated wine were prevented from reaching consumers due to this joint effort.

TTB's Advertising, Labeling, and Product Safety Program also assures that industry members provide full and accurate information on alcohol labels and in advertisements. Before an alcohol beverage can enter commerce, TTB completes a review of the product label to ensure the label contains all mandatory information and does not mislead the consumer. In addition, labels are reviewed for compliance with the Alcohol Beverage Labeling Act, which mandates that a Government health warning statement appear on all alcohol beverages for sale and distribution in the United States.

The number of applications for label approval, or Certificates of Label Approval (COLAs), that TTB receives increased steadily between fiscal years 2004 and 2008, with an overall growth rate of 27 percent. In FY 2009, the Bureau processed nearly 125,000 COLAs, a decline of 6 percent from the prior year and the first reversal of the growth trend since the Bureau began tracking this metric. The decline is partly attributable to the economic downturn, as the cost of redesigning labels or introducing new products may have been prohibitive. Another key reason for the decline in the number of applications received relates to the rise in electronic filing rates for label applications, which grew by 12 percent in FY 2009. Paper applications that require correction and are resubmitted by industry members are counted multiple times toward the total of applications processed. Electronic applications are only counted once, as they can be rerouted electronically to the applicant for corrections with minimal burden and without the assignment of a new TTB identification number. Again in FY 2009, the significant majority of label applications received were for wine products. The wine industry submitted 84 percent of the label applications processed by TTB.

Once alcohol beverages enter the marketplace, TTB monitors labeling compliance through the Alcohol Beverage Sampling Program (ABSP). This involves examining a statistically-valid sample of domestic and imported wine, spirits, and malt beverage products to determine if the labels meet Federal requirements, and if the contents of the bottle match the label description. This process includes a chemical analysis of selected products by the TTB laboratory for identification and product safety purposes. The second cycle of the ABSP was undertaken in FY 2009 and focused on malt beverage products. The pending results of this sampling program will provide a baseline for the level of compliance from this industry segment.

A formal protocol for these consumer protection activities was developed and internally published in FY 2009 in the Alcohol Beverage Safety and Verification Handbook to ensure immediate communication and responsive action to potential health hazard issues involving products regulated by TTB.

TTB also reviews advertisements for alcohol beverage products under the Alcohol Beverage Advertising Program. A representative sample of ads from television, radio, the Internet, and other ad sources are collected and reviewed for compliance with Federal regulations. This year's program centered on malt beverage advertisements, and the findings will be released to TTB management with the ABSP results.

In all of the Collect the Revenue and Protect the Public program areas, TTB emphasizes voluntary compliance from the industry through its outreach efforts. The Bureau sponsors seminars and workshops to educate the industry on Federal requirements in the areas of manufacturing, marketing, importing and exporting, and paying tax on alcohol and tobacco products, and firearms and ammunition.

In FY 2009, TTB sponsored the second TTB Expo to provide advanced instruction on Federal compliance requirements for all segments of the regulated industries. The event consisted of almost 80 educational sessions presented by subject matter experts from within TTB offices, as well as from requisite State or Federal agencies. Exhibition booths provided information and demonstrations to more than 700 attendees. The response from the industry confirmed that there is a need for a large-scale, comprehensive seminar on a regular basis.

TTB also employs a dedicated staff of industry analysts and liaisons to provide industry members and the States with direct assistance on specific needs or guidance on broader issues affecting the regulated commodities.

Organizational Structure

The TTB executive staff includes the Administrator and Deputy Administrator, and four Assistant Administrators (AA) for the directorates of Headquarters Operations, Field Operations, Management/ Chief Financial Officer, and Information Resources/Chief Information Officer. The AA, Headquarters Operations is principally responsible for the Bureau's consumer protection activities, and the AA, Field Operations oversees the Bureau's revenue collection operations. The AAs for Management/CFO and Information Resources/CIO are jointly responsible for the objectives set forth under the Bureau's goal to pursue excellence in its management functions. Also on the executive management team are the Director, Office of Inspection, the Director, Equal Employment Opportunity and Diversity Advancement, and the Executive Liaison for Industry and State Matters. The Bureau's Chief Counsel serves TTB and its mission, but reports through an independent chain of command to the Treasury Office of the General Counsel.

The Bureau has an authorized workforce of 525 employees and occupies facilities throughout the United States. TTB headquarters offices are located in Washington, D.C., and employ about 150 analysts, specialists, attorneys, and management personnel. The largest contingent of TTB employees is located at the National Revenue Center in Cincinnati, Ohio, where about 200 specialists and analysts process tax returns and permit applications.

The remaining TTB employees are located in field offices established in several major U.S. cities, as well as Puerto Rico, or at TTB's laboratory facilities located in Beltsville, Maryland and Walnut Creek, California. The Maryland facility is jointly owned by TTB and the Department of Justice's Bureau of Alcohol, Tobacco, Firearms, and Explosives.

Bureau Highlights

Congress Passes Historic Increase of Tobacco Tax Rate

The Children's Health Insurance Program Reauthorization Act of 2009 (CHIPRA), signed into law in February 2009, imposed statutory amendments that affected TTB operations in a number of ways. In response to this legislation, TTB offices reacted swiftly and decisively to address several operational challenges and to meet our regulatory responsibilities.

Some of the team members at the TTB National Revenue Center who worked to ensure the successful implementation of the CHIPRA provisions.

Briefly, the Act dramatically increased the Federal excise tax on tobacco products, with the exception of large cigars, and instituted a floor stocks tax (FST) on existing tobacco products held in inventory. An FST is a one-time tax placed on a commodity undergoing a tax rate increase. CHIPRA also expanded the definition of what constitutes roll-your-own tobacco; imposed new permit requirements on manufacturers and importers of processed tobacco; and amended the basis for denial, suspension, or revocation of permits. The effective date of the Act was April 1, 2009; permit actions went into effect on February 4, 2009.

In FY 2009, additional revenue collections resulting from provisions of CHIPRA amounted to $5.9 billion—$4.7 billion in tobacco excise taxes and a record $1.2 billion in FST collections. This figure will grow in FY 2010, as that will mark the first full year of collections at the new tax rate. The Act also requires TTB to conduct a study on the estimated Federal revenue loss due to tobacco diversion. The findings and recommendations from the study have been submitted to Congress.

Implementing the statutory provisions of CHIPRA required the coordinated effort of nearly every TTB office. The Regulations and Rulings Division completed several rulemaking documents to implement the mandate, which required the resolution of key policy issues, and did so in less than two months following the enactment of the law. In preparation for the tax increase and subsequent FST, the National Revenue Center (NRC) took numerous proactive steps to ready its databases and operations and inform industry of the new requirements.

NRC program staff worked with the IT office to update the integrated tax and permit database to reflect the new permit category and other statutory changes. The NRC also amended the necessary tax and operational forms to provide for the new requirements, and published guidance on TTB.gov to assist industry in understanding and complying with Federal regulations. In addition, TTB mailed more than 475,000 information packets to industry members, including tobacco wholesalers and retail locations, that were liable for the FST. The NRC also fielded almost 50,000 telephone inquiries regarding the tax rate increase and new permit requirements.

In administering the FST, TTB devised an innovative plan to ensure collections from tobacco wholesalers and retailers, segments of the industry not regulated by TTB. First, the Bureau worked closely with various State agencies, as well as a number of the largest tobacco manufacturers and distributors, to identify industry members who were most likely to have substantial quantities of tobacco products in inventory.

TTB developed an audit program to verify that proper inventories were taken of the tobacco product held by wholesalers and retailers. TTB auditors and investigators conducted site visits at the largest FST filers, and completed more than 200 visits to small and mid-size tobacco manufacturers, importers, wholesalers, and retail locations. TTB also used statistical sampling and intelligence data to help identify various industry members for future audits to verify that proper payment of FST was made.

For FY 2010, TTB plans to place significant emphasis on post audits of those liable for FST. TTB auditors conduct post audits of FST returns and excise tax returns after the tax has been paid to verify that a proper inventory was taken and that the tax payment accurately represents the industry member's liability. TTB is analyzing collected data to identify the largest wholesalers and manufacturers for post audit. Further, our analysts are using automated data analysis techniques to target non-filers for audit, and analyzing sales data to pinpoint unusual patterns that may indicate a business stockpiled product prior to the effective date of the new tax rates.

This work was essential in TTB's successful FST education and enforcement strategy, and the Bureau will apply the gathered information to update its audit plan in the coming fiscal year.

Rave Reviews for Second TTB Expo

Word of the TTB Expo must have spread since the Bureau held its seminal event last year, as more than 700 attendees from across the regulated industries descended on Northern Kentucky for three days of compliance education sessions and networking.

TTB Administrator John Manfreda and members of the TTB executive staff during the keynote address of TTB Expo 2009.

With attendance up more than 20 percent over last year, TTB was prepared with expanded offerings, including 78 courses on a broad swath of topics, an electronic Government demonstration room, and an exhibition hall with booths geared toward the major services TTB and its partners provide.

Holding the Expo grants TTB employees a unique opportunity to interact with industry members in a more novel role—that of an educator. The event theme, "Compliance through Education," is built into the mission of the Bureau and represents a fundamental strategy in affecting that mission. As experience indicates, ensuring continued high rates of voluntary compliance is accomplished in large part by giving those TTB regulates the know-how to meet the rigorous reporting and filing requirements associated with alcohol, tobacco, firearms, and ammunition.

"Almost one-third of the TTB workforce is here today because we believe that our duty as your regulator is to provide you with answers and support in meeting all compliance requirements," John Manfreda, TTB Administrator, said in his keynote address at the opening of TTB Expo 2009.

While TTB has held targeted seminars in the past for specific segments of the regulated industries, the Bureau elected in 2008 to begin hosting a single, comprehensive conference to conserve resources and to furnish a platform for conveying broader TTB messages, such as the benefits of e-filing reports, returns, and applications.

TTB staff demonstrating the COLAs Online system to members of the alcohol beverage industry in the Expo's eGov Hall.

This year, TTB went a step further toward exercising prudence in managing our resources. The Bureau published session presentations in advance online at TTB.gov and requested that attendees judge whether to print and bring copies of the presentations to the event. Staff witnessed attendees take our lead in conserving paper, with many opting to download class presentations to their personal laptops and scroll through the slides along with presenters.

These cost saving measures did not detract from the overall quality of the event, which grew substantially in variety and scope. In the new eGov Hall, the curious got a sneak peek at our upcoming custom application, Formulas Online, which will enable members of the alcohol beverage, specially denatured alcohol, and nonbeverage (drawback) industries to file their formulas electronically for processing and approval. Formulas Online is designed to be fully compatible with our electronic label application system, COLAs Online, resulting in a streamlined application process for members of the alcohol industry so that they can quickly introduce new products to the marketplace.

Staff from the TTB National Revenue Center answering questions for an Expo attendee in the exhibition hall.

The eGov Hall also gave industry members who haven't yet made the leap to e-filing—whether for label applications on COLAs Online or for tax returns and reports through Pay.gov—a chance to experience hands-on demos and receive advice from our specialists. Those who file claims for drawback of tax on alcohol used for nonbeverage purposes could also sit for a personal tour of the online Drawback Tutorial delivered by the chief of our Nonbeverage Products Laboratory.

Offering multiple opportunities for personal interaction was important to event organizers, which is why TTB also offered a private meeting room to industry. Those with specific questions or more complex compliance issues could schedule one-on-one time with TTB specialists to discuss options for potential resolution.

Because TTB is not the only government entity with responsibilities related to the regulation and taxation of alcohol, tobacco, firearms, and ammunition, event organizers invited speakers and exhibitors from State alcohol beverage control boards and other Federal agencies, such as U.S. Customs and Border Protection, the U.S. Department of Agriculture, and the Food and Drug Administration. Having these agencies on hand meant that the right person was available to answer any industry question related to conducting business within the regulated commodities.

Just from anecdotal feedback passed on by attendees, TTB knows that its approach to gaining voluntary compliance through education has substantial merit. Responses to the participant surveys also indicate that 92 percent of those in attendance rated their overall satisfaction as a 4 or 5 on a 5-point scale. With continued interest from the industry, the Bureau expects to hold future Expos to build on the success of this signature event.

Permits Online Development Underway

Members of the team developing the Permits Online system, which will enable industry members to file for new or amended permits online at TTB.gov.

All alcohol and tobacco businesses wishing to operate above the retail level must submit to TTB an application for a permit and multiple documents supporting their qualification– all of which flow to the 56 staff members of the NRC Application Services Branch. The NRC currently processes 23 categories of applications that are used to authorize 19 different types of permits and registrations. In FY 2009, NRC staff screened approximately 5,500 paper-based original application packets and nearly 17,800 amendments to existing applications. With application filings expected to continue their 17 percent average annual growth rate for the foreseeable future, TTB has made automation and efficiency in permit processing one of its top priorities.

"We are a small agency that prides itself on efficiency and uses every opportunity it can to maximize the assets we have so that we can use our resources for enforcement purposes," said Mary Ryan, TTB's Assistant Administrator for Field Operations."Although application packets can be downloaded and printed from our Web site, the applicants need to complete and mail the packets for manual processing – at great cost in time and resources. Switching to a secure electronic submission process will save both applicants and TTB significant time and money, and will help ensure industry compliance with Federal regulations well into the future."

In FY 2009, TTB initiated the Permits Online development effort to use a Web-based technology to gain efficiencies in the issuance of permits to qualified applicants. TTB determined that a commercial product could provide the required capability faster and at a cost lower than a typical TTB custom application development. The Bureau has acquired the product and begun requirements gathering for the system, and anticipates an initial release in FY 2010 with full functionality in FY 2011.

This system is critical to maintaining turnaround times for permit applications and meeting service standards in light of TTB's shrinking workforce and increasing workload. In just five years, the number of applications for original and amended permits has grown 25 percent. Over the same period, the TTB authorized staffing level contracted by nearly 4 percent.

When completed, the new system will provide secure electronic submission capability for applications and online help to guide industry users through the submission process. The Permits Online system also will offer workflow functionality to facilitate online routing, review, and correction of submitted information. The system will also provide a reporting and tracking capability so both TTB staff and applicants can monitor the status of an application.

In terms of gaining efficiencies in internal business operations, Permits Online will mark a huge step forward in the Bureau's strategic automation efforts. By FY 2014, TTB expects to realize a return on investment of 157 percent, and total cost savings of approximately $7.2 million for permit processing.

The system will also bolster improvement plans for several of TTB's primary performance indicators, including voluntary compliance rates and average processing times for original permit applications. With the increased clarity and consistency in the application process and required forms, TTB expects to see an increase in the voluntary compliance rate. The streamlined process should also result in a drop in the average processing time by an estimated 30 days. Customer satisfaction is also predicted to improve, as an electronic filing option for permit applications is something requested by 95 percent of surveyed industry members. Permits Online will meet this expectation, and provide around the clock access to application files and online help features.

Alcohol Beverage Safety and Verification Program

Upholding our responsibility to protect consumers of alcohol beverages from harmful products involves the cooperation of several TTB offices. The coordination of these activities occurs under the Bureau's Alcohol Beverage Safety and Verification Program, which encompasses the TTB-wide strategy for protecting consumers from hazards or safety issues associated with adulterated or contaminated alcohol beverages. This program also works to prevent consumer confusion or deception arising from mislabeled alcohol beverages.

This program applies TTB resources to alcohol beverage products that are offered in the marketplace, and augments mission work that relates to pre-marketplace evaluations, such as the pre-market formula and Certificate of Label Approval (COLA) review processes. By monitoring products on both a pre-market and post-market basis, TTB seeks to validate that alcohol beverages for sale to consumers are safe and manufactured in accordance with good manufacturing processes using wholesome and safe ingredients.

The Alcohol Beverage Safety and Verification Program incorporates ongoing TTB efforts in several consumer protection areas. Formalized in FY 2009, this comprehensive program establishes a process for identification, verification, analyses, notification, and response to potential consumer health hazards that may include product recalls as issues of non-compliance are found. TTB uses the information generated by this program to correct deficiencies in the marketplace and, when called for, to share intelligence and coordinate with the Food and Drug Administration for health hazard evaluations of flagged products. TTB also shares information gleaned from this program with other Federal, State, and foreign agencies as necessary.

In our review of products prior to their entrance to the marketplace, TTB conducts pre-market product evaluations, which focus on ensuring the absence of prohibited ingredients and verifying that limited ingredients are used within prescribed limitations or restrictions. TTB also validates that products are properly and accurately labeled to enable consumers to make informed buying decisions. This involves reviewing label applications on a pre-market basis for conformity with Federal regulations.

Our post-market product review process involves the work of auditors, chemists, analysts, and investigators. One component, the Bureau's Alcohol Beverage Sampling Program (ABSP), uses probability sampling of products available in retail stores to produce accurate estimates of compliance across the industry to help TTB more effectively target non-compliant industry members. In this second year of the program, the TTB Laboratory analyzed 206 malt beverage samples and found 22 to be non-compliant. Specialists in the Market Compliance Office are in the process of taking corrective actions with the concerned industry members.

TTB chemists in the Scientific Services Division test alcohol beverage samples to ensure they are free from contamination or adulteration and comply with Federal standards.

The post-market product reviews conducted under this program also include field and laboratory work related to consumer complaints and referrals. Additionally, TTB chemists analyze collected samples of spirits, wine, and malt beverages for the presence of unauthorized pesticide residues and toxic metals. This program also incorporates product integrity investigations that ensure that domestic and imported alcohol beverages from a permittee are produced, bottled, and labeled in compliance with the provisions of the FAA Act and Internal Revenue Code.

The activities performed under the Alcohol Beverage Safety and Verification Program enable TTB to be both proactive and responsive to incidents concerning adulterated, contaminated, or potentially contaminated alcohol beverages. By establishing the formal procedures and interagency strategies necessary to expeditiously respond to product integrity issues, the Bureau can better fulfill its responsibility to protect consumers from hazards associated with adulterated or contaminated beverages.

Third TTB Laboratory Achieves International Accreditation

The Tobacco Laboratory (TL) was established in January 2008 as a distinct branch of the Scientific Services Division (SSD) to ensure the Bureau addresses the growing needs for technical support in regulating existing and emerging tobacco products. In its mission statement, the TL commits to contributing to TTB's overall mission by producing accurate, objective, and authoritative information on tobacco products through the development of new capabilities and the effective application of novel technologies.

Since its establishment, the TL has made significant progress in expanding its expertise by staying abreast of the advances in tobacco science as well as the changes in tobacco manufacturing processes. Some of its recent work involved the identification of unique chemical markers in various tobacco products. This research was used to establish objective criteria for distinguishing between product classes for manufactured tobacco products. TTB will use the objective criteria in the publication of a notice of proposed rulemaking describing the Bureau's position on little cigars and cigarette products. Currently, the laboratory is developing various analytical methods and protocols for the analyses of counterfeit cigarettes in support of the Bureau's efforts to thwart tax evasion and the illicit tobacco trade.

The TTB Tobacco Laboratory uses state of the art analytical techniques to identify the chemical compounds present in various tobacco products.

The technical support the TL provides to TTB offices in the enforcement and regulation of tobacco products is especially critical given the increase in the Federal excise tax on tobacco, as evidence shows a direct link between the potential for diversion and the tax rate. Hence, it was imperative for the TL to attain accreditation for its laboratory techniques by the International Organization for Standardization (ISO). Achieving third party recognition of the TL's quality results and procedures promotes acknowledgement and respect for its technical competence by the regulated industry and other agencies in the U.S. and abroad.

The ISO accreditation process involves an independent examination of the laboratory methods used for tax classification, the quality of the TL's results, and the standard operating procedures in place to ensure all meet or exceed ISO standards. The TL achieved ISO 17025 accreditation in September 2009 from the American Association for Laboratory Accreditation (A2LA), an accreditation body in the United States. Achieving ISO accreditation is a lengthy and painstaking process. During this fiscal year, the TL had to develop and validate analytical methods, and document every method, protocol, and process in use in the laboratory. Several documents and processes required updating to meet these requirements. TL chemists also had to demonstrate proficiency in each of the methods used for analysis that fall within the scope of the accreditation.

The TL is the third SSD laboratory to achieve ISO accreditation; the Beverage Alcohol Laboratory (BAL) and the Compliance Laboratory (CL) met the requirements for ISO 17025 accreditation in the fall of 2007. In FY 2009, TTB also completed its bi-annual A2LA assessment of the BAL and CL and maintained accreditation for both laboratories.

Now that accreditation has been attained for the TL, the SSD's next challenge is to maintain its accreditation through regular internal audits of all three laboratories and frequent training of chemists on ISO requirements. The laboratories will also be working to expand the scope of their accreditation beyond the routine regulatory methods to include other methods.

Putting User Feedback into Practice on TTB.gov

The TTB Web Team made eye-catching improvements to TTB.gov in June 2009 using visitor feedback in order to make the Web site easier and more satisfying to use for those who rely on the information TTB provides online.

The TTB.gov Web site is critical to the Bureau's mission of collecting the revenue and protecting the public. Industry members and the public look to TTB.gov as a primary resource where they can find the tools they need to make informed choices. For those regulated by TTB, the Internet site provides fast and easy access to resources essential to establishing good business practices and meeting compliance requirements, including forms, guidelines, regulations, and statistics.

The TTB Web Team meeting to discuss the latest analytical and survey feedback data for the TTB.gov Web site.

Based on customer satisfaction with several criteria—including content, navigation, functionality, look and feel, site performance, and search—the Web Team, which is made up of TTB's Knowledge Management Staff and contractor support, focused on enhancing the aspects of the TTB.gov site that received the lowest satisfaction scores.

The redesign included the addition of color and attractive icons that guide users to the top information, as well as the reorganization of the most popular information into easily discernable sections. TTB.gov's new drop-down menus from the main commodity tabs and the updated "How Do I?" sections in the subpages are now task-oriented and written in plain language, which allows visitors to quickly scan a page and select direct links to information and instructions.

The "refreshed" look and feel of TTB.gov was guided by user feedback gathered from Web analytics resources, including the American Customer Satisfaction Index (ACSI), a Web pop-up survey that allows users to rate their satisfaction with the TTB.gov site. To complement the voice-of-the-customer feedback, the Web Team also gathered comments from focus groups with representatives from the various industries that TTB serves.

As a result, the Federal Consulting Group recognized TTB in April 2009, as one of three Federal agencies that has shown the largest increase in overall customer satisfaction scores since implementing the ACSI survey. The Web satisfaction of TTB.gov visitors has climbed more than 11 points since the 2007 ACSI deployment; an improvement of 4 to 5 points is considered excellent performance. Improvement efforts will continue to rely on analytics data and best practices displayed by highly regarded Federal Web sites.

