Part III: Annual Financial Report

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

November 15, 2005

MEMORANDUM FOR SECRETARY SNOW

FROM: Harold Damelin
Inspector General

SUBJECT: Audit of the Department of the Treasury's Financial Statements for Fiscal Years 2005 and 2004

SUMMARY

I am pleased to transmit the attached report presenting the results of the audits of the Department of the Treasury's (the Department) financial statements as of and for the fiscal years (FY) ending September 30, 2005 and 2004. These audits are required by the Chief Financial Officers Act of 1990, as expanded by the Government Management Reform Act of 1994.

The Office of Inspector General contracted with the independent certified public accounting firm KPMG LLP for the audits of the FY 2005 and 2004 financial statements. The contract required that these audits be performed in accordance with generally accepted government auditing standards; Office of Management and Budget Bulletin No. 01-02 *Audit Requirements for Federal Financial Statements*; and, the *GAO/PCIE Financial Audit Manual*. Highlights of the FY 2005 audit results follow:

- KPMG issued an unqualified opinion on the Department's financial statements;
- KPMG reported that the four material weaknesses and two other reportable conditions in financial management and reporting, identified by the auditors of the Internal Revenue Service (IRS), collectively represent a material weakness for the Department as a whole;
- KPMG reported that weaknesses in electronic data processing controls at the Financial Management Service, as well as deficiencies in information security programs over financial systems at various bureaus and offices, represent a reportable condition for the Department as a whole; and

- KPMG reported that the Department's financial management systems are not in substantial compliance with the requirements of the Federal Financial Management Improvement Act of 1996.

We reviewed KPMG's report and related documentation and inquired of its personnel. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the financial statements or conclusions about the effectiveness of internal control or compliance with laws and regulations. KPMG is responsible for its report dated November 11, 2005 and the conclusions expressed therein. However, our review disclosed no instances where KPMG did not comply, in all material respects, with generally accepted government auditing standards.

DISCUSSION

The Department's ability to maintain unqualified audit opinions, while meeting the accelerated annual performance and accountability reporting requirements, is a very significant accomplishment. The Department has also made steady progress in eliminating material weaknesses in internal control, and the only bureau that continues to have material weaknesses reported in connection with its annual financial statement audit is the IRS.

The progress made by the Department in recent years in improving financial management has been noteworthy; however, it has also highlighted the most significant remaining obstacle to achieving true financial management excellence – specifically, the continuing, pervasive financial management deficiencies at the IRS. The Department's financial performance status continues to be rated as red, or unsatisfactory, in the Executive Branch Management Scorecard for the President's Management Agenda. This is primarily due to the material weaknesses at the IRS that, for the most part, have existed since financial statement audits were initiated in FY 1992. Furthermore, although the IRS has established a remediation plan, future corrective actions are on hold primarily due to funding constraints.

As discussed in my October 24, 2005 letter to you, *Management and Performance Challenges Facing the Department of the Treasury*, corporate management is one of the primary challenges facing the Department. A key component in meeting this challenge is a strong and assertive Departmental oversight role in working with the IRS to resolve its longstanding financial management problems. Strong corporate leadership is also needed in other areas, to include ensuring consistent, Department-wide implementation of information security requirements, managerial cost accounting, and uniform application of accounting principles.

Your personal support for the Department to meet these management challenges is appreciated and essential. We are committed to working with you and your management team in this effort.

Should you or your staff have questions, you may contact me at (202) 622-1090 or a member of your staff may contact Marla Freedman, Assistant Inspector General for Audit, at (202) 927-5400.

Attachment

cc: Sandra L. Pack
Assistant Secretary for Management
and Chief Financial Officer

KPMG LLP
2001 M Street, NW
Washington, DC 20036

Independent Auditors' Report

Inspector General
U.S. Department of the Treasury:

We have audited the accompanying consolidated balance sheets of the U.S. Department of the Treasury (the Department) as of September 30, 2005 and 2004, and the related consolidated statements of net cost, changes in net position and financing, the combined statements of budgetary resources, and the statements of custodial activity (financial statements) for the years then ended. The objective of our audits was to express an opinion on the fair presentation of these financial statements. These financial statements are incorporated in the accompanying *Department of the Treasury Fiscal Year 2005 Performance & Accountability Report (Performance & Accountability Report)*.

We did not audit the amounts included in the financial statements related to the gold and silver reserves of the U.S. Government or the financial statements of the Internal Revenue Service (IRS), a component entity of the Department. The gold and silver reserves of the U.S. Government and the financial statements of the IRS were audited by other auditors whose reports have been provided to us. Our opinion, insofar as it relates to the amounts included for the gold and silver reserves of the U.S. Government and the IRS' financial statements, is based solely on the reports of the other auditors.

In connection with the audits referred to above, the Department's internal control over financial reporting was considered, and compliance with certain provisions of laws, regulations, contracts, and grant agreements that could have a direct and material effect on its financial statements was tested.