TTB Initiates First Study of Federal Tax Loss from Tobacco Smuggling

The diversion of alcohol beverages and tobacco products outside the legal chains of commerce threatens global security in terms of public safety and financial stability. As the U.S. agency charged with collecting the Federal taxes owed on these products, TTB commenced studies in FY 2009 to estimate the extent of Federal excise tax revenue lost due to illicit trade in both tobacco and alcohol. Once completed, the information will provide a vital component to TTB's diversion program. By determining the amount of overall Federal excise tax loss due to illicit trade, TTB can more effectively target resources to fighting tax fraud and diversion.

The importance of these studies was magnified when the Children's Health Insurance Program Reauthorization Act of 2009 (Public Law 111-3) was passed on February 4, 2009. CHIPRA mandated the Department of the Treasury to conduct a study concerning the magnitude of tobacco smuggling in the United States, to include the loss of Federal tax receipts and the role of imported tobacco products involved in illicit trade. The study is also to provide recommendations to Congress for combating illicit tobacco smuggling.

The TTB team in the Trade Analysis and Enforcement Division overseeing the tobacco smuggling study.

This Federal tax loss study is the first of its kind; there were no previously established studies or methodologies to evaluate the extent of Federal tax loss due to tobacco diversion in the United States. TTB is modeling its study after a gap analysis conducted in Great Britain, which involves evaluating total consumption versus taxes paid to arrive at a net revenue loss. The study and TTB's recommendations have been provided to Congress.

International Agreements Progress in 2009

Keeping U.S. businesses economically competitive in the global marketplace requires advocacy and intercession on the part of Federal regulators. TTB's International Trade Division (ITD) works to address this interest of the Department of the Treasury by promoting improved economic opportunity and growth for domestic businesses that manufacture or trade alcohol products abroad. At the same time, revenue collecting agencies like TTB must ensure the protection of the revenue through its efforts to combat alcohol and tobacco diversion.

In these respects, ITD made significant progress in negotiating several international agreements and working with TTB's foreign counterparts in FY 2009. The Memoranda of Understanding (MOU) completed or in progress facilitate trade by increasing mutual understanding of each country's alcohol and tobacco production requirements, labeling and licensing standards, and revenue protection measures.

These agreements also provide a formal process whereby each party can exchange information that has the potential to impact trade, regulatory compliance, and product safety, or enhance protection of the revenue.

In June 2009, TTB signed an MOU with SAMTREST, the Department of Wine and Vine of the Ministry of Agriculture for the Republic of Georgia. This MOU is TTB's second with a counterpart foreign regulatory agency, following the MOU with China's General Administration for Quality Supervision, Inspection and Quarantine (AQSIQ), signed in December 2007. TTB has already begun work with SAMTREST to facilitate improvements in their regulation of wine so that U.S. labeling and product standards are assured for products from Georgia that enter the U.S. Under the MOU, we also have initiated a collaboration with the U.S. Agency for International Development that will target specific technical and scientific improvements to Georgian capacity, with the TTB laboratories playing a key role in technology and knowledge sharing for analytical methods and regulatory processes.

TTB officials meeting with the Italian Minister of Agriculture in Washington, D.C. to discuss international trade issues.

TTB has been developing relationships with four federal agencies in Brazil, all of which carry out work related to TTB's mission. There are currently MOUs under review by the Ministry of Agriculture, Livestock, and Food Supply (MAPA) and by the National Institute of Metrology, Standardization and Industrial Quality (INMETRO). ITD is also developing MOUs with the Federal Revenue Secretariat of Brazil's Ministry of Finance and the National Health Surveillance Agency of Brazil's Ministry of Health. In August 2009, these agencies and their federal police visited TTB headquarters to exchange information and pursue these agreements formally. These agreements will support and enhance our international efforts with alcohol beverage standards and safety, processes and methods for alcohol beverage enforcement, procedures and methods for tobacco smuggling and diversion investigations, and collaboration on scientific and technical projects which support enforcement and ensure compliance.

TTB continued its negotiations for an MOU with Italy's Guardia di Finanza (GdF), with whom TTB has been collaborating in regard to certain wine trade issues. This MOU is in the final stages of review within the government of Italy, and TTB expects to sign the MOU in FY 2010. The agreement with GdF will also serve to advance our interests in the area of tobacco diversion and smuggling. Further, in the course of these negotiations, TTB developed a prospect for another MOU with an Italian counterpart agency. The Bureau is consequently preparing an agreement that proposes a collaboration with the Istituto Agrario di San Michele all-Adige (IASMA). The agreement with IASMA will advance our enforcement opportunities with wine varietals and labeling issues.

Finally, in March 2009, TTB proposed a draft MOU with France's General Directorate for Competition Policy, Consumer Affairs, and Fraud Control. This MOU comes at an opportune time, as the French are proposing major changes to their systems of control for wine.

Work on these agreements will continue into the next fiscal year, with the goal of ensuring the success of international trade by representing U.S. industry in negotiations related to the sale and marketing of alcohol and tobacco products abroad.

TTB Lab Finds Evidence of Herbal Additives in a 5,000-Year-Old Wine Jar

Interior of the wine jar found in U-j tomb in Egypt (ca. 3150 BC). The visible accumulation of wine residue was sampled for analysis.

Is there a connection between the TTB and winemaking in ancient Egypt? Apparently, the answer is: yes. A collaboration between the TTB Beverage Alcohol Laboratory (BAL) and a leading expert on ancient wines from the University of Pennsylvania Museum helped to reveal the chemistry of these wines. The study findings were published in the Proceedings of the National Academy of Science in May 2009.

Although the wild grape (Vitis vinifera sylvestris) never grew in ancient Egypt, a royal winemaking industry had been established in the Nile Delta by 3000 B.C. as a result of transplanting the domesticated vine from the Eastern Mediterranean. New light was shed on the "prehistory" of this royal industry by the discovery of some 700 wine jars in Abydos from Tomb U-j, dated to about 3150 B. C. More than 4,000 liters of resinated wine in these jars, which belonged to one of the first kings of ancient Egypt, Scorpion I, could be shown to have been made and exported from the Jordan Valley and environs 600 km away.

In order to confirm the various components of the wine residue found in these vessels, the BAL conducted a series of analytical experiments to identify compounds that serve as markers for wine, such as tartaric acid. A number of compounds identified in the residues of these vessels confirmed the presence of grape wine and, for the first time, suggested that herbs, including mint and rosemary as well as tree resins, were added to the ancient wine.

Although many ancient texts attest to the importance of the herbal additives in the ancient Egyptian and Roman cuisine and pharmacopeia, no such analytical data existed to support these claims. Tree resins such as pine tree, turpentine, and frankincense were known to be widely used in antiquity and added to wine for their antimicrobial, medicinal, and flavoring properties. The experiments conducted at BAL clearly indicate that resinated herbal wines were part of ancient Egyptian pharmacopoeia throughout the historical period.

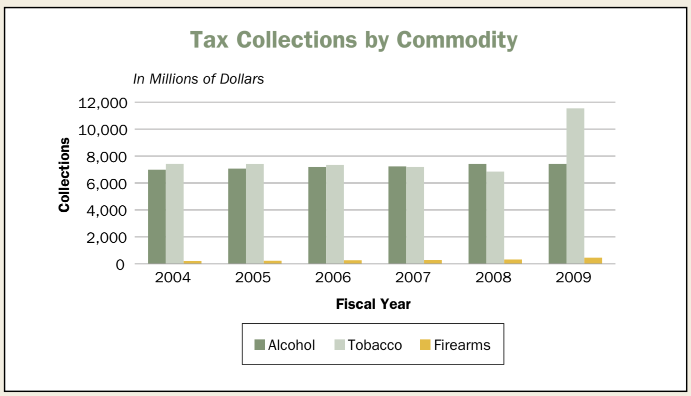
Performance Summary

Collect the Revenue

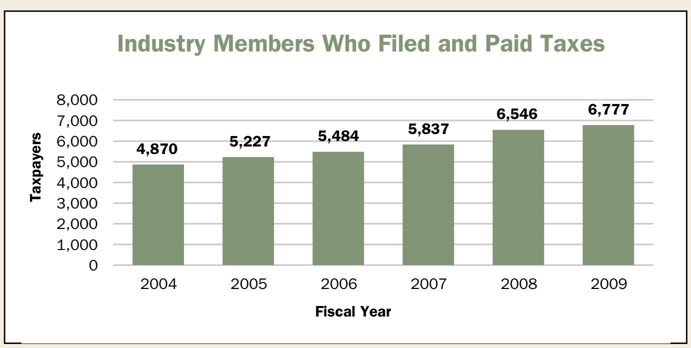
TTB met all of its performance measures under the ***Collect the Revenue*** activity. A detailed summary of TTB performance is discussed in Part II of this report, Program Performance Results.

Investments in the Collect the Revenue mission resulted in several accomplishments during FY 2009:

- TTB collected $20.6 billion in excise taxes and other revenues from approximately 6,800[1] taxpayers in the alcohol, tobacco, firearms, and ammunition industries. The recent rise in excise tax collections for tobacco resulted in a return on investment for the Collect the Revenue program of $427 for every $1 expended on collection activities. The return on TTB tax collection activities increased by 36 percent over FY 2008.



The passage of CHIPRA reversed the trend of declining tobacco revenues, effectively doubling tobacco excise tax collections in FY 2009. Revenue for Firearms and Ammunition Excise Tax (FAET) also grew by 45 percent over the prior fiscal year, the largest single-year margin in the history of this agency collecting FAET.



Of the TTB permit holders, only a small percentage file and pay taxes in a given fiscal year. This is due in large part to the fact that importers and wholesalers—two of the largest sectors of the regulated industries—do not pay tax to TTB. Still, the number of taxpayers has risen 39 percent since FY 2004.

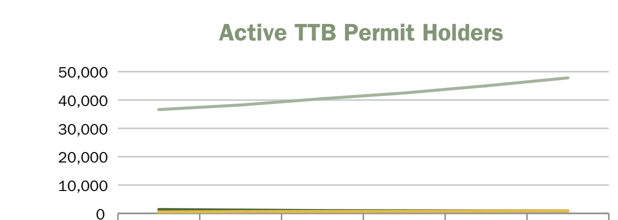
[1] About 10,100 TTB permittees were subject to file a tax return and pay excise taxes this fiscal year; however, many operations do not result in the taxable removal of product from bonded premises. Therefore, in FY 2009, about 6,800 permittees had operations that required them to file a tax return and pay excise tax.

- TTB expanded its e-filing capability to allow all excise taxpayers to file and pay taxes, and file monthly operational reports, electronically through the Pay.gov system. The total number of Pay.gov registrants increased by 36 percent in FY 2009, bringing the total to over 4,900.
- In measuring voluntary compliance, TTB reported a compliance rate of 94 percent among its largest taxpayers in filing timely tax payments. TTB's educational outreach efforts at industry seminars and premises, and through online applications, proved successful in maintaining the compliance rate achieved in the prior fiscal year.
- TTB processed cover-over payments of $481 million to Puerto Rico and the Virgin Islands, an increase of 26 percent compared to the prior year. Federal excise taxes collected on rum produced in Puerto Rico and the Virgin Islands and subsequently imported into the United States are "covered over" (or paid into) the treasuries of Puerto Rico and the Virgin Islands.
- TTB processed $269 million in drawback claims, about 5 percent less in refunded tax money than in FY 2008. Under current law, persons who use nonbeverage alcohol in the manufacture of medicines, food products, flavors, extracts, or perfume and other non-potable products may be eligible to claim drawback of excise taxes paid on distilled spirits used in their products. To assess drawback claims and review specially denatured alcohol formulas, the TTB Laboratory analyzed 12,600 samples in FY 2009.
- TTB also analyzes beverage alcohol and tobacco product samples to assign or verify a tax classification. For this purpose, TTB analyzed 1,021 beverage alcohol samples associated with pre-import evaluation, the 5010 tax credit, and enforcement activities, as compared to 1,302 samples in FY 2008. Pre-import evaluations also test products for limited or prohibited ingredients. Another 265 tobacco samples were analyzed to ensure products were appropriately classified for tax purposes. Though the number of tobacco samples tested was down significantly compared to FY 2008, the workload is comparable to previous fiscal years.
- In FY 2009, TTB completed 171 audits, down slightly from 179 audits in 2008, and completed audit fieldwork on 94 percent of its revised audit plan. TTB audits resulted in additional collections of $8 million in tax liabilities, penalties, and interest, a drop of 56 percent from the prior year but consistent with additional collections from previous years. Recent audit findings demonstrate the success of TTB's audit program. Repeat audits of industry members with significant past violations and additional liabilities show they are now operating in compliance with Federal regulations. TTB initiated approximately 1,306 investigations, including 397 revenue-related investigations (38 percent more than 2008). Many of these investigations involved small producers, tobacco importers, and claims verification. This work resulted in additional collections of more than $613,000. TTB also closed 26 investigations and audits by Offers-in-Compromise, or settlement agreements, for a total of approximately $3.6 million in additional collections. In total, these closed cases resulted in additional revenue of more than $12.2 million.
- TTB has criminal enforcement authority over the commodities it taxes and regulates, but is heavily dependent on the availability of other agencies to supply law enforcement resources to pursue criminal tax cases. Tax fraud in these industries, whether through unlawful product diversion or other means, poses a high risk to Federal revenue collection. Diversion includes tax evasion, theft, distribution of counterfeit products, and distribution in the United States of products marked for export or for use

outside the U.S. Prior to the tobacco tax rate increase, available estimates for lost excise tax revenue related to tobacco diversion were as high as $1 billion annually. Without additional resources, TTB is limited in its ability to address this significant tax collection issue, although specific cases conducted in partnership with other law enforcement agencies have proven successful. During FY 2009, TTB carried out 46 joint investigations, including 17 with State agencies, resulting in the seizure of more than 33,500 cases of alcohol and more than 201,000 cartons of cigarettes having an estimated value of $1.6 million. TTB closed 42 investigations involving diversion of products having an estimated tax liability of more than $9.7 million. As a result of these activities, TTB assessed or collected roughly $7.6 million in taxes owed.

- TTB continued using the U.S. Customs and Border Protection's (CBP) International Trade Data System in FY 2009 to identify illicit alcohol and tobacco importers. In FY 2009, TTB determined that 206 entities, or 15 percent of tobacco importers, were importing illegally, a 7 percent decline compared to FY 2008. Importations from new importers identified as illegally operating totaled more than 400,000 kg of tobacco products, which equates to about $20 million in Federal excise tax. Though the products were illegally imported to the U.S. without the required permits, the excise tax on the products was paid to CBP. All of the entities ceased operations or came into compliance with Federal permit requirements upon receiving notification from TTB.

- TTB participated in several information-sharing conferences on tobacco diversion matters to enhance its diversion program as well as build coalitions with other agencies. TTB held a regional conference in Dallas, Texas, with representatives from western States and other Federal agencies to share information on regulatory and enforcement efforts to target tobacco trafficking. TTB also co-sponsored the U.S./Canada Tobacco Diversion Conference in September 2009 to share information and enforcement practices for combating illegal diversion with domestic and international regulatory and law enforcement partners. Further, TTB served as the primary U.S. representative at the World Health Organization-sponsored negotiations to develop an international protocol on combating the illicit tobacco trade under the Framework Convention on Tobacco Control, International Negotiating Body.



	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008	FY 2009
Alcohol	36,625	38,247	40,480	42,483	45,018	47,818
Tobacco	1,360	1,167	980	931	883	886
Firearms	508	622	674	724	784	855

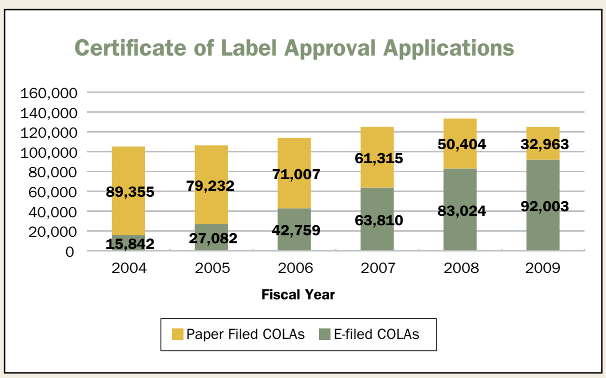
The total number of active TTB permit holders in the alcohol, tobacco, and firearms industries has increased 29 percent since FY 2004. Annual increases range between 4 to 6 percent. Alcohol and firearms permittees have displayed a steady rising trend, while the number of tobacco permittees continued a negative trend in FY 2009. Active tobacco permit holders have fallen by 35 percent in 6 years.

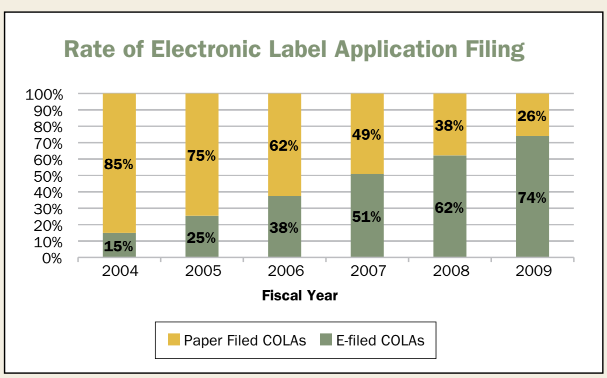
Protect the Public

TTB met all of its performance measures under the ***Protect the Public*** activity. A detailed summary of TTB performance is discussed in Part II of this report, Program Performance Results.

Investments in the Protect the Public mission resulted in several achievements during FY 2009:

- TTB approved 99,336 of the 124,965 COLA applications received; the remaining 25,629, or 21 percent, were either rejected, returned for correction, withdrawn, expired, or surrendered. COLAs received decreased by 6 percent from 2008, due in part to the economic downturn. Another cause of the decline relates to the increase in electronic filing rates. Unlike paper filing, electronically filed applications may be returned for correction without the assignment of a new identification number on the application; incorrect paper applications that are resubmitted are counted as a new application because the processing by TTB starts anew.
- Of the COLA applications received, 74 percent were submitted through COLAs Online, the Bureau's system for the electronic filing of label applications. TTB was successful in increasing the rate of e-filing by 12 percent over the previous fiscal year. The increase in online applications is due in large part to outreach efforts by TTB through educational workshops, improvements to online information, and one-on-one demonstrations to large paper filers.

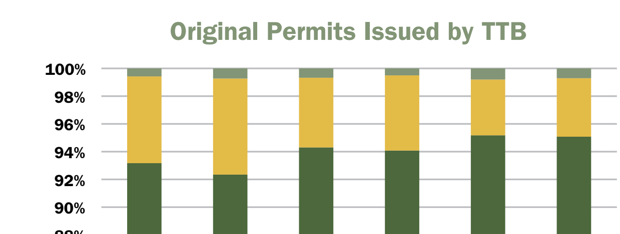




Between fiscal years 2004 and 2008, the Bureau experienced a 27 percent rise in the number of Certificate of Label Approval (COLA) applications submitted by the alcohol beverage industry and processed by TTB. In FY 2009, the growth trend did not continue, with a 6 percent decline in applications. The decline is due in part to economic conditions. The rise in electronic label application filing also contributed to the decrease in processed applications, as paper applications resubmitted by the industry member after corrections may be included in the total count multiple times.

The Bureau's education efforts and ongoing system enhancements have resulted in the usage rate for COLAs Online increasing from 15 percent in FY 2004 to 74 percent in FY 2009.

- TTB processed about 5,500 original and 17,800 amended permits, or approximately 4 percent and 9 percent more than in FY 2008, respectively. TTB also issued more than 5,800 pieces of correspondence related to permit issues, an increase of 14 percent over FY 2008. In FY 2009, TTB processed original applications in an average of 64 days, and issued nearly 4,700 original permits to qualified applicants. TTB issues original and amended permits to persons who are engaged in the alcohol and tobacco industries. As illicit activity in these industries has the potential to be highly lucrative, it is crucial that TTB prevent organized crime and terrorists from commencing operations through its permit investigation process. TTB initiated 380 application investigations to verify that the applicants were qualified and not prohibited from engaging in business activity. As a result of these investigations, 35 applications were withdrawn or abandoned, 7 were recommended for denial, and 27 applications were approved after significant changes. The remaining applications are still under investigation, or were approved with little or no corrections needed.
- As part of its active program to ensure the safety of alcohol beverages, TTB evaluates alcohol beverages for a number of potentially harmful adulterants or contaminants, including heavy metals, pesticide residues, and ochratoxins. In FY 2009, the TTB laboratories analyzed 1,343 product samples for compliance, consumer complaints, and the Alcohol Beverage Sampling Program. Lab analysis in these areas increased 13 percent over FY 2008. To strengthen the impact of its work in this area, TTB initiated collaborations with scientists from the Food Emergency Response Network, the Food and Drug Administration, the Centers for Disease Control and Prevention, and the National Institutes of Health.
- TTB opened more than 492 product integrity investigations in FY 2009. TTB investigators obtained 670 samples of alcohol beverages, of which 192 were found by the TTB laboratory to be non-compliant with Federal requirements. TTB investigators also responded to 21 consumer complaints relating to alcohol beverages, none of which resulted in serious health risks to consumers.



	2004	2005	2006	2007	2008	2009
Firearms	23	29	29	23	37	33
Tobacco	250	275	216	248	185	197
Alcohol	3,724	3,669	4,058	4,308	4,381	4,442

The number of original permit applications approved by TTB has grown 17 percent in 6 years. In FY 2009, the total number of original permits issued increased by about 2 percent from the prior year. Firearms registrations declined slightly, while tobacco permits issued increased over FY 2008. Tobacco permits have generally trended downward since FY 2004.

Financial Summary

Federal Excise Tax Collections

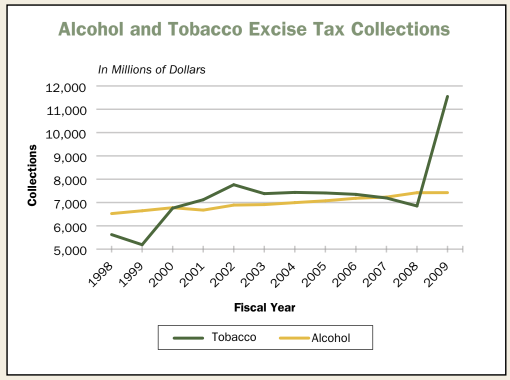
TTB collects excise taxes from the alcohol, tobacco, firearms, and ammunition industries. In addition, the Bureau collects Special Occupational Tax (SOT) from certain alcohol and tobacco businesses. During FY 2009, TTB collected nearly $20.6 billion in taxes, interest, and other revenues.

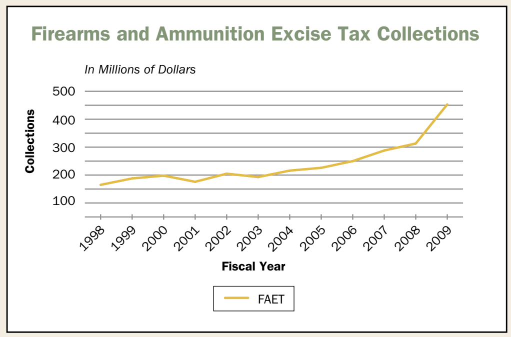
Substantially all of the taxes collected by TTB are remitted to the Department of the Treasury General Fund. The firearms and ammunition excise taxes are an exception. This revenue is remitted to the Fish and Wildlife Restoration Fund under provisions of the Pittman-Robertson Act of 1937. The U.S. Fish and Wildlife Service, which oversees the fund, apportions the money to State governments for wildlife restoration and research, and hunter education programs.

In February 2009, Congress passed the Children's Health Insurance Program Reauthorization Act. This law imposed significantly increased tax rates on tobacco products, swept into the statutory regime requirements for permits and taxes for products which had not previously been taxed or regulated, and levied a floor stocks tax (FST) on all tobacco products held for sale as of April 1, 2009. TTB processed more than 133,000 receipts and collected $1.2 billion dollars of FST. Further, TTB collected an additional $6 billion in tobacco taxes in FY 2009.

FY 2009 Excise Tax Collections:

Alcohol	$7,424,292,000
Tobacco	$11,548,504,000
FAET	$452,693,000
SOT	$272,000
FST	$1,192,375,000
Other	$970,000
TOTAL	**$20,619,106,000**





TTB's tax collections for domestic alcohol beverages have shown a relatively stable rising trend for several years. The tax for imported alcohol beverages is collected by U.S. Customs and Border Protection.

After trending downward for five consecutive years, tobacco tax revenues doubled in FY 2009 with the tax rate increases imposed on tobacco products by the CHIPRA legislation.

Retail sales analysis indicates that gun sales strongly correlate to changes in the political landscape in the United States. Specifically, gun sales rise when citizens perceive an oncoming challenge to their Second Amendment right to bear arms. The upward trend for FAET collections reflects this phenomenon, as tax revenues have increased in relation to the recent rise in gun sales.

Note: On July 2, 2005, legislation was enacted that suspended SOT for most alcohol taxpayers, mainly retail distributors. The law repealed SOT for all alcohol taxpayers effective July 1, 2008. However, the SOT relating to tobacco permittees (manufacturers, importers, and export warehouses) remained intact.

Refunds and Other Payments

During FY 2009, TTB issued $767,974,000 in refunds, cover-over payments, and drawback payments.

Cover-over Payments

Federal excise taxes are collected under the Internal Revenue Code of 1986, 26 U.S.C., on certain articles produced in Puerto Rico and the Virgin Islands, and imported into the United States. In accordance with 26 U.S.C. 7652, such taxes collected on rum imported into the U.S. are "covered over," or paid into, the treasuries of Puerto Rico and the Virgin Islands. During FY 2009, cover-over payments totaled $481 million.

Drawback Payments

Under current law, 26 U.S.C. 5134, Manufacturers of Nonbeverage Products (MNBPs) may be eligible to claim a refund of tax paid on distilled spirits used in their products.

During FY 2009, drawback payments totaled $269 million. In the case of distilled spirits on which the tax has been paid or determined, a drawback is allowed on each proof gallon at the rate of $1 less than the rate at which the distilled spirits tax had been paid or determined. The refund is due upon the claimant providing evidence that the distilled spirits on which the tax has been paid or determined is unfit for beverage purposes, or was used in the manufacture of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfume. The claimant must submit a product formula to the TTB laboratory for analysis and approval of the nonbeverage claim.

Alcohol and Tobacco Excise Tax Refunds	$17,791,000
Cover-over Payments— Puerto Rico	$472,695,000
Cover-over Payments— Virgin Islands	$8,624,000
Drawbacks on MNBP Claims	$268,612,000
Interest and Other Payments	$252,000
Total	**$767,974,000**

FY 2009 Bureau Budget

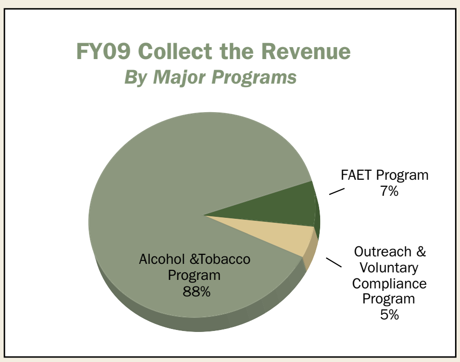
Direct Appropriations

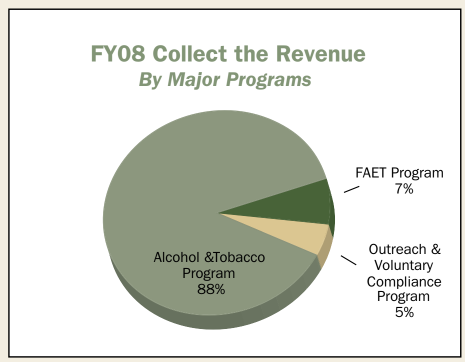
The FY 2009 TTB budget for salaries and expenses was $99,065,000. Of that amount, $2,000,000 was set aside by Congress for information technology (IT) management. The funds for IT hardware refresh remain available until September 30, 2010. The authorized full-time equivalent staffing level for direct positions was 525.

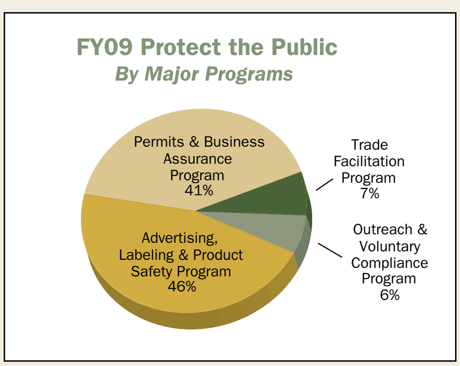
Offsetting Collections and Reimbursable Accounts

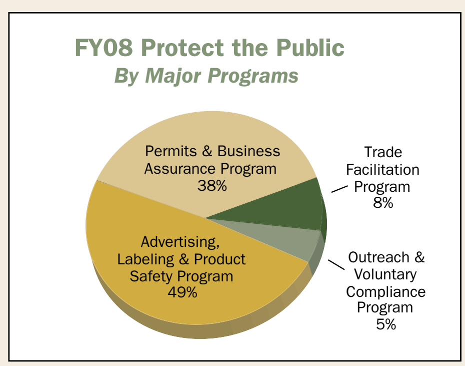
During FY 2009, the Bureau realized offsetting collections in the amount of $3.1 million. Those funds originated from multiple sources including recoveries from the operation of the cover over program and other enforcement activities in Puerto Rico, and funding from the Treasury Department Executive Office of Asset Forfeiture to cover critical investments in the TTB Tobacco Laboratory and diversion training for TTB auditors and investigators. They also included funding from the Office of Technical Assistance, U.S. Treasury Departmental Offices for technical support services.

Obligations and Expenditures









The expenditures by TTB major programs remained relatively constant between FY 2008 and FY 2009.

Audit of TTB's FY 2009 Balance Sheet

The Department of the Treasury is one of 23 Federal agencies that are required by law to produce annual audited financial statements. TTB's financial activities are an integral part of the information reported on by the Treasury Department.

For the purposes of TTB's Annual Report, the Bureau includes an audited FY 2009 balance sheet, and reports on the Bureau's internal controls over financial reporting and compliance with laws and regulations as they apply to the recording and reporting of FY 2009 balance sheet amounts. The Treasury Office of the Inspector General (OIG) audit plan for FY 2010 will include an audit of the TTB FY 2010 financial statements.

Management Assurances

TTB provides reasonable assurance that the objectives of the Federal Managers' Financial Integrity Act have been achieved, and the Bureau is confident that it is in substantial compliance with the Federal Financial Management Improvement Act. This overall determination is based on past and current practices, an improved controls environment, scrutiny by external audit sources, internal evaluations, and administrative and fiscal accounting system enhancements.

During FY 2009, TTB applied its custom risk management tools to its Revenue Accounting Section to identify risks in the accounting and tracking of TTB's annual Federal excise tax collections, and to the National Revenue Center, with a focus on its key business processes. Those tools disclosed that TTB has adequate internal controls in place to mitigate risk to operations, and that the overall risk of fraud, waste, and abuse is characterized as "LOW."

In addition, TTB underwent its first independent audit of the financial information presented on its FY 2009 balance sheet, and received an unqualified opinon. As a result of the audit, two significant deficiencies in internal controls were identified and reported as material weaknesses. To address these deficiencies, the audit recommendations included improvements to property capitalization controls, in addition to the review and recording of year end accruals and allowance for doubtful accounts.

Bureau Challenges

As a result of the FY 2009 balance sheet audit, TTB received constructive recommendations on how to improve its internal controls in two respective areas. In response to the deficiencies identified by the audit regarding TTB property capitalization controls, TTB will reconcile information from its accountable property system to the core accounting system, and enhance oversight of this operation. In regard to the second internal control issue, related to the review and recording of year end accruals and allowance for doubtful accounts, TTB believes that it has established business procedures for recording accrued liabilities and allowance for doubtful accounts that are sensible and represent a rational approach to identifying its year-end liabilities and uncollectible tax receivables; however, TTB is implementing improvements designed to address the deficiencies indentified through the FY 2009 balance sheet audit.

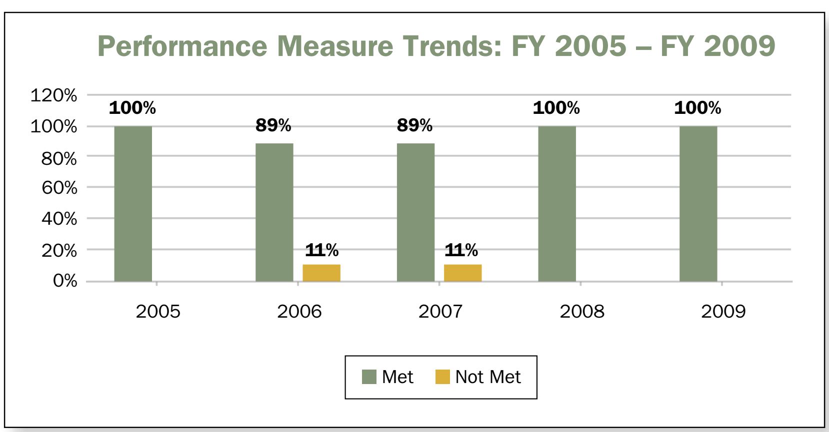
Part II:
Program Performance Results

Performance Overview

TTB revised its suite of measures in FY 2008 to better reflect operating conditions within the industry and method improvements established by TTB program offices. TTB now reports its performance in terms of six metrics that represent its ability to supply satisfactory service to its customers in the industry, foster compliance from taxpayers, employ technology to meet its public protection mission, and return value to the Nation for its investment in TTB programs.

TTB exceeded the performance targets for all six measures reported to its stakeholders in FY 2009. Based on external factors and the results achieved this fiscal year, TTB reviewed its FY 2010 performance targets and updated those in which TTB significantly exceeded its intended performance. To meet its performance goals in FY 2010, TTB will implement an aggressive strategic agenda that integrates new technology, human capital management techniques, and targeted efforts in both outreach and enforcement. All performance results are subject to management review and periodic audit by the Department of the Treasury.

FY 2009 Performance Measure Status	
Performance Targets Met	6
Performance Targets Not Met	0
Baseline	0
Total Performance Measures	6



Summary of Collect the Revenue Performance

Table 1.1

Performance Measure	FY 07	FY 08	FY 09		FY 10 Target	FY 09 Target Met?	% of Target Reached
			Target	Actual			
Amount of revenue collected per program dollar	–	$313	$300	$427	$400	Y	142%
Percentage of voluntary compliance from large taxpayers in filing timely tax payments (in terms of revenue)	–	94%	92%	94%	92%	Y	102%
Percentage of total tax receipts collected electronically	98%	Discontinued	Discontinued		N/A	N/A	N/A
Percentage of voluntary compliance in filing timely and accurate tax payments in terms of revenue	86%	Discontinued	Discontinued		N/A	N/A	N/A
Percentage of voluntary compliance in filing timely and accurate tax payments in terms of the number of compliant industry members	75%	Discontinued	Discontinued		N/A	N/A	N/A
Unit cost to process an excise tax return	$61	Discontinued	Discontinued		N/A	N/A	N/A
Resources as a percentage of revenue	.31%	Discontinued	Discontinued		N/A	N/A	N/A
Cumulative percentage of excise tax revenue audited over three years	16%	Discontinued	Discontinued		N/A	N/A	N/A

Performance Discussion

TTB displayed effective performance in both its measure of how efficiently the Bureau conducts its tax collection activities and in its measure of the extent of voluntary compliance among taxpayers with significant annual tax liabilities.

The Bureau surpassed by a considerable margin its targeted performance level for the measure: "Amount of revenue collected per program dollar." The principle factor contributing to TTB achieving 142 percent of targeted performance was the passage of the Children's Health Insurance Program Reauthorization Act (CHIPRA), which imposed significantly increased Federal excise tax rates on tobacco products. The law was enacted in February 2009 and went into effect in the third quarter of FY 2009, resulting in dramatic increases in monthly collections totals. In July alone, monthly revenues increased by $1.7 billion, or 136 percent over the same month in the previous fiscal year. At year end, tobacco collections exceeded FY 2008 revenues by $6 billion. Without additional funding or resources, TTB implemented the provisions of this legislation, which required the modification of its audit plan and the redeployment of field personnel as needed, as well as major updates to its tax database. The Bureau's effectiveness in implementing CHIPRA resulted in a return on investment for the Collect the Revenue program of $427 for every $1 expended on collection activities. The FY 2010 targeted performance level for this measure was adjusted to reflect the projected increase in collections in the fiscal year ahead.

TTB maintained the FY 2008 voluntary compliance rate of 94 percent for the timely filing of tax returns and payments by taxpayers who owe more than $50,000 annually. This rate exceeded the targeted performance level by 2 percent, and maintained the successful compliance rate achieved in FY 2008. The Bureau fosters voluntary compliance through its electronic filing options, educational outreach program, and targeted enforcement efforts.

TTB supported voluntary compliance by expanding its electronic tax filing program in FY 2009 to enable all excise taxpayers to file and pay taxes electronically through the Pay.gov Web-based system. More than 4,900 TTB taxpayers are registered to use Pay.gov to pay excise taxes and to file excise tax returns and monthly operational reports. TTB increased the number of registered Pay.gov users by 36 percent over FY 2008.

TTB also implemented an aggressive annual audit plan that incorporates a risk model that took effect in FY 2009. TTB statisticians develop a risk model using data received from audits and investigations, statistical analysis, and intelligence received from internal and external sources. Recent audit findings demonstrate that TTB's audit program is performing successfully. Repeat audits of industry members with significant past violations and additional liabilities show they are operating in substantial compliance with Federal regulations.

TTB will sustain its high rate of voluntary compliance from industry in the year ahead through its targeted, risk-based audit plan and outreach efforts. The TTB audit plan is reviewed and revised annually. The FY 2010 audit plan incorporates a refined risk model that accounts for prior year findings and statistical trends. Audits will continue to emphasize industrial distilled spirits plants (DSP) and DSP storage terminals, as these entities move significant amounts of undenatured alcohol through the supply chain.

Efforts to promote voluntary compliance also will focus on educating industry of Federal requirements related to operating in the alcohol, tobacco, and firearms industries, both on premises through guidance provided by TTB auditors and investigators and through industry seminars. Going forward, educational programs like TTB Expo 2009 will enable TTB staff to reach broad groups of users and provide advanced instruction on the reporting and payment of excise taxes and other regulatory requirements.

Summary of Protect the Public Performance

Table 1.2

Performance Measure	FY 07	FY 08	FY 09		FY 10	FY 09 Target Met?	% of Target Reached
			Target	Actual	Target		
Percent of electronically filed Certificate of Label Approval (COLA) applications	51%	62%	53%	74%	78%	Y	140%
National Revenue Center (NRC) customer service survey results	–	90%	85%	89%	85%	Y	105%
Average number of days to process an original permit application at the NRC	–	64	72	64	72	Y	111%
Percentage of importers identified by TTB as illegally operating without a Federal permit	–	22%*	20%	15%	19%	Y	125%
Percentage of instances where the utilization of International Trade Data System (ITDS) results in identifying importers without permits as a percentage of total permits on file at TTB's NRC	–	15%**	Discontinued		N/A	N/A	N/A
Percentage of COLA applications processed within nine calendar days of receipt	42%	Discontinued	Discontinued		N/A	N/A	N/A
Percentage of permit applications (original and amended) processed by the NRC within 60 days	85%	Discontinued	Discontinued		N/A	N/A	N/A
Unit cost to process a Wine COLA	$34	Discontinued	Discontinued		N/A	N/A	N/A

* TTB revised the name and methodology for this measure in September 2008, after the Treasury performance reporting cycle closed, but prior to fiscal year end. The result of 22 percent, reported by the Bureau in the FY 2008 TTB Performance and Accountability Report, was calculated using the new method and historic data for FY 2008 retrieved from ITDS.

** To align with the Department's annual report, TTB is presenting the original measure and the FY 2008 result as reported in the FY 2008 Treasury Performance and Accountability Report, which was achieved using the initial calculation methodology, and marking it discontinued.

Performance Discussion

TTB indicates its level of success in meeting its consumer protection mission goal through four measures of program performance. All of the Bureau's Protect the Public performance targets were exceeded by a substantial margin in FY 2009.

The TTB National Revenue Center (NRC) conducted a customer survey to measure satisfaction with processing times and the level of service provided to the industry. The survey solicits feedback on how well TTB specialists assist applicants in filing for an original or amended permit and in how TTB serves industry members who file claims to recover taxes paid on nonbeverage alcohol or overpayments of tax. Based on responses captured by the NRC through telephone interviews, TTB earned a composite score of 89 percent for permits and claims processing. This result was slightly below the FY 2008 score, but remained 4 percent above the Bureau's goal of maintaining a satisfaction score of at least 85 percent.

Due to strategic improvements in the application investigation process, TTB was able to maintain the 64-day turnaround time achieved in FY 2008 despite a 4 percent increase in the number of processed original permits. Achieving high rates of efficiency and effectiveness in processing permit applications is critically important to both protecting the public and in facilitating market entry for new applicants to the regulated industries.

Efficiency in permit processing is critical to the Department's goal of improved economic opportunity. Improving turnaround time for permit application processing enables alcohol and tobacco permit and registration holders to begin operating businesses sooner, facilitating U.S. economic growth. Effective issuance of permits means that unqualified applicants are prevented from obtaining a permit, a critical barrier to entry for those who seek to conduct illegal operations. Illicit activity in these industries has the potential to be highly lucrative, and proceeds from trade in non-taxpaid alcohol and tobacco have been connected to organized crime and terrorist activities. TTB works in partnership with domestic and international regulatory and law enforcement agencies to address the illicit market and to ensure that those operating in the regulated industries are qualified to operate.

To this end, TTB used the U.S. Customs and Border Protection's International Trade Data System (ITDS) to identify persons importing alcohol and tobacco without a federal permit. Intelligence specialists compared permit data in TTB's tax system to the active importers in ITDS to determine who brought product into the United States without a Federal permit. In FY 2009, TTB issued 206 cease and desist letters to illegal tobacco importers, mostly involving Internet sales of tobacco. By issuing cease and desist letters to entities operating without a permit, TTB has been successful in ensuring that these individuals either complied with TTB permit requirements, or their operations were stopped. The Bureau's continued efforts to enforce compliance in the import area is yielding results. Of the tobacco importers examined by TTB, only 15 percent were found to operating without a permit, 5 percent lower than the Bureau's projection of 20 percent, and an improvement on its FY 2008 performance of 32 percent. TTB established this metric to serve as a starting point to gauge the threat to public safety and Federal revenue posed by illicit imports. TTB is reviewing additional methods to verify its effectiveness in the area of importer compliance.

TTB also made striking improvements in the area of electronic filing of alcohol beverage label applications. Usage rates for the COLAs Online label filing system have increased more than 70 percent in 6 years, from a starting point of 3 percent at the end of FY 2003 to 74 percent in FY 2009. Usage rates for the electronic COLAs application system have grown to almost three out of four eligible users since the system was introduced in 2003. Between fiscal years 2008 and 2009, TTB improved on COLAs Online usage rates by nearly 20 percent. These increases in online applications are due in large part to outreach efforts by TTB through educational workshops, one-on-one demonstrations to large paper filers, and the 2009 TTB Expo. Based on the growing interest in and familiarity with the COLAs Online system, TTB revised its FY 2010 target to an aggressive 78 percent e-filing rate. Reaching this milestone should result in improved processing times for industry as the Bureau becomes more efficient in processing label applications. Electronic applications streamline the review process, as those that must be returned for correction may be resubmitted by the industry member without the assignment of a new TTB identification number. Paper applications that require correction must be rejected by TTB, and resubmitted by the industry member under a new identification number.

Summary of Management and Organizational Excellence Performance

Part of the TTB mission is to create the conditions necessary for programs to reach and sustain excellence. In all aspects of performing its mission, TTB aims to ensure that its programs operate efficiently and effectively, and with full accountability. TTB accomplishes this by ensuring that program offices receive the high-quality management and administrative support needed to achieve the Bureau's goals.

The Bureau's objectives in the area of Management and Organizational Excellence align with the new Administration's emphasis on automating processes to improve services and enhancing its internal operations to be more efficient and effective. In FY 2009, the Bureau demonstrated its ability to enhance efficiency and reduce costs through its strategic management of human capital, IT enhancements to improve operations, and stringent financial management practices.

Human Capital Management

TTB developed a Human Resources (HR) Division Strategic Plan through FY 2012 that outlines strategic goals, strategies to achieve the goals, and measures of results. As the majority of TTB's human resource functions are operated through the Bureau of Public Debt (BPD), TTB establishes and updates, as appropriate, performance benchmarks and measures to monitor these outsourced functions.

The Bureau's HR Division completed the Office of Personnel Management (OPM) 2009 Performance Appraisal Assessment Tool evaluation and reporting. TTB received overall positive feedback from Treasury on its General Schedule Performance Management Program receiving a score of 90 points, a top score among Treasury bureaus.

During FY 2009, TTB received the findings from the evaluation of the Human Capital Management Program Evaluation (HCMPE) conducted by Treasury and OPM in August 2008, and was directed to respond within 60 days on the steps taken to address any required and recommended actions. Working closely with its service providers at BPD, TTB provided a timely response to the five evaluation areas under the Delegated Examining function and developed procedures to ensure that all five areas were adequately addressed. In February 2009, the Department confirmed that TTB had addressed the required and recommended actions associated with the HCMPE. Feedback received from the Department indicated a strong and successful human capital program evidenced by the TTB leadership's commitment to effective human capital management.