SUMMARY

As stated in our opinion on the financial statements, based on our audits and the reports of the other auditors, we concluded that the Department's financial statements as of and for the years ended September 30, 2005 and 2004, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America.

We, and the other auditors, noted the following matters involving internal control over financial reporting and its operation that we consider to be reportable conditions:

- Financial Management and Reporting at the IRS Needs Improvement (Repeat Condition).
- Electronic Data Processing (EDP) Controls and Information Security Programs Over Financial Systems Should Be Strengthened (Repeat Condition).

The reportable condition related to financial management and reporting at the IRS noted above is considered to be a material weakness.

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The results of our tests, and the tests performed by other auditors, of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed instances of noncompliance with *Internal Revenue Code* (IRC) Section 6325 and the *Federal Information Security Management Act of 2002* (FISMA) that is required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. In addition, the Department's financial management systems did not substantially comply with the *Federal Financial Management Improvement Act of 1996* (FFMIA) Section 803(a) requirements related to compliance with Federal financial management system requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level.

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

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of the U.S. Department of the Treasury as of September 30, 2005 and 2004, and the related consolidated statements of net cost, changes in net position and financing, the combined statements of budgetary resources, and the statements of custodial activity for the years then ended. We did not audit the amounts included in the financial statements related to the gold and silver reserves of the U.S. Government, stated at $10.9 billion as of September 30, 2005 and 2004. We also did not audit the financial statements of the IRS, a component entity of the Department, which reflects custodial revenues of $2.3 trillion and $2.0 trillion, total assets of $27.0 billion and $25.6 billion, and net costs of operations of $11.5 billion and $10.4 billion as of and for the years ended September 30, 2005 and 2004, respectively. The gold and silver reserves of the U.S. Government and the financial statements of the IRS as of and for the years ended September 30, 2005 and 2004, were audited by other auditors whose reports have been provided to us and our opinion, insofar as it relates to the amounts included for the gold and silver reserves of the U.S. Government and the IRS' financial statements, is based solely on the reports of the other auditors.

In our opinion, based on our audits and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Department as of September 30, 2005 and 2004, and its net costs, changes in net position, budgetary resources, custodial activities, and reconciliation of net costs to budgetary obligations, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The information in the *Performance & Accountability Report* listed in the accompanying table of contents as Part I – Management's Discussion and Analysis and the Required Supplemental Information and Required Supplemental Stewardship Information sections of Part III – Annual Financial Report, is not a required part of the financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America, or by OMB Circular No. A-136, *Financial Reporting Requirements,* Part A, *Form and Content of the Performance and Accountability Report*. We, and the other auditors, have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and, accordingly, we express no opinion on it.

Our audits, and the audits of the other auditors, were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The information in the *Performance & Accountability Report*

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listed in the accompanying table of contents as Part II – Annual Performance Report; as the Other Accompanying Information area in the Required Supplemental Information section and Management Challenges and High Risk section of Part III – Annual Financial Report; and as Appendices, are integral parts of the *Performance & Accountability Report*. However, this information is not a required part of the financial statements and is presented for purposes of additional analysis. This information has not been subjected to the same auditing procedures applied in the audits of the financial statements and, accordingly, we express no opinion on it.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Our, and the other auditors', consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention, or to the attention of other auditors, relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our, and the other auditors' judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions by management in the financial statements.

Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements, in amounts that would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We, and the other auditors, noted certain matters, summarized below, involving internal control over financial reporting and its operation that we consider to be reportable conditions.

Material Weakness

Financial Management and Reporting at the IRS Needs Improvement (Repeat Condition)

The IRS continues to face many of the pervasive internal control weaknesses that have been reported each year since its financial statements were first subjected to audit in fiscal year 1992. Despite these weaknesses, the IRS was able to produce financial statements covering its tax custodial and administrative activities that are fairly stated in all material respects. IRS has made progress in addressing its financial management challenges; however, many longstanding systems and internal control weaknesses continue to exist, necessitating continued reliance on costly compensating processes, statistical estimates, external contractors, substantial adjustments, and labor-intensive efforts to prepare reliable financial statements. These costly efforts would not have been necessary if IRS' systems and controls had operated effectively.

IRS personnel will continue to be challenged to sustain the level of effort needed to produce reliable financial statements timely until IRS successfully addresses the underlying systems and internal control weaknesses. Additionally, the current financial reporting process does not produce the reliable, useful, and timely financial and performance information IRS needs for decision-making on an ongoing basis, nor can it fully address the underlying financial management and operational issues that adversely affect the IRS' ability to effectively fulfill its responsibilities as the nation's tax collector.