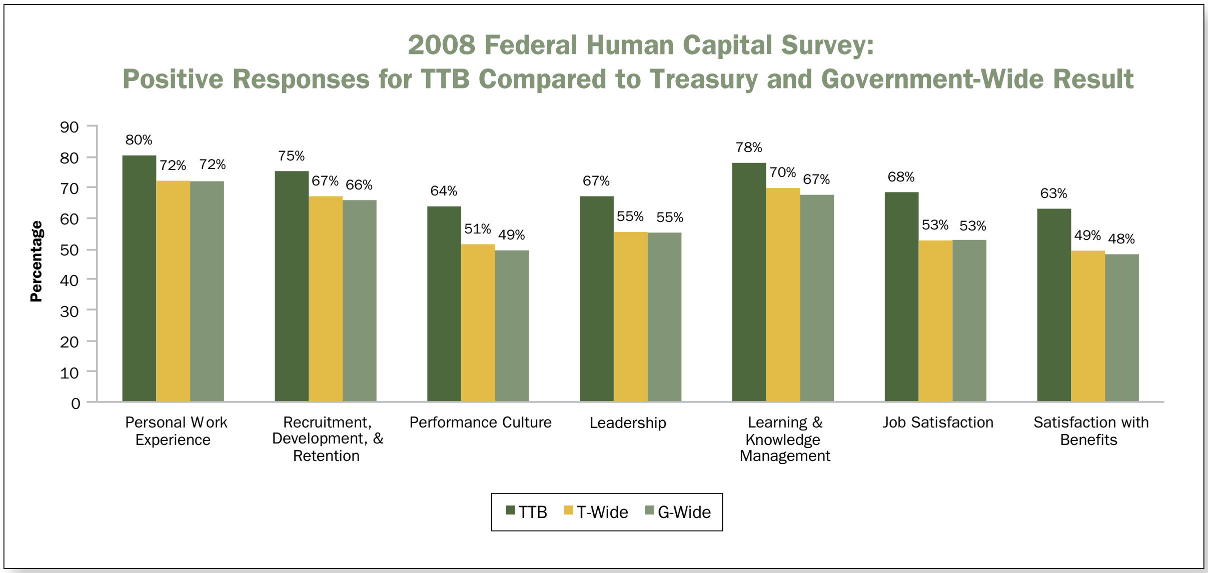
In FY 2009, TTB held three Labor/Management Partnership Council meetings with the National Treasury Employees Union (NTEU) under the provisions of the Collective Bargaining Agreement. These meetings have been instrumental in fostering the Bureau's labor management relations.

TTB also prepared a number of significant human resources policies during FY 2009, which required negotiation with NTEU. These included the TTB orders related to Training Management, Incentive Awards Program, and Absence and Leave. The EEO Office also submitted for review the Alternative Dispute Resolution Policy, which is in negotiation with NTEU. This policy will allow employee and managers to participate in a discussion mediated by a neutral party to settle issues in a manner that will create an acceptable solution for all parties.

In response to the Government-wide survey to obtain employee feedback, TTB developed a Federal Human Capital Survey (FHCS) Action Plan for FY 2009 - FY 2010. TTB ranked 7th out of 216 sub-component agencies on the FY 2009 Best Places to Work in the Federal Government rankings, and had high scores in the area of recruitment, development, and retention. The rankings are determined by the results of the FHCS and are produced by the Partnership for Public Service and American University's Institute for the Study of Public Policy Implementation. The areas where TTB scored lowest are the same areas identified as problematic throughout the Federal government—Performance Culture and Leadership/Knowledge Management. The HR staff conducted focus groups with supervisory and non-supervisory employees to identify specific actions that would address the survey responses of TTB employees. During FY 2009 and through FY 2010, various TTB program offices were given responsibility for completing the following representative actions:

- Ensure continuation of annual management/supervisory training on topics such as performance management, employee recognition, and dealing with problem employees;
- Update the Diversity Strategic Plan and publish it on the Intraweb for access by all employees;
- Publicize the Tuition Reimbursement Program;
- Educate employees on performance management policies;
- Review, and revise as appropriate, guidance on detail assignments;
- Encourage career mapping through greater use of Individual Development Plans; and
- Encourage targeted recruitment (e.g., the Presidential Management Fellows Program) and employee development (e.g., the Emerging Leaders Program) as a means of satisfying workforce planning/succession needs.

Implementing the action plan will produce increased communication to employees regarding the relation between individual responsibilities and the Bureau's mission, ensure a highly talented and well-developed staff, and enhance succession planning activities.



TTB also received a number one ranking on the FHCS among 216 sub-component agencies in the area of work-life programs. The emphasis of the Bureau's program is on the practical utilization of telework and work schedule flexibilities. TTB has also gone beyond the standard protocol to maintain a Health Improvement Program, which allows employees up to three hours per week to exercise during work hours. TTB has procured vending services to include "heart healthy" choices in snack machines. Finally, TTB has extensive Employee Assistance Program services available to all employees. These services include grief/stress management, family counseling, financial consultation services, mental health evaluations and referrals, eldercare services, parental skills training, legal assistance, and a host of video/literary resources.

As a knowledge-intensive organization, TTB requires a highly trained workforce to fulfill the responsibility to protect the public and collect the revenue within a dynamic and global environment. During FY 2009, TTB used a variety of human capital policies and programs for recruiting and attracting talent to ensure qualified people with the necessary skills are in the right positions, and to continue to retain those professionals in the future. Successful strategies included partnerships with a diverse range of universities across the country, use of the Student Educational Experience Program, Federal Career Intern Program (FCIP), and the Presidential Management Fellows (PMF) Program. During FY 2009, TTB was also especially successful with the use of the Student Volunteer Program, creating partnerships and hosting arrangements for 13 volunteers in three areas of expertise: legal research, knowledge management, and tobacco research.

In addition, TTB was able to successfully backfill five critical vacancies through the use of the PMF program, with two of the five hires bringing critically needed new language skills in Russian and Mandarin Chinese to the Bureau's International Trade Division. Also, during this past year, TTB hired 10 interns through college recruitment efforts, the use of online classifieds advertising, and the FCIP authority in the auditor, investigator, and writer-editor occupations.

Succession planning is a strategic priority for the Bureau, especially as it relates to TTB's investigative forces. An estimated 47 percent of the TTB workforce will be eligible to retire in FY 2011. To mitigate the loss of expertise and close skill gaps in mission-critical occupations, TTB continues to use the personnel interventions identified in the Pay Demonstration Program—a successful pay-for-performance pilot project—to enable the Bureau to improve its capacity to recruit, develop, and retain high-caliber employees. TTB uses tailored approaches designed, developed, and implemented specifically for the Bureau's continuing and evolving needs in order to meet mission requirements and remain competitive for highly skilled talent.

In the area of training and professional development, TTB developed a new one-week Disclosure Training course in FY 2009 to be provided to all Field Operations specialists during FY 2010. The protection of taxpayer return information, as defined by 26 U.S.C. § 6103, is a paramount responsibility of Bureau employees. Every employee is expected, at a minimum, to know and comply with the confidentiality rules governing tax matters under the protection of section 6103. This training offers specific guidance regarding the procedures controlling the release of such information.

In addition, during FY 2009, a one-week course on the Statute of Limitation was delivered to all NRC employees. This training addressed Internal Revenue Code regulation requirements regarding the statute of limitation and outlined the basic legal issues that arise in connection with those limitations. The course also covered the statute of limitation requirements on assessing liabilities, collecting liabilities, and filing claims. TTB expects to provide this course annually and expand the offerings to include all Field Operations employees starting in FY 2010. Course evaluations prepared by those attending the FY 2009 class were overwhelmingly favorable.

The first class of TTB's Emerging Leader's Program (ELP) kicked off during FY 2009, offering three unique Leadership and Management Certificate Programs to TTB employees. The certificate programs are for non-supervisory personnel, first-level supervisors, and second-level managers. Each certificate program is comprised of competencies critical for effective leadership, preparing the participants for higher levels of leadership responsibility. The full three-year program series is an effective succession planning tool that is aiding the organization in preparing its leaders to perform in new roles at more challenging levels. The selections for the FY 2010 class have been announced. With the 2010 class selections, 30 TTB employees will be enrolled in the ELP, which is approximately 6 percent of the TTB workforce. The first year of the program has proven to be successful with positive feedback from participants and an increase in applicants for the 2010 program. In addition, first-year participants have, on their own initiative, formed a community of practice and established a monthly book club to read, review, and discuss leadership development books chosen by the group.

TTB's Mentoring Program continues to help promote the development of employees through a one-on-one approach which guides, motivates, and strengthens relationships to accomplish the Bureau's mission. In addition, TTB developed and issued an internal order on ELP Mentoring, and compiled a list of mentoring best practices and resources that offers suggestions on books, organizations, and references for ELP participants.

TTB was the first Treasury bureau to undergo an audit as part of the Department's new evaluation of bureaus' Equal Employment Opportunity (EEO) programs. The feedback received in FY 2009 indicated positive results and an overall effective rating of the Bureau's EEO/Diversity Program. Still, TTB implemented measures to ensure the Bureau sustains and improves effectiveness in this area. TTB has assigned three Special Emphasis Program Managers (SEPMs) to work on personnel issues related to Hispanics, women, and people with disabilities. The SEPMs are responsible for promoting overall awareness and providing information on development opportunities to these groups, with the goal of increasing their representation in the workforce and in positions with higher pay grades.

During FY 2009, TTB organized and held its first Diversity Week. This week served as an opportunity to increase cultural awareness and appreciation and to embrace a culturally inclusive environment where all people are respected.

The Bureau also developed and conducted online EEO refresher training through the Treasury Learning Management System, an automated training delivery and tracking system. The training ensures that all TTB employees know and understand their rights and responsibilities in relation to EEO.

Financial Management

TTB established and monitored key performance standards to ensure that its business activities covering financial accounting and reporting operate in a highly effective and efficient manner. In FY 2009, TTB, in cooperation with its shared service provider at BPD ARC, achieved all of its performance metrics. TTB attained a prompt payment rate of 99 percent or more and a compliance rate of 99 percent or more for electronic funds transfer. TTB also fully met its erroneous payments goals.

Cash accounts were reconciled within 45 days after the end of the accounting period, while the fund balance with Treasury account reconciliation was completed within 15 calendar days of the close of the month. TTB coordinated with BPD ARC to certify the accuracy and reliability of the monthly financial information reported in the Treasury Information Executive Repository, along with other financial documents. The Bureau also met established due dates to ensure timely submission of required Financial Management Service (FMS) reports. Monthly closing of financial data was completed within three business days, and payroll information was downloaded into the Oracle core accounting system within three working days of receipt of payroll tapes from the National Finance Center.

In addition, TTB and its shared service provider conducted joint reviews of its payroll activity to obtain reliable projections of payroll costs relative to continuously changing on-board staffing levels. The payroll projection system has proven to be a valuable tool and its use has led to better financial information for decision making on the budget and has helped the Bureau avoid Anti-Deficiency Act violations. The ability to extract information from both the core accounting system, and make sound payroll projections, continues to provide reliable and accurate financial information for management use in executing the budget.

In FY 2009, the Bureau was able to conduct timely reviews of financial information so that program offices were afforded the data necessary to make efficient use of the Bureau's annual appropriation, and fulfill TTB's tax collection and regulatory responsibilities as outlined under the budget plan. By closely monitoring the Bureau's financial status, TTB was successful in making a number of key investments in support of its mission. These financial reviews were not limited to the current year's appropriation. TTB also conducted a review of prior year obligations. This endeavor led to the close out of accounts that no longer legally obligated TTB. As a result of this comprehensive effort, the Bureau was able to increase its FY 2008 unobligated balance, of which 50 percent, or $159,500, was reapportioned for use in FY 2009. The monies were used to fund activities related to the CHIPRA legislation. This required a coordinated effort by TTB, BPD, and FMS, as well as Treasury, OMB, and Congress.

In support of Treasury's OMB Circular A-123 requirements over financial reporting controls, the Office of Finance and Performance Budgeting tested internal controls related to the financial reporting of tax collections. The review identified no control weaknesses over TTB's collection activity and the reporting of those collections.

The audit of the FY 2009 balance sheet included an opinion on the financial presentation of the FY 2009 balance sheet, a report on internal controls, and a report on compliance with laws and regulations. The report on internal controls disclosed the need for improvements on property capitalization controls, and highlighted the need for more stringent review of the recorded year end accruals for financial reporting. The audit also uncovered an error in the computation of the allowance for doubtful accounts on tax and trade receivables. The Bureau has begun to address these weaknesses, and corrective actions are in place or underway to thoroughly resolve these challenges. As a result of this audit, TTB expects to be well-positioned for the audit of its FY 2010 financial statements. The full audit reports and the TTB management responses are presented in Part III of this report.

Finally, as a mark of TTB's conscientious stewardship of its appropriated dollars, the Government Accountability Office (GAO) did not recommend any reductions, realignments, or restrictions to the Bureau's FY 2010 budget after completing its audit of the Bureau's FY 2010 President's budget request.

Expansion of Technology Solutions

In FY 2009, TTB developed two significant software updates to its tax database—the Integrated Revenue Information System (IRIS). IRIS is the central repository of permit, tax, and operational report data. From receipt of an application through final authorization to operate, each activity associated with this process is tracked through IRIS. The system also provides a single place for all TTB employees to access this data, saving Bureau employees substantial time in the accomplishment of daily duties.

Keeping IRIS up to date is essential to supporting TTB's revenue collection mission. The first development effort focused on platform upgrades to bring the entire IRIS suite up to the latest version of the underlying software. The second release included significant functionality enhancements, most of which were required as a result of CHIPRA. This legislation required major changes to TTB's tax systems, all of which were accomplished on time and with no additional funding. TTB adapted to make the system changes required by this statutory mandate by reprioritizing other development efforts and redeploying existing personnel. IRIS requires additional maintenance to address a growing list of minor fixes and necessary functional enhancements.

To improve efficiency, TTB explored options to develop an automated permit application system called Permits Online, aimed at reducing permit application processing and turnaround time. The NRC currently processes application packets for 23 types of permits or registrations for the alcohol, tobacco, firearms, and ammunition industries. New or existing alcohol and tobacco industry members file these packets to request permission to commence a new regulated industry operation, or to update critical industry member information such as trade names on an existing operation. Over the past several years, the volume of paper applications has increased, making it difficult to maintain current service levels. With the workload increasing at the same time the Bureau's workforce is shrinking, this IT initiative is critical to maintaining present turnaround times.

After an intensive requirements gathering session and market research effort, TTB determined that a commercial product could provide the required capability 25 percent faster and at a cost that is 25 percent lower than its typical custom application development. The commercial off-the-shelf solution, purchased in FY 2009, will be deployed in FY 2010 and fully operational in FY 2011. The system will substantially improve the Bureau's ability to timely process permit applications. The system will benefit the industry as well by giving alcohol and tobacco permit and registration holders' authorization to operate their businesses sooner.

TTB also implemented the Voice over Internet Protocol (VoIP) phone system and customer call centers at its NRC and headquarters offices. The new system leverages TTB's digital network to provide access to all TTB resources, including data, fax, phone, and video conferencing capabilities. VoIP also includes standard features that traditionally involve added cost, such as voicemail, call forwarding, call waiting, caller ID, and call return. In total, this system will cost TTB about 50 percent less than its previous traditional phone bills.

The VoIP capability at the NRC was critical in meeting the emerging requirements that resulted from the CHIPRA legislation, which established an FST on tobacco products that TTB was responsible for administering. This legislation resulted in more than 50,000 phone calls to the NRC. The system capacity, advanced voicemail system, and call management features allowed NRC personnel to immediately answer or return every call received, and ultimately helped in the collection of more than $1.2 billion in FST revenue.

Because of the substantial increase in phone system capability and the cost savings already realized, TTB accelerated the VoIP rollout to include all personnel working at remote locations. With VoIP phones, TTB employees are not tied to their geographical locations and can make calls, securely, from any location with access to the Internet. Once the transition is completed, full-time teleworkers, which make up one-third of TTB's workforce, will no longer need dedicated phone and fax lines at their home offices or remote work sites. TTB expects to discontinue telephone service for all teleworking employees next fiscal year, providing substantial FY 2010 savings.

In April 2009, TTB completed testing and began the implementation of a commercial product for server virtualization. This process involves applying a software application to maximize use of server capability by dividing a single physical server into multiple isolated virtual environments. This application enabled TTB to replace physical servers with virtual servers at both TTB data centers. The Bureau implemented 41 virtual servers and retired 17 physical servers. This effort will result in substantial recurring savings as it significantly reduces the need for space, power, cooling, and hardware refresh. With the success of the server virtualization program, TTB has targeted a 50 percent reduction in the physical server footprint. An added benefit to server virtualization is the improved TTB disaster recovery capabilities due to the high availability features found in server virtualization.

The TTB Internet site, TTB.gov, serves as a primary means of communicating with the public and with those whom TTB regulates. TTB draws its direction for Web enhancements from customer feedback provided by the American Customer Satisfaction Index (ACSI) survey—an online survey provided at random to TTB.gov visitors. In FY 2009, TTB made its site easier to navigate, added color and attractive icons, and reorganized information to be easier to use and more informative. As a result, the Federal Consulting Group recognized TTB in April 2009, as one of three Federal agencies that have shown the largest increase in overall customer satisfaction scores since implementing the ACSI survey. Web satisfaction has climbed more than 11 points since the 2007 ACSI deployment; an improvement of 4 to 5 points is considered outstanding performance.

TTB also leveraged available Web technologies to add a new online tool for management to keep a pulse on key workload and performance metrics. The performance dashboard provides a consistent and efficient means of calculating, collecting, and maintaining key agency performance metrics and makes the results readily available to TTB managers through an online portal. This system automates the reporting and presentation of metrics related to collections, permit and label application processing times, and customer service. The system will ensure increased accuracy in TTB reporting and help management monitor Bureau performance and industry compliance trends to facilitate strategic decision making.

Message from the Chief Financial Officer

Part of the TTB mission is to meet a standard of excellence in the management of Bureau programs and operations. In FY 2009, the Bureau continued its journey toward increased levels of accountability through integrated financial and performance data and rigorous reviews of our financial operations and related business processes to identify areas for improved efficiency.

Historically, TTB's financial information has been evaluated as part of the Department of the Treasury's consolidated annual financial statements. With TTB's annual excise tax collections now reaching $21 billion, it was decided that TTB should undergo an independent audit of its financial statements. In FY 2009, the Treasury Office of the Inspector General engaged a private certified public accounting firm and launched an audit of the FY 2009 balance sheet, which resulted in the auditors' issuing an opinion on the FY 2009 balance sheet, as well as reports on internal control and compliance with government laws and regulations. This effort precedes an audit of the FY 2010 financial statements. Our request and support of these audits affirms our commitment to a sound internal control environment and financial reporting excellence.

The Bureau also underwent an audit of its FY 2010 President's Budget request to Congress by a team from the Government Accountability Office (GAO). The objective of the audit was to identify existing programs with significant increases from the prior year and significant unexpended balances, and to review any new programs in the budget request. Based on their review, GAO did not recommend any reductions, realignments, or restrictions to TTB's FY 2010 budget.

In FY 2009, TTB continued its heightened focus on risk management assessments and stringent internal controls to ensure reliability in financial activities. Results from comprehensive evaluations of our tax collection and revenue accounting operations indicate that the Bureau adheres to sound internal and administrative controls, especially in key business processes at the National Revenue Center in support of the TTB mission, and with the accounting and tracking of the nearly $21 billion in annual Federal excise tax collections.

Today's search for management excellence also requires investments in technology that create efficiencies and realize savings. In this regard, TTB implemented the Voice Over Internet Protocol (VoIP) phone system, essentially transforming our computers into mobile offices by leveraging our digital network to provide access to all TTB resources, including data, fax, phone, and video conferencing. This technology proved critical in meeting the unprecedented flood of phone calls that resulted from the recent CHIPRA legislation. Once the technology is fully implemented, full-time teleworkers, a significant portion of TTB's workforce, will no longer need dedicated phone and fax lines at remote work sites, providing substantial savings in future budget years.

In the area of performance, TTB used available technologies to develop a new online tool for managers to track key workload and performance metrics. Use of quality metrics, including customer satisfaction survey data, plays an integral part in ensuring accountability and improvement in Government performance. The TTB performance dashboard provides a consistent and efficient means of calculating and reporting performance metrics to TTB managers through an easily accessible online portal. This effort has improved the reliability and accuracy of the performance information being gathered and reported by TTB.

Providing superior administrative support services while meeting our financial management improvement goals is critical to producing sound agency performance results and providing taxpayer value. We are excited about the years ahead, and the opportunity to develop and implement new ideas for improving the management and performance of this organization.

Cheri D. Mitchell

Cheri D. Mitchell

Assistant Administrator, Management/Chief Financial Officer

Part III:
Financial Results, Position, Condition and Auditors' Reports

Budget Highlights by Fund Account

Salaries and Expenses

FY 2009 Salaries and Expenses	
Appropriations (Public Law 110-161) Consolidated Appropriations Bill	**$99,065,000**
Salaries & Expenses FY 2009	$97,065,000
Salaries & Expenses FY 2009/2010 (Information Technology Management)	$2,000,000

The FY 2009 TTB budget of $99,065,000 consists of direct appropriations. The budget authorizes the full time equivalent (FTE) staffing level at 525 direct FTE.

The budgeted amount maintains a program level consistent with the current level of effort necessary to support TTB's responsibility for revenue collection and the enforcement of laws and regulations governing alcohol and tobacco commodities.

The Bureau obligated or expended 99.5 percent of the $97,065,000 in FY 2009 direct funding from its Salaries and Expenses appropriation.

In addition, TTB was provided with $2 million, available until September 30, 2010, to begin implementation of comprehensive lifecycle planning for information technology equipment. In FY 2009, the Bureau awarded contracts in the amount of $869,000 to replace all data storage arrays that were approaching end-of life, remote access network equipment, servers that are at or beyond end-of life, and other internal network equipment in our data centers.

In addition to the annual appropriations, the Bureau recovered reimbursable funding of $3.9 million during the year. The majority of recovered costs are associated with the functioning and support of the Puerto Rico field office, and are paid from the "cover over" program, which is offset from the $481 million in cover-over taxes collected on Puerto Rico and Virgin Islands alcohol products sold in the United States.

FY 2008/2009 Salaries and Expenses	
Reprogramming	$159,505

Also during FY 2009, an additional $159,505 from the prior year account of unobligated available balances (often referred to as the 50 percent account) was authorized by Congress to cover postage and printing costs associated with the implementation of th CHIPRA legislation.

Offsetting Collections and Reimbursable Accounts from Puerto Rico Cover Over/ Enforcement Activities

The Bureau collected $3.1 million in offsetting collections during FY 2009. The primary source of reimbursable funding involved collections from the cover over program and enforcement activity in Puerto Rico, which amounted to $2.5 million (81 percent) of the offsetting collections.

Puerto Rico Cover Over and Enforcement Activities

All costs associated with the functioning and support of the Puerto Rico office are paid from the cover over program, which is offset from cover-over taxes collected in the United States on products originating in Puerto Rico ($472.7 million) and the Virgin Islands ($8.6 million).

In Puerto Rico, TTB conducts annual audits and investigations of industry members regarding the collection of revenue, application processing, and product integrity. Revenue inspections are used to conduct tax examinations on major producers of alcohol and tobacco. This is critical due to the requirements of verifying tax payments under the Internal Revenue Code (IRC), as well as TTB's subsequent accountability for all cover-over amounts due to the government of Puerto Rico.

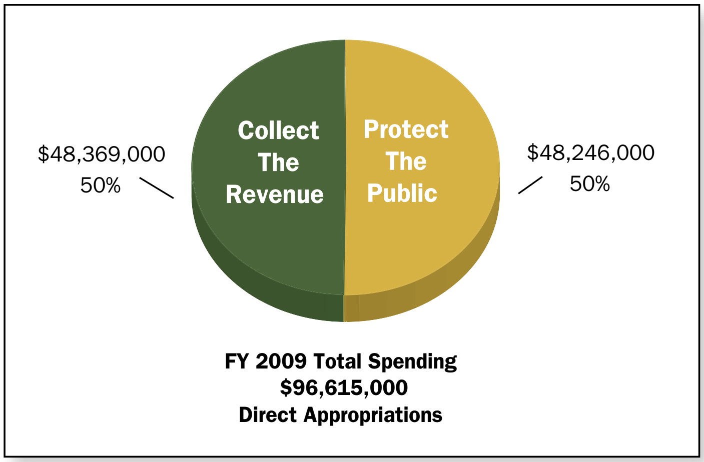
All distilled spirits producers and processors, wineries, wholesalers, importers, Manufacturer of Nonbeverage Products claimants, and specially denatured alcohol permit applicants are subject to a qualification inspection under the IRC.

Additionally, major producers of distilled spirits, wine, and malt beverages are subject to inspection and audits in Puerto Rico.

Linking Budget and Program Spending

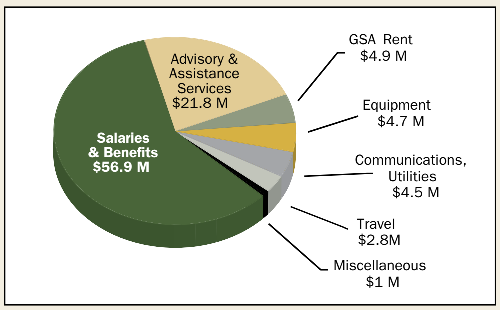
TTB has two primary budget activities: collecting all the revenue that is rightfully due and protecting consumers of alcohol beverages. Assisting industry members to understand and comply with the Federal laws and regulations regarding the commodities TTB regulates is an integral part of both activities.

In FY 2009, TTB used an account code structure which provides a direct link from the Bureau budget to specific programs and project activities. An analysis of the data stemming from the account code structure shows that, in FY 2009, TTB spent the $96,615,000 in obligated or expended resources equally (50/50) under these two budget activities.



The Total Spending amount includes obligations and expenditures from the FY 2009 TTB appropriation.

Spending by Major Object Class



In this report, TTB presents its spending by budget activity and program to explain the cost of delivering the services that support the mission. The Bureau also presents specific data regarding the purchase of goods and services by major object class that support its program activities. For TTB, the majority of spending falls into two principal major object classes. These two object class categories comprise 82 percent of the Bureau's spending from its annual appropriations and include Salaries and Benefits and Advisory and Assistance Services (Contracts). At a cost of $56.9 million, or 59 percent of total spending by object class, Salaries and Benefits covers the cost of the Bureau's roughly 500 FTE positions in FY 2009. The Advisory and Assistance Services object class constitutes $21.8 million, or 23 percent, of FY 2009 spending, and covers the cost of both commercial and intragovernmental services. The commercial contracts category is predominantly IT contracts in support of engineering, infrastructure, and support services. Also, it includes other commercial contracts for services such as the scanning and imaging of label applications and tax forms, lab maintenance, and Web site development. Intragovernmental services include spending related to administrative support services provided by our shared service provider for human resources, accounting, travel, and procurement. Other intragovernmental contract services include the costs for background investigations, publications in the Federal Register, and Federal protective services. The Bureau's travel costs are primarily related to its audits and investigations. The remaining object classes that cover the FY 2009 spending activity include those cost categories for rent, communications, equipment, and other miscellaneous categories.

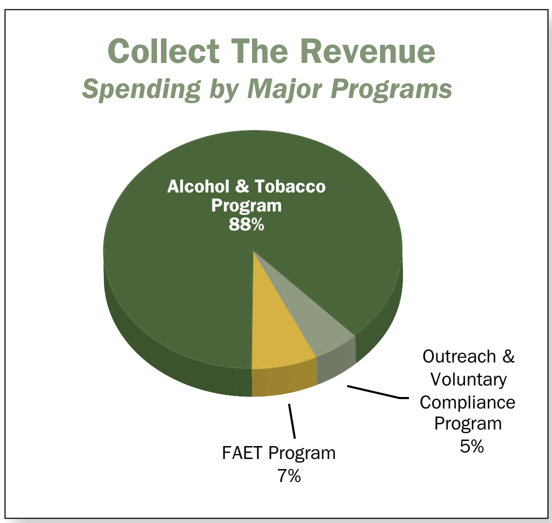
In order to ascertain the full costs of each of these budget activities, the overhead costs were allocated and combined with the direct program costs. TTB arrived at the overhead allocation by applying the pro rata share of the number of direct program dollars to each overhead cost category. The overhead is comprised of three major cost components: 1) general and administrative costs; 2) legal costs; and 3) information technology costs. The general and administrative category consists of costs related to operating the human resources, finance, procurement, training, facilities management, and other support-type functions.

Spending by Budget Activity to Achieve TTB Mission Goals

Collect the Revenue..... $48,369,000

The Collect the Revenue budget activity encompasses TTB's revenue strategy and goal to provide the most effective and efficient system for the collection of all revenue that is rightfully due. It is also designed to prevent or eliminate tax evasion and other criminal conduct and provide high-quality service while imposing the least regulatory burden.

Under the Collect the Revenue activity, TTB administers three programs: 1) Alcohol and Tobacco Tax; 2) Firearms and Ammunitions Excise Tax (FAET); and 3) Outreach and Voluntary Compliance.



In FY 2009, TTB expended 88 percent of its Collect the Revenue resources in collecting Federal excise taxes from the alcohol and tobacco industries and 7 percent in collecting FAET. The specific projects that comprise these costs include the processing of tax returns and operational reports at the National Revenue Center and the audits and investigations conducted on industry.

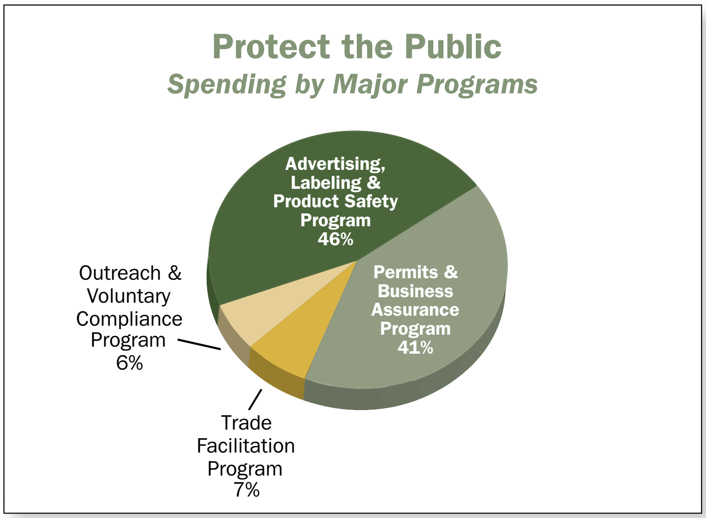
Costs for the Outreach Program reached five percent of our Collect the Revenue resources. These resources went toward efforts to educate and train industry members regarding their obligations in the areas of tax calculations and remittance.

Protect the Public..... $48,246,000

The Protect the Public budget activity encompasses TTB's strategy and goal to ensure industry compliance with laws and regulations designed to protect the consumers of alcohol beverages.

TTB does this by assuring the integrity of the people who operate these businesses, of the products themselves, and of the marketplace in which they are traded.

TTB administers four programs under the Protect the Public budget activity: 1) Permits and Business Assurance; 2) Advertising, Labeling, and Product Safety; 3) Trade Facilitation; and 4) Outreach and Voluntary Compliance.



An analysis of the financial data from FY 2009 reveals that TTB spent the preponderance of its Protect the Public resources on two programs: Labeling, Advertising, and Product Safety at 46 percent, and Permits and Business Assurance at 41 percent.

The Labeling, Advertising, and Product Safety Program includes activities designed to assure that beverage alcohol labels fully and accurately describe the products upon which they appear and are not misleading. It also encompasses activities to verify that alcohol advertisements contain all mandatory information and do not mislead consumers. The Product Safety component involves all investigative and laboratory activities performed as part of the Alcohol Beverage Safety and Verification Program, including work related to domestic and imported product analysis.

The Permits and Business Assurance Program is designed to determine the eligibility of persons wishing to enter any of the businesses TTB regulates and to process applications for changes to the original permit. These activities may include a field investigation. The permit is necessary in order to conduct operations in the regulated industries.

The remainder of the Protect the Public resources were divided between the Trade Facilitation Program (7 percent) and the Outreach and Voluntary Compliance Program (6 percent).

Systems and Controls

Introduction

During FY 2009, TTB contracted with BPD ARC to handle its administrative, human resources, and financial functions.

Accounting Systems and Controls

The BPD ARC accounting system, known as Oracle Federal Financials, is certified by the Joint Financial Management Improvement Program and is in full compliance with Treasury reporting requirements; it also meets requirements under the Federal Financial Management Improvement Act (FFMIA).

The Bureau successfully met the Department of the Treasury's reporting requirements and has maintained accurate and reliable financial information on TTB's program activities. The various administrative modules integrated with the TTB financial system have proven to accurately capture Bureau financial data and provide reliable information to management to inform decision making. Only two TTB databases operate outside the BPD ARC environment—the TTB property management system and the tax administration database, IRIS.

Federal Managers' Financial Integrity Act of 1982 (FMFIA)

The FMFIA requires Federal agencies to conduct ongoing evaluations of the systems of internal accounting and administrative control. Annually, TTB must report to Treasury all material weaknesses found through these evaluations. Treasury submits a consolidated report on the Department's controls to the President.

The FMFIA also requires the heads of agencies to provide the President with yearly assurance that obligations and costs are in compliance with applicable laws; that funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and revenues and expenditures are properly recorded and accounted for.

To provide this report and assurance to the President, the Secretary of the Treasury depends upon information from component heads regarding their management controls. The FMFIA program places reliance on each office at TTB to maintain a cost-effective system of controls to provide reasonable assurance that Government resources are protected against fraud, waste, abuse, mismanagement, or misappropriation.

Responsibilities of the Bureau's executive staff include ensuring that programs and administrative support activities are managed efficiently and effectively. Managers must conform to specific management accountability and improvement policies when designing, planning, organizing, and carrying out their responsibilities in order to ensure the most efficient and effective operation of their programs.

These policies address:

- Delegation of authority and responsibility;
- Hierarchical reporting of emerging management problems;
- Personal integrity;
- Quality data;
- Separation of key duties and responsibilities;
- Periodic comparisons of actual with recorded accountability of resources;
- Routine assessment of programs with a high potential for risk;
- Systematic review strategy to assess the effectiveness of program operations; and
- Prompt management actions to correct significant problems or improve operations.

Since its inception, TTB has gradually developed its own Bureau-specific policies.

Management accountability systems must assure basic compliance with the objectives of the FMFIA and the management control standards set by the Government Accountability Office. In addition, any inspection, audit, evaluation, peer or program review process, self-assessment, or the equivalent, used by TTB management to keep informed about needs and opportunities for improvement must incorporate these same standards into its methodology.

Furthermore, the Bureau completed an annual risk assessment for improper payments on all of its programs and activities. This process disclosed low risk susceptibility for improper payments, and documented that sound internal management and controls were in place at the Bureau to cover its disbursements.

The Bureau continues to strengthen and improve the execution of its mission through the application of sound internal controls over financial reporting. In response to OMB Circular A-123, Management's Responsibility for Internal Controls, the Bureau, in concert with the Department, developed and implemented an extensive testing and assessment methodology that identified and documented internal controls over financial reporting on our revenue accounting activities.

This increased emphasis on management controls has had a positive impact on programs and enabled the Bureau to achieve the intended results. The process also ensures that the utilization of resources is consistent with mission priorities and that program and resources are being used without waste, fraud, or mismanagement. Also, in addition to the A-123 review, TTB conducted a series of office reviews during FY 2009 that included an extensive review of administrative and internal controls.

The audit of the FY 2009 balance sheet disclosed no instances of noncompliance on FFMIA matters, and showed that the Bureau operates in susbstantial compliance with 1) Federal financial management systems requirements, 2) applicable Federal accounting standards, and 3) the United States Government

Standard General Ledger at the transaction level. However, the audit identified two control deficiencies related to property accounting and the computation and recording of accrued liabilities and allowance for doubtful accounts.

Financial Statement Highlights

The following overview of the TTB financial statements highlights certain aspects of the financial statements for the fiscal year ended September 30, 2009.

- The Statement of Custodial Activity shows the amount of revenue received during FY 2009 compared with FY 2008, along with tax refunds, drawback on Manufacturer of Nonbeverage Products claims, and cover-over payments. The amount displayed shows that the total Federal excise tax revenues collected from alcohol, tobacco, firearms, and ammunition amounted to $20.6 billion. Within this total, the Bureau processed tax refunds, drawback claims, and cover-over payments in the amount of $768 million.
    - **Drawback claims** of $269 million were processed based on claims filed from MNBPs. Under current law, a drawback claim is allowed when distilled spirits on which the tax has been paid were unfit for beverage purposes and used in the production of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfumes.
    - **Tax refunds** and other adjustments (e.g., interest) were processed in the amount of $18 million.
    - **Cover-over payments** were returned to Puerto Rico and the Virgin Islands in the amount of $481 million. Such taxes collected on rum imported in the United States are "covered over," or paid into, the treasuries of Puerto Rico and the Virgin Islands.
    - **The disposition of the custodial revenue**, after refunds, claims, and cover-over payments, nets to $19.9 billion, and that amount was deposited to the U.S. Treasury to fund the Federal Government, with the exception of the Federal firearms and ammunition Federal excise taxes. Those revenues, in the amount of $453 million, were remitted to the Fish and Wildlife Restoration Fund under provisions of the Pittman Robertson Act of 1937.
- The Statement of Net Cost shows the total net cost of operations at $99.9 million for the Bureau to administer its two budget activities.
    - The total net cost reported as program costs under the Collect the Revenue program was $50.0 million.
    - The total net cost reported as program costs under the Protect the Public program was $49.9 million.

- The Balance Sheet shows the assets, liabilities, and net position as of a point in time, in this case, as of September 30, 2009.
    - The total assets were reported as $67.2 million at the close of the fiscal year. Of this amount, $31.2 million is classified as the fund balance with Treasury. That fund balance account is the undisbursed account balance with the Treasury, primarily resulting from undisbursed appropriations.
    - The total liabilities amount reported is $38.4 million, of which total intragovernmental liabilities amounts to $10.2 million. The other liabilities are classified by type, such as accrued tax refunds, payables, and other liabilities.
- The Statement of Change in Net Position shows a total net position balance of $28.7 million, and that amount represents the unexpended appropriations from both prior periods and from the current operating cycle in addition to Net Position from Operations.
- The Statement of Budgetary Resources shows the budgetary resources received and the status of those resources. For TTB, the resources are primarily annual appropriations received from the Omnibus Appropriations Act in the amount of $99.1 million, in addition to spending authority from collections. The offsetting collections amount was $3.1 million. Of that amount, $2.5 million is from the recovery of those costs associated with the administration of the cover over program, along with other miscellaneous reimbursable activities.

Notes to the Basic Financial Statements

The notes to the basic financial statements provide additional information that is essential to a full understanding of the financial information provided in the statements.

Supplementary Information

In addition to the basic financial statements and accompanying notes, this report presents other supplementary information. For instance, TTB includes a table that outlines the tax collections for the past 10 years for each of the key revenue sources. Also, a table has been included to show the refunds, cover-over payments, and drawback payments for the past 10 years.

Financial Statements, Accompanying Notes, and Supplemental Information

Limitations of Financial Statements

The principal statements have been prepared to report the financial position and results of operations of the entiy, pursuant to the requirements of 31 U.S.C. 3515(b). While the statements have been prepared from the books and records of the entity in accordance with GAAP for federal entities and the formats prescribed by the Office of Management and Budget (OMB), the statements are in addition to the financial reports used to monitor and control budgetary rescources, which are prepared from the same books and records. Only the fiscal 2009 Balance Sheet and related notes have been audited.

Management Responsibilities

Bureau management is responsible for the fair presentation of information contained in the principal financial statements, in conformity with generally accepted accounting principles (GAAP), and the form and content for entity financial statements specified by OMB in Circular A-136.

Management is also responsible for the fair representation of TTB's performance measures in accordance with OMB requirements. The quality of the Bureau's internal control structure rests with management, as does the responsibility for identification of and compliance with pertinent laws and regulations.

TTB in Relation to Treasury's Annual Financial Statements

The Department of the Treasury received an unqualified audit opinion on its FY 2009 financial statements. The financial activities of the Bureau are an integral part of the information reported by the Department of the Treasury.

This unqualified audit opinion means that the financial information presented by the Treasury, which includes TTB's financial activities, was presented fairly and in conformity with generally accepted accounting principles (GAAP) of the United States.

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Financial Statements

Inspector General
United States Department of the Treasury

Administrator
Alcohol and Tobacco Tax and Trade Bureau

We have audited the accompanying balance sheet of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2009 (hereinafter referred to as "2009 balance sheet"). The 2009 balance sheet is the responsibility of the Alcohol and Tobacco Tax and Trade Bureau's management. Our responsibility is to express an opinion on the 2009 balance sheet based on our audit. We were not engaged to audit the balance sheet as of September 30, 2008, or the accompanying statements of net cost, changes in net position, budgetary resources, and custodial activity for the years ended September 30, 2009 and 2008 (hereinafter referred to as "other 2009 and 2008 financial statements"), and accordingly, we do not express an opinion on the other 2009 and 2008 financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements* as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the 2009 balance sheet is free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures related to the 2009 balance sheet, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall 2009 balance sheet presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2009 balance sheet referred to above presents fairly, in all material respects, the financial position of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2009 in conformity with U.S. generally accepted accounting principles.

The information in the *Part I: Management's Discussion and Analysis* (MD&A) and *Required Supplemental Information* (RSI) sections is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. Certain information presented in the MD&A and RSI is based on the other 2009 and 2008 financial statements on which we have not expressed an opinion. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information as they relate to the 2009 balance sheet. However, we did not audit this information and, accordingly, we express no opinion on it.

KPMG

Our audit was conducted for the purpose of forming an opinion on the 2009 balance sheet. The Other Accompanying Information included in (1) pages i through vi, (2) *Part II: Program Performance Results*, (3) pages 45 through 54 and pages 95 through 98 of *Part III: Financial Results, Position, and Condition*, and (4) *Part IV: Appendices* is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the 2009 balance sheet, and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our reports dated May 28, 2010, on our consideration of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of those reports is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in assessing the results of our audits.

KPMG LLP

May 28, 2010

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Internal Control Over Financial Reporting

Inspector General
United States Department of the Treasury

Administrator
Alcohol and Tobacco Tax and Trade Bureau:

We have audited the balance sheet of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2009 (hereinafter referred to as "2009 balance sheet") and have issued our report thereon dated May 28, 2010. We were not engaged to audit the balance sheet as of September 30, 2008, or the statements of net cost, changes in net position, budgetary resources, and custodial activity for the years ended September 30, 2009 and 2008, and accordingly, we do not express an opinion on these financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the 2009 balance sheet is free of material misstatement.

The management of the Alcohol and Tobacco Tax and Trade Bureau is responsible for establishing and maintaining effective internal control. In planning and performing our audit of the 2009 balance sheet, we considered the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting as it relates to the 2009 balance sheet by obtaining an understanding of the design effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our auditing procedures for the purpose of expressing our opinion on the 2009 balance sheet. To achieve this purpose, we did not test all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982*. The objective of our audit was not to express an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Alcohol and Tobacco Tax and Trade Bureau's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in the internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses.

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

KPMG

In our audit of the 2009 balance sheet, we identified certain significant deficiencies in internal control over financial reporting that we consider to be material weaknesses, described in Exhibit I.

The Alcohol and Tobacco Tax and Trade Bureau's response to the findings identified in our audit are presented in Exhibit I. We did not audit the Alcohol and Tobacco Tax and Trade Bureau's response and, accordingly, we express no opinion on it.

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

KPMG LLP

May 28, 2010

MATERIAL WEAKNESSES

IMPROVEMENTS ARE NEEDED IN PROPERTY CAPITALIZATION CONTROLS

During the 2009 audit we tested capital property processes and controls. We found the "property ledger" that serves as the Alcohol and Tobacco Tax and Trade Bureau's record of assets for the purposes of calculating depreciation, maintaining the record of accumulated depreciation, and for financial reporting was not reconciled to property inventories, and that records and files maintained for the property recorded in the ledger did not agree to the property in use at headquarters, the lab facilities, and the data centers.

Additionally, the Alcohol and Tobacco Tax and Trade Bureau's Acquisition and Facilities Management Division is responsible for issuing bureau guidance related to capital property. This guidance was last issued in September of 2005 and the guidance did not include policies and procedures critical to accounting for and reporting capital property.

Statement on Federal Financial Accounting Standards (SFFAS) 6 states that "all general PP&E shall be recorded at cost. Cost shall include all costs incurred to bring the PP&E to a form and location suitable for its intended use." SFFAS 6 further states that for "existing general PP&E, if historical cost information necessary to comply with recognition and measurement provisions has not been maintained, estimates are required. Estimates shall be based on: cost of similar assets at the time of acquisition, or current cost of similar assets discounted for inflation since the time of acquisition (i.e., deflating current costs to costs at the time of acquisition by general price index)."

The U.S. Government Accountability Office Standards for Internal Controls in the Federal Government states, "Internal control techniques are the mechanism by which control objectives are achieved. Techniques include, but are not limited to, such things as specific policies, procedures, plans of organization, and physical arrangements." It also states, "Documentation of internal control systems should include identification of the cycles and related objectives and techniques, and should appear in management directives, administrative policy, and accounting manuals.