The material weaknesses and other reportable conditions in internal control over financial reporting identified by the auditors of the IRS' financial statements, all of which are repeat conditions, and collectively are considered a material weakness for the Department as a whole, are summarized as follows:

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- Weaknesses in controls over the financial reporting process, resulting in IRS (1) not being able to prepare reliable financial statements without extensive compensating procedures, and (2) not having current and reliable ongoing information to support management decision-making and prepare cost-based performance measures;

- Weaknesses in controls over unpaid tax assessments, resulting in IRS' inability to properly manage unpaid assessments and leading to increased taxpayer burden;

- Weaknesses in controls over the identification and collection of tax revenues due the U.S. Government and over the issuance of tax refunds, resulting in lost revenue to the U.S. Government and potentially billions of dollars in improper payments; and

- Weaknesses in information security controls, resulting in increased risk of unauthorized individuals being allowed to access, alter, or abuse proprietary IRS programs and electronic data and taxpayer information.

The material weaknesses in internal control noted above may adversely affect any decision by IRS' management that is based, in whole or in part, on information that is inaccurate because of these weaknesses. Also, unaudited financial information reported by the IRS, including performance information, may also contain inaccuracies resulting from these weaknesses.

Two other reportable conditions were identified as follows:

- Weaknesses in controls over hard-copy tax receipts and taxpayer data resulting in a risk of theft, loss, or misuse of such funds and information; and

- Weaknesses that preclude IRS from generating detailed property records that reconcile to the financial records.

Recommendations

Recommendations to address the material weaknesses and other reportable conditions discussed above have been provided to IRS management by the auditors of the IRS' financial statements. We recommend that the Assistant Secretary for Management and Chief Financial Officer provide effective oversight to ensure that corrective actions are taken by the IRS to fully address these material weaknesses and other reportable conditions.

Other Reportable Condition

EDP Controls and Information Security Programs Over Financial Systems Should Be Strengthened

Information controls and security programs require additional improvements. The weaknesses identified are summarized below:

Financial Management Service (FMS) **(Repeat Condition)**

A reportable condition was identified related to the EDP general control environment for computer systems maintained by FMS. Our testing indicated that general control weaknesses still exist that do not effectively prevent (1) unauthorized access to and disclosure of sensitive information, (2) unauthorized changes to systems and application software, or (3) unauthorized access to programs and files that control computer hardware and secure applications. A summary of these weaknesses follows:

- Access Controls – Access controls are designed to limit or detect access to computer programs, data, equipment, and facilities to protect these resources from unauthorized modification, disclosure, loss, or impairment. Such controls include logical and physical security controls. Although prior access control findings have been addressed, additional access control weaknesses were identified this year. A comprehensive plan for access controls security, including increased management oversight, is needed to fully address the administration of access controls in order to increase the reliability of computerized data and decrease the risk of destruction or inappropriate disclosure of data.

- Change Controls – Change controls are designed to prevent the introduction of unauthorized changes to application software programs. We found weaknesses in the enforcement of configuration management procedures related to several major applications.

- System Software Controls – System software controls limit and monitor access to the programs and sensitive files that (1) control the computer hardware and (2) secure applications supported by the system. We determined that improvement is needed in the administration of mainframe dataset names and operating system versions.

Departmental Bureaus and Offices

The Department's Office of Inspector General report titled *Information Technology: Evaluation of Treasury's FISMA Implementation for Fiscal Year 2005* dated October 7, 2005 (2005 FISMA Evaluation Report), which incorporated the results of Treasury's Inspector General for the Tax Administration's evaluation of IRS' systems, identified significant deficiencies throughout the Department. FISMA lays out a framework for required annual information security reviews, reporting, and remediation planning by Federal agencies. It is intended to strengthen information security by requiring agencies to develop, document, and implement agencywide information security programs. The elements required by FISMA, as described below, also constitute an integral part of an effective internal control structure for information systems:

- Periodic testing and evaluation of the effectiveness of information security policies, procedures, and practices;

- Security awareness training for Department personnel, including contractors;

- A process for planning, implementing, evaluating, and documenting remedial action to address information security deficiencies; and

- Plans and procedures to ensure continuity of operations for information systems that support the operations and assets of the Department.

A key reason for the Department's information security weaknesses is that it has not yet fully implemented an agencywide information security program to ensure that controls are effectively established and maintained to meet FISMA requirements. The Department's information and security programs and practices need additional improvements to adequately protect the information systems that support the Department's operations.

Recommendations

Recommendations will be provided to FMS management in a separate letter. The 2005 FISMA Evaluation Report has been provided to the Department's Chief Information Officer.

We recommend that the Department's Chief Information Officer provide effective oversight to ensure that information security requirements over financial systems are implemented completely and timely throughout the Department.

* * * *

We also noted other matters involving internal control over financial reporting and its operation that we will report to the management of the Department in a separate letter dated November 11, 2005.