As a result of these weaknesses, the Alcohol and Tobacco Tax and Trade Bureau's property and general ledgers were incomplete and inaccurate. Not all capital assets in use had been recorded and for other assets the amount recorded were inaccurate. The financial statement effects of these weaknesses were as follows: acquisition costs were understated by approximately $1,398,000, accumulated depreciation was overstated by approximately $413,000, and net capital assets were understated by approximately $1,811,000.

Recommendations:

We recommend that management of the Alcohol and Tobacco Tax and Trade Bureau:

1. Update policy and procedures to establish proper procedures for maintaining records for property, plant, and equipment.

2. Provide the training and instruction necessary to carry out the established procedures.

3. Institute policies and procedures to ensure that recording, physical inventory, and adjustments to capital property are complete, accurate, and timely throughout the year.

Management Response:

Management concurs with the finding.

TTB accepts the constructive recommendations from KPMG which will improve the financial reporting on property capitalization controls. As background, and for purposes of providing context for the current internal controls environment related to property capitalization, the Alcohol and Tobacco Tax and Trade Bureau (TTB) was established on January 24, 2003, as a result of the Homeland Security Act of 2002 (Pub. L. 107-296). The Act abolished the former Bureau of Alcohol, Tobacco and Firearms and created two new agencies—TTB within the Department of the Treasury and the Bureau of Alcohol, Tobacco, Firearms and Explosives within the Department of Justice. During the transitional period, the new Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF), continued to provide administrative support services to TTB, including property management services, and maintained the bureau's property records for both non-capital and capital property. Beginning in fiscal year (FY) 2005, TTB transitioned its property management services from ATF to the Bureau of Public Debt (BPD). In the transfer of inventory information between those two organizations, the asset values and the sources of the values were not included as part of the TTB inventory data, which contributed to the lack of documentation for property, plant, equipment (PP&E) reported under this audit. In late FY 2005, TTB was notified that BPD would no longer provide property management services. TTB requested, and was granted, a six-month extension of BPD's services, and in that time procured, installed, and transferred PP&E data to a new asset management system. TTB acquired a commercial off-the-shelf (COTS) package, trained its staff on the use of that system, and the system went into operation in April 2006. This product is a standalone COTS package and is not interfaced with the core accounting system, maintained by our shared service provider, BPD Administrative Resource Center (BPD ARC). This absence of system communication is a significant cause of the problems referenced by the audit. An investment to integrate the core accounting system and the COTS package would be costly, and most likely outweigh the expected benefits that would be realized for TTB to invest in an automated solution. Presently, BPD ARC does not have an automated solution that would interface a property subsystem with the core accounting and procurement systems. In the absence of an automated solution, TTB will need to establish policy and procedures to capture and record information on PP&E. Moving forward, TTB will reconcile information from its accountable property system and its subsidiary records to the core accounting system, and will enhance oversight of this operation.

Additionally, TTB plans to develop business processes to ensure the accurate value of assets is recorded in the accountable property system to support financial reporting. TTB will address this problem through its directive on Property Management, which is in the final stages of review and approval. Training of the property custodians under the TTB Field Operations (FO) directorate has been completed, and our objective is to finish the training of all TTB property custodians by the end of FY 2010. Furthermore, the TTB asset management system has been updated to include the asset values supported by documentation of either the actual cost of the assets or a reasonable determination of the estimated value of the recorded assets. TTB has engaged a consulting company to assist in the monitoring and implementation of property management procedures, which will support the implementation of a sound strategy for proper accountability of recorded assets for financial reporting.

IMPROVEMENTS ARE NEEDED IN ACCOUNTS PAYABLE ACCRUAL CONTROLS, TESTING AND REVIEW OF JOURNAL ENTRY SUPPORT, AND REVIEW OF ALLOWANCES FOR ACCOUNTS RECEIVABLE

During the 2009 audit we tested the accounts payable balances and the related processes and controls. We identified amounts recorded to accounts payable in error. Year end accruals for services performed were recorded based upon estimates that were incomplete. Additionally, we identified instances where accruals entered during September were incorrectly reversed upon invoice payment that occurred later that month.

As a part of the year-end closing process the Alcohol and Tobacco Tax and Trade Bureau reviews expense accruals. However this review of the accruals for contract services was not comprehensive and did not identify the incorrect reversal of accruals and did not identify errors in the amounts for the accrual of services identified as received but not yet paid.

In addition, during the 2009 audit we tested journal entry support for the allowance for loss on tax and trade receivables. We identified an error in the calculations used to arrive at the allowance balance for tax and trade receivables at year-end. At year-end TTB recorded entries to the allowance balances based upon the application of historical data to the year-end receivable balances, however, the calculation used resulted in an understatement to the allowance account by $8.5 million. We also tested the appropriateness of the review of the status of accounts receivable subsequent to the fiscal year-end. At year-end TTB reviews and establishes an allowance for doubtful accounts receivable. The review of this allowance is not continuous but only at a point in time at or near fiscal year-end, however the collectability of accounts receivable changes with events and the passage of time throughout the year. During the period of time subsequent to the end of the fiscal year we identified the need to increase the allowance for loss on tax and trade receivables by $82.2 million for a material receivable that was not identified due to the lack of review of the status of accounts receivable.

SFFAS 1 states that "accounts payable are amounts owed for goods and services received from, progress in contract performance made by, and rents due to other entities; for which payment has not been made." And "When goods or services are received or work progress is made under either a short or long term contract, a liability for unpaid amounts should be recognized."

SFFAS 1 also states that "An allowance for estimated uncollectible amounts should be recognized to reduce the gross amount of receivables to its net realizable value.

As a result of these weaknesses in internal control, accounts payable were understated, prior to the identification by the auditors of errors, by approximately $850,000; the allowance for loss on tax and trade receivables balance was understated by $90.7 million.

Recommendations:

We recommend that management of the Alcohol and Tobacco Tax and Trade Bureau:

1. Perform a comprehensive review of the status of all contracts with significant open obligation balances, the significance of which should be determined through the review of the amounts recorded for the individual obligations in relation to the total of open obligations.

2. Perform reviews, on a test basis, of all contract obligations not otherwise reviewed.

3. Conduct a 100% review and authorization of the accrual entries developed as a part of the year end closing process to ensure the accrual entries are appropriate.

4. Ensure the mathematical accuracy of the calculations for significant accounts such as the allowance for tax and trade receivables, where the transactions are based upon inputs and estimates.

5. Review accounts receivable and their related allowance on a continuous periodic basis to ensure the allowance accounts are updated appropriately as events occur affecting the collectability of accounts receivable.

Management Response:

TTB management acknowledges errors in the computation of both accrued liabilities and the calculation of the allowance account pertaining to the tax and trade accounts receivable account. Those miscalculations were limited to financial reporting as to the amount of liabilities due at the end of the year, and with the understatement of the allowance for doubtful accounts related to tax and trade receivables.

Accrued Liabilities Issue: The accrued liabilities error did not result in any overpayments or improper payments to vendors. All vendor payments made were based on the invoice amounts that were certified by TTB employees responsible for overseeing the receipt of those goods and services. TTB does not anticipate any major changes to its year end accrual process, but does plan to exercise greater care and due diligence in the computation and supervisory review of accrual entries. TTB's present policy and procedures for developing the accrual entries substantially capture these requirements. TTB will renew its efforts to ensure that those computations are accurately recorded at year end. Present procedures require a comprehensive review of all open obligations with an outstanding open balance of $100,000 or greater. TTB's procedures already provide for considering a lower threshold for the obligation balance if the items covered by that threshold do not represent the preponderance of open obligations.

The vast majority of the differences noted during the audit (i.e., more than $704,000 of $830,000 adjustments) related to four contracts where TTB's procedures identified the need to accrue for unbilled goods and services. Human error, not TTB's policy and procedures, resulted in underestimating the cost of those unbilled services. Some additional differences resulted because orders with open balances below $100,000 were not reviewed by TTB. However, the vast majority of these differences were not the result of the process, but rather errors in estimated unbilled amounts.

Allowance for doubtful accounts on Tax and Trade Receivable Account Issue: Additionally, the audit uncovered an error in the computation of the allowance for doubtful accounts on tax and trade receivables. At year end, a computation is made to determine an appropriate amount to record as an allowance for doubtful accounts for the tax and trade receivables. The error resulted in an understatement of the allowance amount by approximately $8.5 million. The methodology for computing that allowance was based on a combination of specific identification and aging of accounts receivable, and was found to be reasonable. The methodology used both historical and current year information. The analysis encompassed the full scope of accounts and activity covering all fiscal years. The miscalculation in the allowance resulted from a formula error, in a single cell, in one of multiple spreadsheets that factored into the analysis. TTB recognizes that an error was made in this computation and will revisit current accounting procedures. Before recording the allowance adjustment in the accounting system, where practical, we will conduct a more detailed supervisory review of the analysis in an effort to ensure mathematical accuracy and that our operating procedures were followed.

Lastly, on September 18, 2009, TTB recorded an $82.2 million tax receivable resulting from an assessment and related Notice and Demand issued to tobacco manufacturer who had been operating illicitly. The manufacturer had applied for a permit with TTB, which the Bureau denied. In response to the denial, the manufacturer appealed to an Administrative Law Judge (ALJ). Based on various facts that became more evident during the hearing process, when the ALJ issued a recommended decision on March 19, 2010, upholding TTB's decision to deny the manufacturer's permit application, it became more clear that the Bureau would have extreme difficulties in collecting the $82.2 million assessment, given the many enforcement challenges it would face as a result of the operation taking place on an Indian reservation on the New York and Canada border. As a result, TTB's management reassessed the collectability of the receivable and concluded that it would be very unlikely that it would be collectible, and adjusted the fiscal 2009 financial statements and related notes with an allowance for doubtful accounts to recognize it as such.

TTB also recognizes that further consideration must be given to events occurring subsequent to September 30 and prior to the issuance of the annual report, that if not recognized would materially misstate balances recorded as of September 30.

In summary, TTB is confident that its established business procedures for recording accrued liabilities and allowance for doubtful accounts are sensible and represent a rational approach to identifying and recording its year end liabilities and uncollectible tax receivables. Moving forward, TTB will exercise greater due diligence in the computation of the entries and the supervisory review process. We will also periodically review the accounts receivable and related allowances to appropriately recognized events that would affect the collectability of the receivable, particularly during the period between September 30 and the issuance of the auditors' report.

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report on Compliance and Other Matters

Inspector General
United States Department of the Treasury

Administrator
Alcohol and Tobacco Tax and Trade Bureau:

We have audited the balance sheet of the Alcohol and Tobacco Tax and Trade Bureau as of September 30, 2009 (hereinafter referred to as "2009 balance sheet") and have issued our report thereon dated May 28, 2010. We were not engaged to audit the balance sheet as of September 30, 2008, or the statements of net cost, changes in net position, budgetary resources, and custodial activity for the years ended September 30, 2009 and 2008, and accordingly, we do not express an opinion on these financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*, as amended. Those standards and OMB Bulletin No. 07-04 require that we plan and perform the audit to obtain reasonable assurance about whether the 2009 balance sheet is free of material misstatement.

The management of the Alcohol and Tobacco Tax and Trade Bureau is responsible for complying with laws, regulations, and contracts applicable to the Alcohol and Tobacco Tax and Trade Bureau. As part of obtaining reasonable assurance about whether the Alcohol and Tobacco Tax and Trade Bureau's 2009 balance sheet is free of material misstatement, we performed tests of the Alcohol and Tobacco Tax and Trade Bureau's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of the 2009 balance sheet amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of the *Federal Financial Management Improvement Act of 1996* (FFMIA). We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, and contracts applicable to the Alcohol and Tobacco Tax and Trade Bureau. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

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

The results of our tests of FFMIA disclosed no instances in which the Alcohol and Tobacco Tax and Trade Bureau's financial management systems did not substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

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

KPMG LLP

May 28, 2010

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
BALANCE SHEET
As of September 30, 2009 and 2008

	2009	2008 (Unaudited)
	(In Thousands)	
ASSETS		
Intragovernmental Assets:		
Fund Balance with Treasury (Note 2)	$ 31,225	$ 34,948
Accounts Receivable (Note 3)	489	87
Due from the General Fund (Note 5)	8,489	12,167
Advances (Note 7)	1,933	2,303
Total Intragovernmental Assets	42,136	49,505
Accounts Receivable (Note 3)	379	366
Tax and Trade Receivables, Net (Note 4)	9,030	12,255
Property, Plant and Equipment, Net (Note 6)	15,650	13,282
TOTAL ASSETS (Note 8)	$ 67,195	$ 75,408
LIABILITIES		
Intragovernmental Liabilities:		
Accounts Payable	$ 408	$ 579
Payroll Benefits	527	462
FECA Liabilities	64	95
Due to the General Fund (Note 4 and Note 5)	8,173	12,203
Other Liabilities (Note 9)	854	52
Total Intragovernmental Liabilities	10,026	13,391
Accounts Payable	3,820	2,730
Payroll Benefits	2,408	2,139
FECA Actuarial Liability	243	243
Refunds (Note 5)	8,491	12,167
Unfunded Leave	4,319	4,280
Cash Bond Liabilities (Note 2)	8,677	6,394
Other Liabilities (Note 9)	446	7,941
TOTAL LIABILITIES	$ 38,430	$ 49,285
NET POSITION		
Unexpended Appropriations	$ 17,734	$ 17,463
Cumulative Results of Operations	11,031	8,660
TOTAL NET POSITION	28,765	26,123
TOTAL LIABILITIES AND NET POSITION	$ 67,195	$ 75,408

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF NET COST
For the Years Ended September 30, 2009 and 2008

	2009 (Unaudited)	2008 (Unaudited)
	(In Thousands)	
PROTECT THE PUBLIC		
Program Costs		
Intragovernmental Gross Costs	$ 13,489	$ 13,513
Less: Intragovernmental Earned Revenue	(7)	-
Intragovernmental Net Costs	13,482	13,513
Gross Costs with the Public	36,442	35,647
Less: Earned Revenues from the Public	(27)	(1)
Net Costs with the Public	36,415	35,646
Total Net Program Cost	$ 49,897	$ 49,159
COLLECT THE REVENUE		
Program Costs		
Intragovernmental Gross Costs	$ 14,330	$ 13,542
Less: Intragovernmental Earned Revenue	(606)	(419)
Intragovernmental Net Costs	13,724	13,123
Gross Costs with the Public	38,713	35,724
Less: Earned Revenues from the Public	(2,472)	(2,468)
Net Costs with the Public	36,241	33,256
Total Net Program Cost	$ 49,965	$ 46,379
NET COST OF OPERATIONS (Note 13)	$ 99,862	$ 95,538

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF CHANGES IN NET POSITION
For the Years Ended September 30, 2009 and 2008

	2009 (Unaudited)	2008 (Unaudited)
	(In Thousands)	
Cumulative Results of Operations		
Beginning Balances	$ 8,660	$ 8,541
Budgetary Financing Sources		
Appropriations Used	97,704	91,811
Other Financing Sources		
Transfers-in/out without reimbursement (+/-)	399	116
Imputed Financing from Costs Absorbed by Others (Note 12)	4,130	3,730
Total Financing Sources	102,233	95,657
Net Cost of Operations (Note 13)	(99,862)	(95,538)
Net Change	2,371	119
Cumulative Results of Operations	$ 11,031	$ 8,660
UNEXPENDED APPROPRIATIONS		
Beginning Balances	$ 17,463	$ 17,893
Budgetary Financing Sources		
Appropriations Received	99,065	93,515
Other Adjustments	(1,090)	(2,134)
Appropriations Used	(97,704)	(91,811)
Total Budgetary Financing Sources	271	(430)
Net Position of Unexpended Appropriations	$ 17,734	$ 17,463
TOTAL NET POSITION	$ 28,765	$ 26,123

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended September 30, 2009 and 2008

	2009 (Unaudited)	2008 (Unaudited)
	(In Thousands)	
BUDGETARY RESOURCES (Note 14)		
Unobligated Balance		
Beginning of Period	$ 2,408	3,136
Recoveries of Prior Year Obligations	1,102	1,228
Budget Authority:		
Appropriations Received	99,065	93,515
Spending Authority from Offsetting Collections:		
Earned		
Collected	3,097	2,929
Change in Receivable from Federal Sources	408	74
Change in Unfilled Customer Orders		
Without Advance from Federal Sources	276	206
Subtotal	102,846	96,724
Permanently not Available	(1,090)	(2,134)
TOTAL BUDGETARY RESOURCES	105,266	98,954
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred: (Note 15)		
Direct	$ 98,235	$ 93,255
Reimbursable	3,874	3,291
Subtotal	102,109	96,546
Unobligated Balance Apportioned	1,653	317
Unobligated Balance not Available	1,504	2,091
TOTAL STATUS OF BUDGETARY RESOURCES	$ 105,266	$ 98,954

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF BUDGETARY RESOURCES
For the Years Ended September 30, 2009 and 2008

	2009 (Unaudited)	**2008** (Unaudited)
	(In Thousands)	
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS:		
Unpaid obligations brought forward, Oct 1	$ 19,084	$ 19,218
Uncollected customer payments from Federal sources brought forward Oct 1	(880)	(599)
Total unpaid obligated balance brought forward, net	18,204	18,619
Obligations incurred, net	102,109	96,546
Gross Outlays	99,582	95,451
Recoveries of prior year unpaid obligations, actual	(1,102)	(1,228)
Change in uncollected customer payments from Federal sources	(684)	(280)
Obligated balances, net end of period		
Unpaid obligations	20,509	19,084
Uncollected customer payments from Federal sources	(1,563)	(880)
Total unpaid obligated balance, net, end of period	18,946	18,204
Net Outlays		
Gross outlays	99,582	95,451
Offsetting collections	(3,097)	(2,929)
Distributed offsetting receipts	(17)	(5)
NET OUTLAYS	$ 96,468	$ 92,517

The accompanying notes are an integral part of these statements.

DEPARTMENT OF THE TREASURY
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU
STATEMENTS OF CUSTODIAL ACTIVITY
For the Years Ended September 30, 2009 and 2008

	2009 (Unaudited)	2008 (Unaudited)
	(In Thousands)	
SOURCES OF CUSTODIAL REVENUE		
Revenue Received		
Excise Taxes (Note 16)	$ 20,616,487	$ 14,585,275
Interest, Fines and Penalties	2,602	705
Other Custodial Revenue	17	5
Total Revenue Received (Note 17)	20,619,106	14,585,985
Refunds and Drawbacks (Note 16)	(286,655)	(300,525)
Net Revenue Received	20,332,451	14,285,460
Accrual Adjustment	450	45,805
Total Source of Custodial Revenue	$ 20,332,901	$ 14,331,265
DISPOSITION OF CUSTODIAL REVENUE		
Amounts Provided to Non-Federal Entities (Note 16)	481,319	381,033
Amounts Provided to Fund the Federal Government (Note 17)	19,851,132	13,904,427
Accrual Adjustment	450	45,805
Total Disposition of Custodial Revenue	$ 20,332,901	$ 14,331,265
NET CUSTODIAL REVENUE ACTIVITY	$ -	$ -

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements

Note 1. Summary of Significant Accounting Policies

A. Reporting Entity

The Alcohol and Tobacco Tax and Trade Bureau (TTB) was established on January 24, 2003, as a result of the Homeland Security Act of 2002. The Act transferred firearms, explosives, and arson functions of the Bureau of Alcohol, Tobacco and Firearms (ATF) to the Department of Justice and retained the tax collection and consumer protection provisions of the Internal Revenue Code (IRC) and Federal Alcohol Administration Act in TTB within the Department of the Treasury. While the agency has a new name, the history of TTB's regulatory responsibility dates back to the creation of the Department of the Treasury and the first Federal taxes levied on distilled spirits in 1791. TTB has two primary programs: Collect the Revenue and Protect the Public. Under the Collect the Revenue program, TTB collects alcohol, tobacco, firearms, and ammunition excise taxes, and under its Protect the Public program, TTB protects the consumer by ensuring that alcohol beverages are labeled, advertised, and marketed in accordance with the law, and facilitates trade in beverage and industrial alcohols.

B. Basis of Presentation

The financial statements were prepared to report the significant assets, liabilities, and net cost of operations, changes in net position, budgetary resources, and custodial activities of TTB. The financial statements have been prepared from the books and records of TTB in conformity with generally accepted accounting principles (GAAP) in the United States, and form and content guidance for entity financial statements issued by the Office of Management and Budget (OMB) in OMB Circular A-136. TTB's accounting policies are summarized in this note. GAAP for Federal entities is prescribed by the Federal Accounting Standards Advisory Board (FASAB), which has been designated the official accounting standards-setting body for the Federal Government by the American Institute of Certified Public Accountants. Certain prior year balances may have been reclassified to conform to the current year's presentation.

C. Basis of Accounting

Transactions are recorded on a proprietary accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recorded when incurred, regardless of when cash is exchanged. However, under the budgetary basis, funds availability is recorded based upon legal considerations and constraints. As a result, certain line items on the proprietary statements may not equal similar lines on the budgetary financial statements.

D. Revenue and Financing Sources

(1) Exchange Revenue

Exchange Revenues are inflows of resources to a Government entity that the entity has earned by providing something of value to the public or another Government entity at a price. The majority of the Exchange Revenues earned by the Bureau result form providing services to the Government of Puerto Rico , as well as other Treasury entities.

(2) Financing Sources

Financing sources provide inflows of resources during the reporting period and include appropriations used and imputed financing. Unexpended appropriations are recognized separately in determining net position, but are not financing sources until used. Imputed financing sources are the result of other Federal entities financing costs on behalf of TTB.

TTB receives the majority of the funding needed to support the Bureau through congressional appropriations. The appropriations received are annual and multi-year funding that may be used, within statutory limits, for operating and capital expenditures.

(3) Imputed Financing Sources

Imputed financing sources are the result of Federal entities financing costs on behalf of TTB. Those entities pay future benefits for health insurance, life insurance, and pension benefits for TTB employees.

E. Custodial Revenue

For TTB, most custodial revenues result from collecting taxes on alcohol and tobacco products, which are transferred to the General Fund, and recognized as a nonexchange revenue on the Federal government's consolidated financial statements. The excise taxes collected by TTB come from businesses, and the taxes are imposed and collected at the producer and importer levels of operations. Members of the regulated industries paying excise taxes are distilleries, breweries, bonded wineries, bonded wine cellars, manufacturers of cigarette tubes, manufacturers of tobacco products, and manufacturers and importers of firearms and ammunition. These taxes are recorded on the records on a modified cash basis of accounting.

F. Fund Balance with Treasury

The Fund Balance with Treasury is the undisbursed account balance with the Treasury, primarily resulting from undisbursed appropriations. The balance is available within statutory limits to pay current liabilities and finance authorized purchase obligations. The Fund Balance also includes a non-entity balance, primarily the result of custodial activities related to collecting escrow payments designed to finance Offers-in-Compromise and cash bonds held in lieu of corporate surety bonds guaranteeing payment of taxes.

G. Accounts Receivable

Intragovernmental accounts receivable consist of amounts due under reimbursable agreements with Federal entities for services provided by TTB. Public accounts receivable consist of taxes, penalties, and interest that have been assessed but unpaid at year end.

Receivables due from Federal agencies are considered to be fully collectible. An allowance for doubtful accounts is established for public receivables based on specific identification and individual analysis.

H. Property, Plant, and Equipment

Property, plant, and equipment purchased with a cost greater than or equal to $25,000 per unit and a useful life of two years or more, is capitalized and depreciated. Normal repairs and maintenance are charged to expense as incurred.

TTB also capitalizes internal use of software when the unit cost or development costs are greater than or equal to $25,000. The same threshold also applies to enhancements that add significant functionality to the software. TTB will amortize this software based on its classification. The classifications are as follows: (1) Enterprise and other business software (five years) and (2) Personal productivity and desktop operating software (three years).

Additionally, TTB also capitalizes like assets purchased in bulk when the unit price is greater than or equal to $5,000 and less than $25,000, with the aggregated purchase amount greater than or equal to $250,000.

Assets are depreciated on a straight-line basis beginning the month the asset was put in to use.

I. Advances

Advances are payments made to cover certain periodic expenses before those expenses are incurred. In accordance with Public Law 91-614, TTB participated in the Treasury's Working Capital Fund for which it receives services on a reimbursable basis. Payments from TTB to Treasury are made in advance and are authorized for services that have been deemed as more advantageous and more economical when provided centrally. The services provided include those for telecommunications, payroll/personnel systems, printing, and other central services. The amount reported represents the balance available at the end of the fiscal year after charges/expenses incurred by the fund are deducted.

J. Non-entity Assets

Non-entity assets consist primarily of cash and receivables for excise taxes and fees that are to be distributed to the Treasury, other Federal agencies, and other governments. Non-entity assets are not considered a financing source (revenue) available to offset the operating expenses of TTB.

K. Liabilities

Liabilities represent the amount of monies, or other resources, that are likely to be paid by TTB as the result of a transaction or event that has already occurred. However, no liability can be paid by TTB absent an appropriation. Liabilities for which an appropriation has not been enacted and for which there is uncertainty an appropriation will be enacted, are classified as a liability not covered by budgetary resources. Also, the Government, acting in its sovereign capacity, can abrogate liabilities of TTB that arise from other than contracts.

Intragovernmental liabilities consist of amounts payable to the Treasury for collections of excise tax, fees receivable, payments to other Federal agencies, and accrued Federal Employees' Compensation Act (FECA) charges. Liabilities also include amounts due to be refunded to taxpayers, as well as amounts held in escrow for Offers-in-Compromise and cash bonds held in guaranteeing payment of taxes.

L. Litigation Contingencies and Settlements

Probable and estimable litigation and claims against TTB are recognized as a liability and expense for the full amount of the expected loss. Expected litigation and claim losses include settlements to be paid from the Treasury Judgment Fund (Judgment Fund) on behalf of TTB and settlements to be paid from Bureau appropriations. The Judgment Fund pays claims in excess of $2,500. Settlements paid from the Judgment Fund for TTB are recognized as an expense and imputed financing source.

M. Annual, Sick, and Other Leave

Annual and compensatory leave earned by TTB employees, but not yet used, is reported as an accrued liability. The accrued balance is adjusted annually to current pay rates. Any portions of the accrued leave, for which funding is not available, are recorded as an unfunded liability. Sick and other leave are expensed as taken.

N. Interest on Late Payments

Pursuant to the prompt payment Act, 31 # U.S.C. & 3901-3907, Federal agencies must pay interest on payments for goods or services made to business concerns after their due date. The due date is generally 30 days after receipt of a proper invoice or acceptance of the goods or services.

O. Retirement Plan

Employees hired after December 31, 1983, are automatically covered by FERS and Social Security. For most employees hired after December 31, 1983, TTB also contributes the employers' matching share of Social Security. For the FERS basic benefit, employees contribute 0.8 percent of basic pay while TTB contributes 11.2 percent, for a total contribution rate of 12.0 percent in FY 2009, as well as FY 2008. The cost of providing a FERS basic benefit, as provided by the Office of Personnel Management (OPM), is equal to the amounts contributed by TTB and the employees, because the plan is fully funded.

All employees are eligible to contribute to the Thrift Savings Plan (TSP). For those employees participating in the FERS, a TSP account is automatically established and TTB makes a mandatory 1 percent contribution to this account. In addition, TTB makes matching contributions, ranging from 1 to 4 percent, for FERS-eligible employees who contribute to their TSP accounts. Matching contributions are not made to the TSP accounts established by CSRS employees.

TTB recognized the full cost of providing future pension and other retirement benefits (ORB) for current employees as required by Statement of Federal Financial Accounting Standards (SFFAS) No. 5. Full cost includes pension and ORB contributions paid out of Bureau appropriations and costs financed by OPM. Costs financed by OPM are reported in the accompanying financial statements as an imputed financing revenue source. Reporting amounts such as plan assets, accumulated plan benefits, or unfunded liabilities, if any, is the responsibility of OPM.

P. Federal Employees' Compensation Act

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job and employees who have incurred a work-related injury or occupational disease. The future workers' compensation estimates were generated from an application of actuarial procedures developed to estimate the liability for FECA benefits. The actuarial liability estimates for FECA benefits include the expected liability for death, disability, medical, and miscellaneous costs for approved compensation cases. The liability is determined using the paid losses extrapolation method, which is calculated over the next 37-year period. This method utilizes historical benefit patterns related to a specific incurred period to predict ultimate payments related to that period.

Claims are paid for TTB employees by the Department of Labor (DOL) from the FECA fund, for which TTB reimburses DOL. The accrued liability represents claims paid by DOL for TTB employees, for which the fund has not been reimbursed. The actuarial liability is an estimate of future costs to be paid on claims made by TTB employees. The estimated future cost is not obligated against budgetary resources until the year in which the cost is billed to TTB.

Q. Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, as well as the disclosure of contingent liabilities at the date of the financial statements, and the amount of revenues and cost reported during the period. Actual results could differ from those estimates.

R. Tax Exempt Status

As an agency of the Federal Government, the Alcohol and Tobacco Tax and Trade Bureau is exempt from all income taxes imposed by any governing body, whether it is a Federal, state, commonwealth, local or foreign government.

Note 2. Fund Balance with Treasury

Fund Balance with Treasury as of September 30, 2009 and 2008 consisted of the following (in thousands):

	2009	2008 (Unaudited)
Fund Balances:		
General Funds	$22,103	$20,612
Other Funds	9,122	14,336
Total	$31,225	$34,948
Status of Fund Balances:		
Unobligated Balance - Available	$ 1,653	$ 317
Unobligated Balance - Unavailable	1,504	2,091
Obligated Balance Not Yet Disbursed	18,946	18,204
Subtotal	22,103	20,612
Adjustment for Non-Budgetary Funds	9,122	14,336
Total Status of Fund Balances	$31,225	$34,948

The other funds and non-budgetary fund balance primarily represents cash bonds, which are cash payments made to the Bureau by taxpayers, in lieu of obtaining corporate surety bonds, guaranteeing payment of taxes. It also includes Offers-in-Compromise (OIC). OICs are payments made to the Bureau, being held in escrow, to finance offers from taxpayers to settle their tax debt at less than the assessed amount.

The unobligated balance that is unavailable is the balance of prior years' expired appropriations.

Note 3. Accounts Receivable

Accounts Receivable as of September 30, 2009 and 2008 consisted of the following (in thousands):

	2009	2008 (Unaudited)
Intragovernmental Accounts Receivable:		
Due from Treasury Departmental Offices	$ 204	$ 87
Due from Treasury Executive Office of Asset Forfieture	285	-
Total Intragovernmental Accounts Receivable	$ 489	$ 87
Due from the Government of Puerto Rico	$ 365	$ 355
Due from Commercial Vendors	5	3
Due from Employees	9	8
Total Accounts Receivable Due from the Public	$ 379	$ 366

No allowance for doubtful accounts has been recognized, nor have any accounts been written off. All intragovernmental accounts receivable are fully collectible. Additionally, other non-Federal receivables consist of a receivable from the government of Puerto Rico, which is collected via an offset to cover-over payments the Bureau remits to Puerto Rico, and employee accounts receivable, which can be collected via salary offsets.

Note 4. Tax and Trade Receivables, Net

Tax and Trade Receivables as of September 30, 2009 and 2008 consisted of the following (in thousands):

	2009	2008 (Unaudited)
Tax and Trade Receivables	$ 107,925	$57,036
Interest Receivable	18,767	10,096
Penalties, Fines and Administrative Fees Receivable	12,007	6,941
Total Tax and Trade Receivables	138,699	74,073
Allowance for Doubtful Accounts	(129,669)	(61,818)
Total Tax and Trade Receivables, Net	$ 9,030	$12,255

All tax and trade receivables are non-entity assets. An allowance for uncollectible amounts has been established based on: 1) an analysis of individual receivable balances and 2) the application of historical non-collection rates for similar types of receivables. Because current laws governing the collection period for these tax assessments, 26 U.S.C. 6502, stipulate taxes are collectible for 10 years from the date the taxes were assessed, a large amount of aged receivables that are not likely to be collected have been offset with an allowance, but not written off. This is an offsetting liability for Due to General Fund.

Note 5. Due from the General Fund and Due to the General Fund

In addition to collecting taxes from the alcohol and tobacco industries, the Bureau also is responsible for paying refunds, when applicable, to those same industry members. Amounts due from the General Fund represent a receivable from appropriations to cover the Bureau's accrued refund liability to taxpayers of alcohol and tobacco excise taxes.

	2009	2008 (Unaudited)
Due from the General Fund	$ 8,489	$ 12,167

Amounts due to the General Fund primarily represent the balance of receivables related to Alcohol and Tobacco excise taxes. Receivables related to Firearms and Ammunition excise taxes are payable to the Department of Interior's Fish and Wildlife Fund, not the General Fund.

	2009	2008 (Unaudited)
Due to the General Fund	$ 8,173	$ 12,203

Note 6. Property, Plant, and Equipment, Net (PP&E)

Property, Plant and Equipment as of September 30, 2009 and 2008 consisted of the following (in thousands):

2009	Estimated Useful Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Internal Use Software	3 - 5	$ 8,760	$ 3,926	$ 4,834
Equipment	4 - 6	5,885	3,687	$ 2,198
Leasehold Improvements	2 - 5	535	350	$ 185
Building	40	9,772	1,339	$ 8,433
Total PP&E		$ 24,952	$ 9,302	$ 15,650

2008 (Unaudited)	Estimated Useful Life (Years)	Acquisition Value	Accumulated Depreciation	Net Book Value
Internal Use Software	3 - 5	$ 6,053	$ 2,658	$ 3,395
Equipment	4 - 6	4,815	4,484	331
Leasehold Improvements	2 - 5	1,346	393	953
Building	40	9,689	1,086	8,603
Total PP&E		$ 21,903	$ 8,621	$ 13,282

Depreciation and amortization are calculated using the straight-line method.

The balance in the buildings account represents TTB's 13.2 percent equity interest in the National Laboratory Center facility in Beltsville, Maryland, which TTB co-owns with ATF. The ownership rights were established in a June 4, 2004, opinion from the Chief Counsel.

Note 7. Advances

Intragovernmental advances consist of the balances paid to Treasury's Working Capital Fund that have not yet been earned and billed by the fund.

Note 8. Non-entity Assets

Non-entity assets as of September 30, 2009 and 2008 consisted of the following (in thousands):

	2009	2008 (Unaudited)
Intragovernmental Non-entity Assets:		
Fund Balance with Treasury	$ 9,122	$ 14,336
Due from the General Fund	8,489	12,167
Total Intragovernmental Non-entity Assets	17,611	26,503
Tax and Trade Receivables, Net	9,030	12,255
Total Non-Entity Assets	26,641	38,758
Total Entity Assets	40,554	36,650
Total Assets	$ 67,195	$ 75,408

Note 9. Other Liabilities

Other Liabilities as of September 30, 2009 and 2008 consisted of the following (in thousands):

	2009	2008 (Unaudited)
Due to the Fish and Wildlife Fund	$ 854	$ 52
Other Intragovernmental Liabilities	854	52
Offers-in-Compromise not yet Accepted	446	7,941
Total Other Liabilities with the Public	446	7,941
Total Other Liabilities	$ 1,300	$ 7,993

All Other Liabilities are considered current liabilities.

Note 10. Liabilities Not Covered by Budgetary Resources

Liabilities not Covered by Budgetary Resources as of September 30, 2009 and 2008 consisted of the following (in thousands):

	2009	2008 (Unaudited)
Accrued FECA Liability	$ 64	$ 95
Total Intragovernmental Liabilities not Covered by Budgetary Resources	64	95
FECA Actuarial Liability	243	243
Accrued Leave	4,319	4,280
Total Liabilities with the Public not Covered by Budgetary Resources	4,562	4,523
Total Liabilities not Covered By Budgetary Resouces	4,626	4,618
Total Liabilities Covered by Budgetary Resources	115,954	44,667
Total Liabilities	$ 120,580	$ 49,285

Note 11. Future Funding Requirements

Total liabilities not covered by budgetary resources generally do not equal the total financing sources yet to be provided on the Reconciliation of Net Cost of Operations to Budget. The amounts reported on the Balance Sheet are period ending balances, while the amounts reported on the Reconciliation of Net Cost of Operations to Budget are activity for the period.

Generally, liabilities not covered by budgetary resources require future funding and can be liquidated only with the enactment of future appropriations.

Note 12. Imputed Financing (Unaudited)

Imputed Financing as of September 30, 2009 and 2008 consisted of the following (in thousands):

	2009 (Unaudited)	2008 (Unaudited)
Health Insurance	$ 2,576	$ 2,339
Life Insurance	8	7
Pension	1,546	1,384
Total Imputed Financing	$ 4,130	$ 3,730

Imputed financing recognizes actual cost of future benefits to be paid by other Federal entities. These benefits include Federal Employees Health and Benefits Program (FEHB), Federal Employees Group Life Insurance Program (FEGLI), and pensions. Imputed financing also recognizes costs paid by the Judgment Fund. The Fund was established and funded by Congress under 31 U.S.C. 1304 to pay in whole or in part court judgments and settlement agreements negotiated by Treasury on behalf of agencies, as well as certain types of administrative awards. The Judgment Fund did not pay out any awards on TTB's behalf during fiscal years 2009 or 2008.

TTB does not report CSRS assets, FERS assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to retirement plans because the accounting for and reporting of such amounts is the responsibility of OPM. Based on cost factors provided by OPM, which vary by retirement plan, estimated future pension benefits for TTB employees, to be paid by OPM, totaled $1.5 million and $1.4million for fiscal years 2009 and 2008 respectively. Similarly, OPM rather than TTB, reports liabilities for future payments to retired employees who participate in the FEHB and FEGLI programs. The FEHB cost factor applied to a weighted average number of employees enrolled in the FEHB program increased in fiscal year 2009 to $5,756, from $5,220 in fiscal 2008, producing $2.6 million and $2.3 million of imputed cost for employees' heatlth benefits in each respective year. The cost factor, as provided by OPM, for employees enrolled in the FEGLI program, remained unchanged from fiscal 2008 to 2009, at .02 percent of employees' basic pay. The FEGLI amounts totaling $8,000 and $7,000 are also included as an expense and imputed financing source in TTB financial statements for fiscal years 2009 and 2008 respectively.

Note 13. Consolidated Gross Cost and Earned Revenue by Budget Function (Unaudited)

Consolidated Gross Cost and Earned Revenue by Budget Function Classification as of September 30, 2009 and 2008 consisted of the following (in thousands):

Fiscal Year Ended September 30, 2009 (Unaudited)

	Budget Function Classification		Gross	Earned	Net
Activity	Name	Code	Costs	Revenue	Costs
Intragovernmental	Central Fiscal Operations	803	$ 27,819	$ (613)	$ 27,206
With the Public	Central Fiscal Operations	803	75,155	(2,499)	72,656
Consolidated	Central Fiscal Operations	803	$ 102,974	$ (3,112)	$ 99,862

Fiscal Year Ended September 30, 2008 (Unaudited)

	Budget Function Classification		Gross	Earned	Net
Activity	Name	Code	Costs	Revenue	Costs
Intragovernmental	Central Fiscal Operations	803	$ 27,055	$ (419)	$ 26,636
With the Public	Central Fiscal Operations	803	71,371	(2,469)	68,902
Consolidated	Central Fiscal Operations	803	$ 98,426	$ (2,888)	$ 95,538

Note 14. Statement of Budgetary Resources vs. Budget of the United States Government (Unaudited)

The following charts displays balances from the fiscal year 2009 and 2008 Statement of Budgetary Resources and actual fiscal year balances included in the fiscal year 2011 and 2010 President's Budgets. There were no differences.

	September 30, 2009 (In Millions / Unaudited)		September 30, 2008 (In Millions / Unaudited)	
	Statement of Budgetary Resourses	President's Budget	Statement of Budgetary Resourses	President's Budget
BUDGETARY RESOURCES AVAILABLE FOR OBLIGATION	$ 103	$ 103	$ 97	$ 97
STATUS OF BUDGETARY RESOURCES AVAILABLE OBLIGATION				
Obligations Incurred	$ 102	$ 102	$ 97	$ 97
Unobligated balance carried forward, end of year	1	1	-	-
TOTAL STATUS OF BUDGETARY RESOURCES AVAILABLE FOR OBLIGATION	$ 103	$ 103	$ 97	$ 97
NET OUTLAYS	$ 96	$ 96	$ 93	$ 93

Additionally, the FY 2011 President's Budget disclosed budget authority of $473 million for fiscal year 2009, funding cover-over payments to Puerto Rico, which is not reported in the Statement of Budgetary Resources.

The cover-over payments and associated tax revenues are reported as custodial activity of the Bureau. The tax revenues are not available for use in the operation of the Bureau and are not reported on the Statement of Net Cost. Likewise, the resultant cover-over payments are not recognized as an operating expense of the Bureau. Consequently, to present the refunds as an expense of the Bureau on the Statement of Net Cost would be inconsistent with the reporting of the related Federal tax revenue and would materially distort the costs incurred by the Bureau in meeting its strategic objectives. Further, since this activity is not reported on the Statement of Net Cost, it would be contradictory to report the budget authority on the Statement of Budgetary Resources.

Note 15. Apportionment Categories of Obligations Incurred (Unaudited)

Obligations Incurred as of September 30, 2009 and 2008 consisted of the following (in thousands):

Fiscal Year	Apportionment Category	Direct Obligations	Reimbursable Obligations	Total Obligations Incurred
2009 (Unaudited)	Category B	$ 98,235	$ 3,874	$ 102,109
2008 (Unaudited)	Category B	$ 93,255	$ 3,291	$ 96,546

The amount of direct and reimbursable obligations against amounts apportioned under Category B is reported in the table above. Apportionment categories are determined by the apportionment categories reported on the Standard Form 132 *Apportionment and Reapportionment Schedule.* Category B represents annual apportionments.

	2009 (Unaudited)	2008 (Unaudited)
Undelivered Orders End of Period	$ 15,278	$ 15,478

Note 16. Net Custodial Revenue Activity (Unaudited)

- **Excise Taxes**

As an agent of the Federal Government and as authorized by 26 U.S.C., TTB collects excise taxes from alcohol, tobacco, firearms, and ammunition industries. In addition, special occupational taxes are collected from certain alcohol and tobacco businesses. During FY 2009 and FY 2008, TTB collected $20.6 billion and $14.6 billion respectivlely in taxes, interest, and other custodial revenues.

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

- **Refunds and Other Payments**

  During FY 2009 and FY 2008, TTB issued nearly $768 million and $682 million in refunds, cover-over payments, and drawback payments in the respective years.

Tax Refunds

Tax Refunds result when taxpayers file returns for payments made for a given tax period and the result of the return is an overpayment.

Cover-over Payments

Federal excise taxes are collected under the Internal Revenue Code of 1986, 26 U.S.C., on certain articles produced in Puerto Rico and the Virgin Islands, and imported into the United States. In accordance with 26 U.S.C. 7652, such taxes collected on rum imported into the United States are custodial revenues and "covered over," or paid into, the treasuries of Puerto Rico and the Virgin Islands.

TTB maintains operations in Puerto Rico to enforce the provisions of chapter 51 in respect to items of Puerto Rican manufacture brought in to the United States. These operations include conducting annual revenue, application, and product integrity investigations of large alcohol and tobacco industry members. Except for application investigations, TTB investigates medium and small alcohol and tobacco producers in response to specific problems and risk indicators. Revenue inspections are used to verify that TTB is collecting all of the revenue that is rightfully due from the taxpayer. TTB staff in Puerto Rico also conducts qualification inspections of all distilled spirits producers/processors, wineries, wholesalers, importers, Manufacturer of Nonbeverage Products (MNBP) claimants, and Specially Denatured Alcohol permit applicants. All costs associated with the functioning and supporting of the Puerto Rico office, $2.5 million in each of FY 2009 and FY 2008 respectively, are offset against the cover-over payments made by the United States to Puerto Rico.

Drawbacks

Under current law, 26 U.S.C. 5134, Manufacturers of Nonbeverage Products may be eligible to claim a refund of tax paid on distilled spirits used in their products. In the case of distilled spirits, on which the tax has been paid or determined, a drawback shall be allowed on each proof gallon at the rate of $1 less than the rate at which the distilled spirits tax had been paid or determined. The refund is due upon the claimant providing evidence that the distilled spirits on which the tax has been paid or determined were unfit for beverage purposes and were used in the manufacture or production of medicines, medicinal preparations, food products, flavors, flavoring extracts, or perfume.