COMPLIANCE AND OTHER MATTERS

Our tests, and the tests performed by the other auditors, of compliance with certain provisions of laws, regulations, contracts, and grant agreements as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed the following two instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02:

- **Noncompliance with IRC Section 6325** – The IRC grants IRS the power to file a lien against the property of any taxpayer who neglects or refuses to pay all assessed Federal taxes. Under IRC Section 6325, the IRS is required to release a Federal tax lien within 30 days after the date the tax liability is satisfied or has become legally unenforceable or the Secretary of the Treasury has accepted a bond for the assessed tax. The fiscal year 2005 audit identified instances in which the IRS did not release the applicable Federal tax lien within 30 days of the tax liability being either paid off or abated as required by the IRC (Repeat Condition).

- **Noncompliance with FISMA** – Information security weaknesses continue to exist throughout the Department, as discussed in the Internal Control Over Financial Reporting section above. These deficiencies constitute substantial noncompliance with FISMA.

Except for the instances described above, the results of our tests, and the tests performed by other auditors, of compliance with certain provisions of laws, regulations, contracts, and grant agreements as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

The results of our tests, and the tests performed by the other auditors, disclosed instances where the Department's financial management systems did not substantially comply with FFMIA Section 803(a) requirements related to compliance with Federal financial management system requirements (FFMSR), applicable Federal accounting standards, and the United States Government Standard General Ledger (SGL) at the transaction level, as described below (Repeat Condition).

Instances of noncompliance with FFMSR are summarized below:

- IRS' financial management systems do not provide timely and reliable information for financial reporting and preparation of financial statements. IRS had to rely extensively on resource intensive compensating procedures to generate reliable financial statements. IRS also lacks a subsidiary ledger for its unpaid assessments and lacks an effective audit trail from its general ledger back to subsidiary detailed records and transaction source documents for material balances such as tax revenues and tax refunds.

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- Deficiencies identified in information security controls at the IRS, resulting in increased risk of unauthorized individuals being allowed to access, alter, or abuse proprietary IRS programs and electronic data and taxpayer information.

These instances of noncompliance with Federal accounting standards are summarized below:

- Material weaknesses at the IRS related to controls over unpaid tax assessments and tax revenue and refunds.

- IRS' financial management system cannot routinely accumulate and report the full cost of its activities.

The instance of noncompliance with the SGL at the transaction level is summarized below:

- IRS' general ledger system is not supported by adequate audit trails and is not integrated with its supporting records for material balances such as tax revenues and tax refunds.

The Secretary of the Treasury also has determined in the Secretary's Letter of Assurance, in Part I – Management's Discussion and Analysis of the accompanying *Performance & Accountability Report,* that the Department cannot provide assurance that its financial management systems are in substantial compliance with FFMIA. The Department's remedial actions and related timeframes are presented in Appendix D of the *Performance & Accountability Report*.

FFMIA requires that if the head of an agency determines that its financial management systems do not substantially comply with FFMIA, a remediation plan must be developed, in consultation with OMB, that describes the resources, remedies, and intermediate target dates for achieving substantial compliance. FFMIA also requires OMB concurrence with any plan not expected to bring the agency's system into substantial compliance within three years after a determination of noncompliance is made.

IRS has established a remediation plan to address the conditions affecting its systems' ability to comply with the requirements of FFMIA. This plan outlines actions to be taken to resolve these issues, but future corrective actions are on hold and are currently unfunded. Due to the long-term nature of the IRS' systems modernization efforts, which IRS expects will resolve many of the most serious issues, many of the planned timeframes exceed the three-year resolution period specified in FFMIA. However, for these instances, IRS has received a waiver from this requirement from OMB, as authorized by FFMIA.

Recommendations

We recommend that the Assistant Secretary for Management and Chief Financial Officer provide effective oversight to ensure that (1) IRS implements appropriate controls so that Federal tax liens are released in accordance with Section 6325 of the IRC; (2) information security programs are implemented throughout the Department in accordance with FISMA; and (3) IRS implements its remediation plan to address the identified instances of financial management systems noncompliance with the requirements of FFMIA.

Management's Response to Internal Control and Compliance Findings

The Department's management has indicated in a separate letter immediately following this report that it concurs with the findings presented in this section of our report. Further, it has responded that it will take corrective action as necessary to ensure the matters presented are addressed by the respective bureau management within the Department.

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RESPONSIBILITIES

Management's Responsibilities. The *Government Management Reform Act of 1994* (GMRA), *Accountability for Tax Dollars Act*, and *Government Corporation Control Act* require agencies to report annually to Congress on their financial status and any other information needed to fairly present their financial position and results of operations. To meet these reporting requirements, the Department prepares and submits financial statements in accordance with Part A of OMB Circular No. A-136.

Management is responsible for the financial statements, including:

- Preparing the financial statements in conformity with accounting principles generally accepted in the United States of America;
- Preparing the Management's Discussion and Analysis (including the performance measures), Required Supplementary Information, and Required Supplementary Stewardship Information;
- Establishing and maintaining internal controls over financial reporting; and
- Complying with laws, regulations, contracts, and grant agreements, including FFMIA.

In fulfilling this responsibility, management is required to make estimates and judgments to assess the expected benefits and related costs of internal control policies. Because of inherent limitations in internal control, misstatements, due to error or fraud, may nevertheless occur and not be detected.

Auditors' Responsibilities. Our responsibility is to express an opinion on the fiscal year 2005 and 2004 financial statements of the Department based on our audits and the reports of the other auditors. We, and the other auditors, conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but is not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we express no such opinion.

An audit also includes:

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

We believe that our audits and the reports of the other auditors, related to the amounts included for the IRS' financial statements and the gold and silver reserves of the U.S. Government, provide a reasonable basis for our opinion.

In planning and performing our fiscal year 2005 audit, we considered the Department's internal control over financial reporting, exclusive of the internal control over financial reporting related to the IRS or to the gold and silver reserves of the U.S. Government, by obtaining an understanding of the Department's

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internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. Internal control over financial reporting related to the IRS and to the gold and silver reserves of the U.S. Government was considered by other auditors whose reports thereon have been provided to us. We, and the other auditors, limited our internal control testing to those controls necessary to achieve the objectives described in *Government Auditing Standards* and OMB Bulletin No. 01-02. 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 and the other auditors' audits was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion thereon.

As required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, we considered the Department's internal control over Required Supplementary Stewardship Information by obtaining an understanding of the Department's internal control, determining whether these internal controls had been placed in operation, assessing control risk, and performing tests of controls. Our procedures were not designed to provide assurance on internal control over Required Supplementary Stewardship Information and, accordingly, we do not provide an opinion thereon.

As further required by OMB Bulletin No. 01-02, in our fiscal year 2005 audit, with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis (Part I) and Annual Performance Report (Part II) sections, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, exclusive of those related to performance measures presented for the IRS. An understanding of the design of significant internal controls relating to the existence and completeness assertions related to the IRS' performance measures was obtained by the other auditors whose report thereon was provided to us. Our, and the other auditors', procedures were not designed to provide assurance on internal control over performance measures and, accordingly, we do not provide an opinion thereon.

As part of obtaining reasonable assurance about whether the Department's fiscal year 2005 financial statements are free of material misstatement, we and the other auditors, performed tests of the Department's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain provisions referred to in FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to the Department. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our or the other auditors' audits and, accordingly, we do not express such an opinion.

Under OMB Bulletin No. 01-02 and FFMIA, we are required to report whether the Department's financial management systems 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. To meet this requirement, we and the other auditors, performed tests of compliance with FFMIA Section 803(a) requirements.

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DISTRIBUTION

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

KPMG LLP

November 11, 2005

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Management's Response

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

November 11, 2005

KPMG LLP
2001 M Street, N.W.
Washington, D.C. 20036

Ladies and Gentlemen:

On behalf of Secretary Snow, I am responding to your draft audit report on the Department of the Treasury's FY 2005 financial statements.

All of our bureaus and program offices can be proud of the Department's success in issuing its Performance and Accountability Report by November 15th. Further, I congratulate them for overcoming many obstacles to achieve another unqualified opinion on the Department's financial statements. Without their collective dedicated efforts, our accelerated reporting would not be possible.

These successful results also are due in large part to the high level of professionalism, technical expertise, and commitment demonstrated by KPMG in conducting the audit. I appreciate your efforts during the audit process to provide timely, constructive advice on how to improve our financial reporting. I am equally appreciative of the equivalent expertise and commitment level demonstrated by the other organizations involved in the audit process – the Office of Inspector General, the Government Accountability Office, and the firms that conducted the audits at several of our bureaus.

The Department made progress in FY 2005 in addressing several financial management and systems deficiencies. We agree that we must continue our efforts to address longstanding weaknesses, which hamper our ability to produce timely, reliable financial information. We now must employ labor-intensive procedures in certain critical areas to compensate for deficiencies in our financial systems in order to achieve an unqualified audit opinion. Until we correct these deficiencies, they will hamper our overall financial management capabilities. In addition, they are a burden on our employees, who must deal with these deficiencies on a daily basis, particularly during the year-end reporting process. We will increase our emphasis on addressing these deficiencies.

We concur with the Departmental level material weakness, the reportable conditions, and the instances of noncompliance with laws and regulations described in your report. Corrective actions are underway to address each of these items. We are improving our efforts to address the problems discussed in your report.

We appreciate the professional, cooperative relationship we experienced with both KPMG and the Office of Inspector General throughout the audit process.