Refunds, Drawbacks and Coverover Payments as of September 30, 2009 and 2008 consisted of the following (in thousands):

	2009 (Unaudited)	2008 (Unaudited)
Alcohol and Tobacco Excise Tax Refunds	$ 17,791	$ 14,125
Drawbacks on MNBP Claims	268,612	283,462
Interest and Other Payments	252	2,938
Refunds and Drawbacks	286,655	300,525
Cover-over Payments - Puerto Rico	472,695	373,418
Cover-over Payments - Virgin Islands	8,624	7,615
Amounts Provided to Non-federal Entities	481,319	381,033
Total Refunds, Drawbacks and Coverover Payments	$ 767,974	$ 681,558

Note 17. Custodial Revenue (Unaudited)

Collection and Disposition of Custodial Revenue as of September 30, 2009 and 2008 consisted of the following (in thousands):

	FY 2009 Collections and Refunds by Tax Year (Unaudited)				FY 2009
Revenue Type	2009	2008	2007	Pre-2007	Total
Excise Taxes	$ 16,779,884	$ 3,822,950	$ 2,678	$ 10,975	$ 20,616,487
Fines, Penalties, Interest and Other	$ 738	$ 1,518	$ 355	$ 8	$ 2,619
Total Revenue Received	16,780,622	3,824,468	3,033	10,983	20,619,106
Less: Amounts Collected for Non-federal Entities	(481,319)	-	-	-	(481,319)
Total	$ 16,299,303	$ 3,824,468	$ 3,033	$ 10,983	$ 20,137,787
Refund Type					
Excise Taxes	$ 135,765	$ 146,681	$ 2,317	$ 1,699	$ 286,462
Fines, Penalties, Interest and Other	193	-	-	-	193
Total Refunds & Drawbacks	$ 135,958	$ 146,681	$ 2,317	$ 1,699	$ 286,655
Amounts Provided to Fund the Federal Government	$ 16,163,345	$ 3,677,787	$ 716	$ 9,284	$ 19,851,132

	FY 2008 Collections and Refunds by Tax Year (Unaudited)				FY 2008
Revenue Type	2008	2007	2006	Pre-2006	Total
Excise Taxes	$ 10,733,580	$ 3,847,347	$ 1,935	$ 2,413	$ 14,585,275
Fines, Penalties, Interest and Other	343	290	18	59	710
Total Revenue Received	10,733,923	3,847,637	1,953	2,472	14,585,985
Less: Amounts Collected for Non-federal Entities	(381,033)	-	-	-	(381,033)
Total	$ 10,352,890	$ 3,847,637	$ 1,953	$ 2,472	$ 14,204,952
Refund Type					
Excise Taxes	$ 155,607	$ 139,432	$ 4,120	$ 530	$ 299,689
Fines, Penalties, Interest and Other	836	-	-	-	836
Total Refunds & Drawbacks	$ 156,443	$ 139,432	$ 4,120	$ 530	$ 300,525
Amounts Provided to Fund the Federal Government	$ 10,196,447	$ 3,708,205	$ (2,167)	$ 1,942	$ 13,904,427

Note 18. Reconciliation of Net Cost of Operations to Budget (Unaudited)

The Reconciliation of Net Cost of Operations to Budget explains the difference between the budgetary net obligations and the proprietary net cost of operations.

Reconciliation of Net Cost of Operations to Budget, as of September 30, 2009 and 2008 consisted of the following (in thousands)

	2009 (Unaudited)	2008 (Unaudited)
	(In Thousands)	
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred	$ 102,109	$ 96,546
Less: Spending Authority from Offsetting Collections and Recoveries	(4,883)	(4,437)
Obligations Net of Offsetting Collections and Recoveries	97,226	92,109
Less: Offsetting Receipts	(17)	(5)
Net Obligations	97,209	92,104
Other Resources		
Transfers In/Out without Reimbursement (+/-)	399	116
Imputed Financing from Costs Absorbed by Others	4,130	3,730
Net Other Resources Used to Finance Activities	4,529	3,846
Total Resources Used to Finance Activities	$ 101,738	$ 95,950

Resources Used to Finance Items not Part of the Net Cost Of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not Yet Provided (+/-)	$ (473)	$ 401
Resources that Fund Expenses Recognized in Prior Periods	31	-
Other Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations	(17)	(5)
Resources that Finance the Acquisition of Assets	5,536	2,179
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations (+/-)	(399)	(116)
Total Resources Used to Finance Items not Part of the Net Cost of Operations	$ 4,678	$ 2,459
Total Resources Used to Finance the Net Cost of Operations	$ 97,060	$ 93,491
Components of the Net Cost of Operations Requiring or Generating Resources in Future Periods		
Components Requiring or Generating Resources in Future Periods:		
Increase in Annual Leave Liability	$ 39	$ 393
Other (+/-)	-	159
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	$ 39	$ 552
Components of the Net Cost of Operations not Requiring or Generating Resources		
Depreciation and Amortization	$ 2,763	$ 1,499
Other	-	(4)
Total Components of Net Cost of Operations that will not Require or Generate Resources	$ 2,763	$ 1,495
Total Components of Net Cost of Operations that will not Require or Generate Resources in the Current Period	$ 2,802	$ 2,047
NET COST OF OPERATIONS	$ 99,862	$ 95,538

Note 19: Contingent Liabilities

As of September 30, 2009, TTB is party to three legal actions, regarding personnel matters, where legal counsel believes an unfavorable outcome is reasonably possible. The total maximum amount plaintiffs can recover for these three cases is $700,000. However, the total potential liability cannot be estimated.

Required Supplementary Information (Unaudited)

Budgetary Information

Budgetary information aggregated for the purposes of the Statement of Budgetary Resources should be disaggregated for each of an entity's major budget accounts (i.e., Approriated Funds, Trust Funds, Revolving Funds, or other funds) and presented as Supplementary Information. However, for proprietary reporting, TTB only has appropriated funds. Consequently, a Combining Statement of Budgetary Resources disaggregated by fund type has not been presented.

Excise Tax and Other Collections

Required Supplementary Information
Excise Tax and Other Collections by Fiscal Year
Unaudited

Dollars in Thousands

Fiscal Year	Alcohol	Tobacco	FAET	SOT	FST	Other	Total
2000	$ 6,777,592	$ 6,758,060	$ 197,840	$ 102,803	$ 261,824	$ 351	$ 14,098,470
2001	6,674,425	7,119,726	175,959	103,610	528	168	14,074,416
2002	6,889,401	7,763,652	205,027	101,893	115,609	159	15,075,741
2003	6,910,631	7,380,807	193,414	103,781	1,628	-	14,590,261
2004	6,995,366	7,433,852	216,006	100,562	-	359	14,746,145
2005	7,074,076	7,409,608	225,818	10,190	9	141	14,719,842
2006	7,182,940	7,350,058	249,578	2,895	638	146	14,786,255
2007	7,232,138	7,194,081	287,835	2,808	-	32	14,716,894
2008	7,420,576	6,851,705	312,622	448	-	634	14,585,985
2009	7,424,292	11,548,504	452,693	272	1,192,375	970	20,619,106
Average	$ 7,058,144	$ 7,681,005	$ 251,679	$ 52,926	$ 157,261	$ 296	$ 15,201,312

The sharp decrease in SOT tax collections was the result of a new law that became effective during fiscal year 2005 that suspended the collection of most of the taxes. The law became permanent in 2008.

TTB collects Firearms and Ammunition Excise Tax (FAET) on behalf of the Department of Interior, U.S. Fish and Wildlife Service, and deposits the collections directly into the Fish and Wildlife Restoration Fund. During fiscal years 2009 and 2008, TTB incurred $2.9 million and $3.2 million respectively of direct and indirect costs associated with collecting the FAET taxes. The law currently does not provide for us to recover these costs. The cost of the program was communicated to the U.S. Fish and Wildlife Service so they could properly record an imputed cost in their financial records.

Refunds, Cover-over Payments, and Drawback Payments

Required Supplementary Information
Refunds, Cover-over Payments, and Drawback Payments by Fiscal Year
Unaudited

Dollars in Thousands

Fiscal Year	Cover Over Puerto Rico	Cover Over Virgin Islands	A&T Excise Tax	Drawbacks MNBP Claims	Interest and Other	Total
2000	$ 296,313	$ 2,963	$ 5,420	$ 261,377	$ 1,221	$ 567,294
2001	332,903	3,532	13,260	289,985	1,765	641,445
2002	340,362	5,145	10,523	361,854	1,855	719,739
2003	356,144	6,405	15,168	296,168	2,011	675,896
2004	335,293	6,244	15,409	355,605	1,216	713,767
2005	419,602	6,010	18,504	317,132	2,100	763,348
2006	358,664	6,491	17,524	337,632	699	721,010
2007	459,278	8,054	13,208	335,706	972	817,218
2008	373,418	7,615	14,125	283,462	2,938	681,558
2009	472,695	8,624	17,791	268,612	252	767,974
Average	$ 374,467	$ 6,108	$ 14,093	$ 310,753	$ 1,503	$ 706,925

A&T - Alcohol and Tobacco
MNBP - Manufacturer of Nonbeverage Products
Note - During October 2008, the Puerto Rico cover-over rate was increased from $10.50 per proof gallon to $13.25 per proof gallon, with retroactive provisions, resulting in a subtantial increase in the Puerto Rico cover-over payments during FY 2009.

Other Accompanying Information (Unaudited)

Intragovernmental Assets

Other Accompanying Information
Consolidated Intragovernmental Assets
As of September 30, 2009
Unaudited

Dollars in Thousands

Trading Partner	Agency Code	Fund Balance W/Treasury	Accounts Receivable	Advances and Other Assets
Department of the Treasury	20	$ 31,225	$ 489	$ 1,933
General Fund	99	-	8,489	-
Total		$ 31,225	$ 8,978	$ 1,933

Other Accompanying Information
Consolidated Intragovernmental Assets
As of September 30, 2008
Unaudited

Dollars in Thousands

Trading Partner	Agency Code	Fund Balance W/Treasury	Accounts Receivable	Advances and Other Assets
Department of the Treasury	20	$ 34,948	$ 87	$ 2,303
General Fund	99	-	12,167	-
Total		$ 34,948	$ 12,254	$ 2,303

Intragovernmental Liabilities

Other Accompanying Information
Consolidated Intragovernmental Liabilities
As of September 30, 2009
Unaudited

Dollars in Thousands

Trading Partner	Agency Code	Accounts Payable	Accrued FECA	Custodial and Other Liabilities
Government Printing Office	04	$ 241	$ -	$ -
Department of the Interior	14	-	-	854
Department of Justice	15	104	-	-
Department of Labor	16	-	64	-
Office of Personnel Management	24	-	-	384
General Services Administration	47	55	-	-
Department of Health and Human Services	75	2		
Department of Defense	97	6	-	-
Treasury General Fund	99	-	-	8,316
Total		$ 408	$ 64	$ 9,554

Other Accompanying Information
Consolidated Intragovernmental Liabilities
As of September 30, 2008
Unaudited

Dollars in Thousands

Trading Partner	Agency Code	Accounts Payable	Accrued FECA	Custodial and Other Liabilities
Government Printing Office	04	$ 55	$ -	$ -
Department of the Interior	14	-	-	52
Department of Justice	15	308	-	-
Department of Labor	16	-	95	-
Department of the Treasury	20	35	-	-
Office of Personnel Management	24	-	-	335
General Services Administration	47	156	-	-
Treasury General Fund	99	25	-	12,330
Total		$ 579	$ 95	$ 12,717

Intragovernmental Earned Revenue

Other Accompanying Information
Consolidated Intragovernmental Earned Revenue
For the Fiscal Years Ended September 30, 2009 and 2008
Unaudited

Dollars in Thousands		FY 2009	FY 2008
Trading Partner	Agency Code		
Department of Justice	15	$ -	42
Department of Treasury	20	613	377
Total		$ 613	$ 419
Budget Function Classification	Code	FY 2009	FY 2008
Central Fiscal Operations	803	$ 613	$ 419
Total		$ 613	$ 419

Intragovernmental Gross Cost

Other Accompanying Information
Consolidated Intragovernmental Gross Cost
For the Fiscal Years Ended September 30, 2009 and 2008
Unaudited

Dollars in Thousands		FY 2009	FY 2008
Trading Partner	Agency Code		
Library of Congress	03	$ 55	$ 54
Government Printing Office	04	402	296
Department of Interior	14	2	-
Department of Justice	15	650	679
Department of Labor	16	28	26
Department of State	19	2	9
Department of the Treasury	20	5,983	5,930
Office of Personnel Management	24	11,852	11,164
General Services Administration	47	5,607	5,817
Environmental Protection Agency	68	7	-
Department of Homeland Security	70	319	351
Department of Health and Human Services	75	30	28
National Archives Records Administration	88	35	29
Department of Defense	97	41	37
General Fund	99	2,806	2,635
Total		$ 27,819	$ 27,055

During fiscal years 2009 and 2008, TTB incurred costs with other Federal agencies totaling more than $27 million in each of the respective years. The majority of those costs were associated with the five entities detailed below.

- **Department of Justice:** TTB paid ATF $650,000 and $679,000 in fiscal years 2009 and 2008 respectively for shared lab space and shared building services.
- **Department of the Treasury:** The Bureau received services from Treasury's Working Capital Fund, as well as administrative services from the Bureau of Public Debt's Administrative Resource Center, in fiscal years 2009 and 2008 in the amounts of $6.0 million and $5.9million respectively.
- **Office of Personnel Management:** TTB incurred $11.9 million and $11.2million in costs for employee benefits for fiscal years 2009 and 2008 respectively.
- **General Services Administration:** TTB paid $5.6 million and $$5.8 million to GSA for rent and information technology services in fiscal years 2009 and 2008 respectively.
- **General Fund:** The Bureau paid $2.8 million and $2.6 million respectively for employee benefits and lockbox fees in fiscal years 2009 and 2008.

Part IV: Appendices

Principal Officers of TTB

Administrator . . . . John Manfreda

Deputy Administrator . . . . Vacant

Equal Employment Opportunity and Diversity . . . . Altivia Jackson

Assistant Administrator, Field Operations . . . . Mary Ryan

Assistant Administrator, Headquarters Operations . . . . William Foster

Assistant Administrator, Management/CFO . . . . Cheri Mitchell

Assistant Administrator, Information Resources/CIO . . . . Robert Hughes

Director, Office of Inspection . . . . Theresa Glasscock

Executive Liaison for Industry and State Matters . . . . Susan Stewart Evans

Chief Counsel . . . . Robert Tobiassen

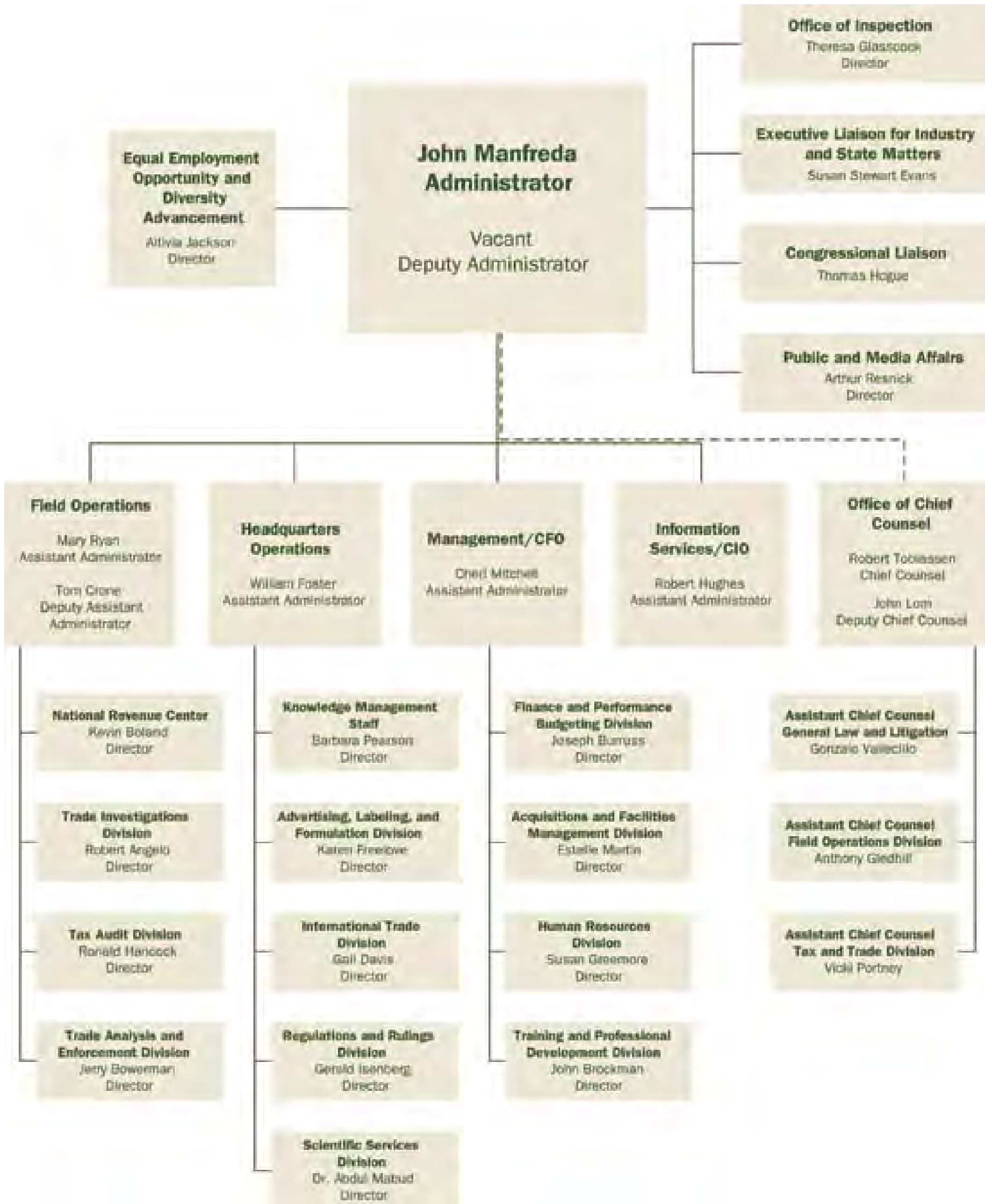
For additional information, contact:

Alcohol and Tobacco Tax and Trade Bureau
1310 G Street, NW, Suite 300 East
Washington, DC 20220

(202) 453-2000

http://www.ttb.gov

TTB Organization Chart



Connecting the Treasury and TTB Strategic Plans

Economy: U.S. and World Economies Perform at Full Economic Potential		
TREASURY STRATEGIC GOALS AND OBJECTIVES	**TTB MISSION AND STRATEGIC GOALS**	**TTB PTP OBJECTIVES**
TREASURY ECONOMIC STRATEGIC OBJECTIVE: Improved economic opportunity, mobility and security with robust, real, sustainable economic growth at home and abroad **Outcome:** Strong U.S. economic competitiveness	**PROTECT THE PUBLIC:** **1. BUSINESS INTEGRITY:** Assure that only persons who carry permits as authorized by statute operate within the industries TTB regulates **2. PRODUCT INTEGRITY:** Help industry members comply with all Federal labeling and advertising requirements for their products **3. MARKET INTEGRITY:** Assure the alcohol marketplace is free from anti-competitive practices **4. EFFECTIVE AND EFFICIENT SYSTEMS TO PROMOTE ECONOMIC OPPORTUNITY:** Facilitate economic opportunity and growth by maximizing TTB PTP systems' effectiveness and efficiencies	**TTB PTP 1.1** Issue permits to qualified applicants **TTB PTP 1.2** Assure that no current industry members are linked to criminal or terrorist organizations, or are otherwise a prohibited person **TTB PTP 2.1** Assure that industry members provide full and accurate product information to the consumer **TTB PTP 2.2** Assure that industry members avoid prohibited language and misleading statements on their labels and advertising **TTB PTP 3.1** Identify and address unfair trade practices and barriers in the U.S. alcohol marketplace **TTB PTP 3.2** Identify and address barriers in the international marketplace **TTB PTP 4.1** Increase effectiveness and efficiencies of TTB Protect the Public processes and systems

Finance: Effectively Managed U.S. Government Finances		
TREASURY STRATEGIC GOALS AND OBJECTIVES	**TTB MISSION AND STRATEGIC GOALS**	**TTB CTR OBJECTIVES**
TREASURY FINANCIAL STRATEGIC OBJECTIVE: Available cash resources to operate the government **Outcome:** Revenue collected when due through a fair and uniform application of the law at the lowest possible cost	**COLLECT THE REVENUE:** **1. VOLUNTARY COMPLIANCE:** Provide high quality service, while imposing the least regulatory burden **2. TAX VERIFICATION AND VALIDATION:** Promote voluntary compliance and eliminate or prevent tax evasion and other criminal conduct **3. EFFECTIVE AND EFFICIENT TAX COLLECTION SYSTEMS:** Provide the most effective and efficient system for the collection of all revenue that is rightfully due	**TTB CTR 1.1** Improve service to the taxpayer and reduce the burden of compliance with Federal law [Service and Outreach] **TTB CTR 2.1** Promote voluntary compliance and prevent tax evasion and identify other criminal conduct in the regulated industries [Enforcement] **TTB CTR 3.1** Maximize electronic solutions [eGov]

Security: Strengthened International Financial System Security and Enhanced U.S. National Security		
TREASURY STRATEGIC GOALS AND OBJECTIVES	**TTB MISSION AND STRATEGIC GOALS**	**TTB PTP OBJECTIVES (Security)**
TREASURY SECURITY STRATEGIC OBJECTIVE: Pre-empted and neutralized threats to the international financial systems and enhanced U.S. national security **Outcome:** Removed or reduced threats to national security from terrorism, proliferation of weapons of mass destruction, narcotics trafficking and other criminal activity on the part of rogue regimes, individuals, and their support networks	**PROTECT THE PUBLIC:** **1. BUSINESS INTEGRITY (Security):** Assure that only persons who carry permits as authorized by statute operate within the industries TTB regulates	**TTB PTP 1.1** Issue permits to qualified applicants **TTB PTP 1.2** Assure that no current industry members are linked to criminal or terrorist organizations, or are otherwise a prohibited person

Management: Management and Organizational Excellence		
TREASURY STRATEGIC GOALS AND OBJECTIVES	**TTB MISSION AND STRATEGIC GOALS**	**TTB MOE OBJECTIVES**
TREASURY MGT STRATEGIC OBJECTIVE: Enabled and effective Treasury Department **Outcome:** A citizen-centered, results-oriented and strategically aligned organization **Outcome:** Exceptional accountability and transparency	**MANAGEMENT AND ORGANIZATIONAL EXCELLENCE:** **MGT 1. MANAGEMENT-SUPPORTED OPTIMUM PROGRAM EFFECTIVENESS AND EFFICIENCY:** Ensure that all TTB programs operate at optimum efficiency and effectiveness and with full accountability, by providing high-quality management and administrative support	**TTB MGT 1.1** Implement a performance-based management system for meeting TTB's mission **TTB MGT 1.2** To deliver streamlined, flexible, and robust IT solutions that maximize the performance, value, and results to enable TTB to fulfill its mission and goals **TTB MGT 1.3** Use financial management systems to support TTB strategic management and financial accountability by providing information that is useful, timely, and reliable, and that assists TTB in optimizing decision-making **TTB MGT 1.4** Manage human capital to support TTB programs and the achievement of Bureau goals by building and sustaining a work environment conducive to performance excellence and personal and organizational development

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