Sincerely,

Sandra L. Pack

Sandra L. Pack
Assistant Secretary for Management
and Chief Financial Officer

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Consolidated Balance Sheets
As of September 30, 2005 and 2004
(In Millions)

	2005	2004
ASSETS		
Intra-governmental Assets		
Fund Balance (Note 2)	$66,334	$59,946
Loans and Interest Receivable (Note 3)	228,491	214,065
Advances to the Black Lung Trust Fund	9,186	8,741
Due From the General Fund (Note 4)	7,978,081	7,420,492
Accounts Receivable and Related Interest (Note 10)	626	632
Other Intra-governmental Assets	40	12
Total Intra-governmental Assets	**8,282,758**	**7,703,888**
Cash, Foreign Currency, and Other Monetary Assets (Note 5)	47,578	53,161
Gold and Silver Reserves (Note 6)	10,933	10,933
Loans and Interest Receivable (Note 3)	670	977
Investments and Related Interest (Note 7)	9,404	10,870
Reserve Position in the International Monetary Fund (Note 8)	13,247	19,442
Investments in International Financial Institutions (Note 9)	5,464	5,403
Tax, Other, and Related Interest Receivable, Net (Note 10)	21,430	20,520
Inventory and Related Property, Net (Note 11)	468	459
Property, Plant, and Equipment, Net (Note 12)	2,398	2,745
Other Assets	22	24
Total Assets (Note 13)	**$8,394,372**	**$7,828,422**
LIABILITIES		
Intra-governmental Liabilities		
Federal Debt and Interest Payable (Notes 4 & 14)	$3,354,905	$3,097,949
Other Debt and Interest Payable (Note 14)	14,164	0
Due to the General Fund (Note 4)	273,551	276,436
Other Intra-governmental Liabilities	422	935
Total Intra-governmental Liabilities	**3,643,042**	**3,375,320**
Federal Debt and Interest Payable (Notes 4 & 14)	4,600,668	4,305,302
Certificates Issued to Federal Reserve Banks (Note 5)	2,200	2,200
Allocation of Special Drawing Rights (Note 5)	7,102	7,197
Gold Certificates Issued to Federal Reserve Banks (Note 6)	10,924	10,924
Refunds Payable (Notes 4 & 22)	1,952	1,808
D.C. Pension Liability (Note 16)	8,511	8,367
Other Liabilities (Notes 15 & 18)	4,665	4,146
Total Liabilities (Note 18)	**8,279,064**	**7,715,264**
Commitments & Contingencies (Notes 3, 5, 12, 15, 16 & 17)		
NET POSITION		
Unexpended Appropriations	63,182	56,850
Cumulative Results of Operations	52,126	56,308
Total Net Position (Note 19)	**115,308**	**113,158**
Total Liabilities and Net Position	**$8,394,372**	**$7,828,422**

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

Consolidated Statements of Net Cost
For the Years Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
COST OF TREASURY OPERATIONS		
Economic Program		
Gross Cost	$3,066	$3,019
Less Earned Revenue	(782)	(1,687)
Net Program Cost	2,284	1,332
Financial Program		
Gross Cost	15,580	14,737
Less Earned Revenue	(4,487)	(4,711)
Net Program Cost	**11,093**	**10,026**
Management Program		
Gross Cost	1,156	947
Less Earned Revenue	(739)	(525)
Net Program Cost	417	422
Total Program Gross Costs	19,802	18,703
Total Program Gross Earned Revenues	(6,008)	(6,923)
Total Net Cost of Operations (Note 20)	**13,794**	**11,780**
FEDERAL COSTS:		
Federal Debt Interest	354,386	322,142
Less Interest Revenue from Loans (Note 19)	(11,984)	(11,500)
Net Federal Debt Interest Costs (Note 20)	**342,402**	**310,642**
Other Federal Costs (Note 20)	8,673	12,915
Net Federal Costs	**351,075**	**323,557**
Net Cost of Operations, Federal Debt Interest, and Other Federal Costs	**$364,869**	**$335,337**

The accompanying notes are an integral part of these financial statements.
See Note 20 for Net Cost Schedule by Sub-organizations.

Consolidated Statement of Changes in Net Position
For the Year Ended September 30, 2005
(In Millions)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balance	**$56,308**	**$56,850**
Budgetary Financing Sources:		
Appropriations Received (Note 19)		369,312
Appropriations Transferred In/Out		(594)
Other Adjustments		(319)
Appropriations Used	362,067	(362,067)
Non-exchange Revenue	36	
Donations and Forfeitures of Cash and Cash Equivalents	169	
Other Financing Sources:		
Donations and Forfeitures of Property	51	
Accrued Interest & Discount on the Debt	9,879	
Transfers In/Out Without Reimbursement	(133)	
Imputed Financing Sources	722	
Transfers to the General Fund and Other (Note 19)	(12,104)	
Total Financing Sources	**360,687**	**6,332**
Net Cost	(364,869)	
Net Change	**(4,182)**	**6,332**
Ending Balances	**$52,126**	**$63,182**

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

Consolidated Statement of Changes in Net Position
For the Year Ended September 30, 2004
(In Millions)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balance	**$58,925**	**$50,433**
Budgetary Financing Sources		
Appropriations Received (Note 19)		347,808
Appropriations Transferred In/Out		214
Other Adjustments		(400)
Appropriations Used	341,205	(341,205)
Non-exchange Revenue	45	
Donations and Forfeitures of Cash and Cash Equivalents	119	
Transfers In/Out Without Reimbursement	(42)	
Other Budgetary Financing Sources	(4)	
Other Financing Sources		
Donations and Forfeitures of Property	31	
Accrued Interest & Discount on the Debt	3,481	
Transfers In/Out Without Reimbursement	(38)	
Imputed Financing Sources	714	
Transfers to the General Fund and Other (Note 19)	(12,791)	
Total Financing Sources	**332,720**	**6,417**
Net Cost	(335,337)	
Net Change	**(2,617)**	**6,417**
Ending Balances	**$56,308**	**$56,850**

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

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
BUDGETARY RESOURCES		
Budgetary Authority:		
Appropriations Received	$379,567	$352,212
Borrowing Authority	331	30
Net Transfers	99	(809)
Unobligated Balance:		
Beginning of the Year	69,912	73,859
Net Transfers	(629)	(39)
Spending Authority from Offsetting Collections:		
Earned:		
Collected	6,286	7,328
Receivable from Federal Sources	36	(1)
Change in Unfilled Customer Orders:		
Advance Received	(29)	(9)
Without Advance from Federal Sources	(81)	290
Subtotal	**6,212**	**7,608**
Recoveries of Prior Year Obligations	1,286	338
Temporarily Not Available Pursuant to Public Law	1,957	(322)
Permanently Not Available	(5,403)	(2,180)
Total Budgetary Resources	**$453,332**	**$430,697**
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct	$384,853	$357,046
Reimbursable	3,809	3,739
Subtotal	388,662	360,785
Unobligated Balance:		
Apportioned	14,572	14,365
Exempt for Apportionment	40,084	45,368
Unobligated Balance Not Available	10,014	10,179
Total Status of Budgetary Resources	**$453,332**	**$430,697**

(Continued)

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS		
Obligated Balance, Net, Beginning of the Year	$41,446	$35,018
Obligated Balance, Net, End of the Year		
Accounts Receivable	(211)	(173)
Unfilled Customer Orders from Federal Sources	(432)	(513)
Undelivered Orders	44,722	40,430
Accounts Payable	1,659	1,702
Outlays:		
Disbursements	383,128	353,729
Collections	(6,258)	(7,319)
Subtotal	**376,870**	**346,410**
Less: Offsetting Receipts (Note 21)	(15,649)	(1,828)
Net Outlays	**$361,221**	**$344,582**

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

Consolidated Statements of Financing
For the Year Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
RESOURCES USED TO FINANCE ACTIVITIES		
Budgetary Resources Obligated:		
Obligations Incurred	$388,662	$360,785
Less: Spending Authority from Offsetting Collections and Recoveries	(7,498)	(7,946)
Obligations Net of Offsetting Collections and Recoveries	**381,164**	**352,839**
Less: Offsetting Receipts	(15,649)	(1,828)
Net Obligations	**365,515**	**351,011**
Other Resources:		
Donations and Forfeitures of Property	51	31
Accrued Interest & Discount on the Debt	9,879	3,481
Transfers In/Out Without Reimbursement	(133)	(38)
Imputed Financing Sources	722	714
Transfers to the General Fund and Other (Note 19)	(12,104)	(12,791)
Net Other Resources Used to Finance Activities	**(1,585)**	**(8,603)**
Total Resources Used to Finance Activities	**363,930**	**342,408**
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	4,384	6,713
Resources that Fund Expenses Recognized in Prior Periods	432	243
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations:		
Credit Program Collections that Increase Liabilities for Loan Guarantees or Allowances for Subsidy	(7)	(128)
Other (Note 21)	(15,677)	(1,150)
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	522	563
Adjustment to Accrued Interest & Discount on the Debt	7,313	2,590
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations	2,060	(479)
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	**(973)**	**8,352**
Total Resources Used to Finance the Net Cost of Operations	**$364,903**	**$334,056**

(Continued)

Consolidated Statements of Financing
For the Year Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
COMPONENTS OF NET COST OF OPERATIONS THAT WILL NOT REQUIRE OR GENERATE RESOURCES IN THE CURRENT PERIOD		
Components of Net Cost of Operations Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	$9	$24
Upward Reestimates of Credit Subsidy Expense	1	328
Increase in Exchange Revenue Receivable from the Public	(2)	0
Other	141	90
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	**149**	**442**
Components of Net Cost of Operations That Will Not Require or Generate Resources		
Depreciation and Amortization	612	529
Revaluation of Assets or Liabilities	(714)	323
Other	(81)	(13)
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	**(183)**	**839**
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**(34)**	**1,281**
Net Cost of Operations	**$364,869**	**$335,337**

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

Statements of Custodial Activity
For the Year Ended September 30, 2005 and 2004
(In Millions)

	2005	2004
SOURCES OF CUSTODIAL REVENUE: (Note 22)		
Revenue Received		
Individual and FICA Taxes	$1,864,687	$1,695,212
Corporate Income Taxes	306,869	230,377
Estate and Gift Taxes	25,605	25,580
Excise Taxes	71,970	69,552
Railroad Retirement Taxes	4,539	4,421
Unemployment Taxes	6,948	6,718
Deposit of Earnings, Federal Reserve System	19,297	19,652
Fines, Penalties, Interest & Other Revenue	3,552	2,456
Total Revenue Received	**2,303,467**	**2,053,968**
Less Refunds	(267,114)	(278,436)
Net Revenue Received	**2,036,353**	**1,775,532**
Accrual Adjustments	643	(1,938)
Total Custodial Revenue	**2,036,996**	**1,773,594**
DISPOSITION OF CUSTODIAL REVENUE		
Amounts Provided to Fund Non-Federal Entities	454	612
Amounts Provided to Fund the Federal Government (Note 22)	2,035,899	1,774,920
Accrual Adjustment	643	(1,938)
Total Disposition of Custodial Revenue	**2,036,996**	**1,773,594**
Net Custodial Revenue	**$0**	**$0**

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

Notes to The Financial Statements

1. Summary of Significant Accounting Policies

A. Reporting Entity

The accompanying financial statements include the operations of the U.S. Department of the Treasury (Treasury), one of 25 Cabinet level agencies of the Executive Branch of the United States Government, and certain custodial activities managed on behalf of the entire U.S. government. The following paragraphs describe the activities of the reporting entity.

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

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

The Treasury includes Departmental Offices (DO) and nine operating bureaus. For financial reporting purposes, DO is comprised of: International Assistance Programs (IAP), Office of Inspector General (OIG), Treasury Forfeiture Fund, Treasury Franchise Fund, Exchange Stabilization Fund (ESF), Community Development Financial Institutions Fund (CDFI), Office of D.C. Pensions (DCP), Treasury Inspector General for Tax Administration (TIGTA), the Federal Financing Bank (FFB) and the Air Transportation Stabilization Board (ATSB).

The Treasury's nine operating bureaus are: Office of the Comptroller of the Currency (OCC); Bureau of Engraving and Printing (BEP); Financial Crimes Enforcement Network (FinCEN); Financial Management Service (FMS); Internal Revenue Service (IRS); U.S. Mint (Mint); Bureau of the Public Debt (BPD); Office of Thrift Supervision (OTS), and the Alcohol and Tobacco Tax and Trade Bureau (TTB).

Treasury's financial statements reflect the reporting of its own entity activities, which include appropriations it receives to conduct its operations and revenue generated from those operations. They also reflect the reporting of certain non-entity (custodial) functions it performs on behalf of the U.S. government and others. Non-entity activities include the collection of federal revenue, servicing the federal debt, disbursing certain federal funds, and maintaining certain assets and liabilities for the U.S. government as well as for others. Treasury's reporting entity does not include the "General Fund" of the U.S. government, which maintains receipt, disbursement and appropriation accounts for all federal agencies.

Transactions and balances among Treasury's entities have been eliminated from the Consolidated Balance Sheet, the Consolidated Statement of Net Cost, the Consolidated Statement of Changes in Net Position, and the Consolidated Statement of Financing.

B. Basis of Accounting & Presentation

The financial statements have been prepared from the accounting records of Treasury in conformity with accounting principles generally accepted in the United States, and the Office of Management and Budget (OMB) Circular A-136, *"Financial Reporting Requirements."* Accounting principles generally accepted for federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB). FASAB is recognized by the American Institute of Certified Public Accountants as the official accounting standards-setting body of the U.S. government.

These financial statements are provided to meet the requirements of the Government Management Reform Act of 1994. They consist of the consolidated Balance Sheet, the consolidated Statement of Net Cost, the consolidated Statement of Changes in Net Position, the combined Statement of Budgetary Resources, the consolidated Statement of Financing, and the Statement of Custodial Activity. The statements and the related notes are prepared in a comparative form to present both FY 2005 and FY 2004 information.

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

Throughout these financial statements, intra-governmental assets, liabilities, earned revenues, and costs have been classified according to the entity for these transactions. Intra-governmental assets and liabilities are those from or to other federal entities. Intra-governmental earned revenues are collections or accruals of revenue from other federal entities, and intra-governmental costs are payments or accruals to other federal entities.

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

C. Tax and Other Non-Entity Receivables

Tax receivables are not accrued until related tax returns are filed or assessments are made. Prepayments of taxes are netted against liabilities. Accruals are made to reflect penalties and interest on tax receivables through the balance sheet date. Tax receivables consist of unpaid assessments (taxes and associated penalties and interest) due from taxpayers for which Treasury can support the existence of a receivable through taxpayer agreement, such as filing a tax return without sufficient payment, or a court ruling in favor of Treasury. Tax receivables are shown on the balance sheet net of an allowance for doubtful accounts and abatements. The allowance for doubtful accounts reflects an estimate of the portion deemed to be uncollectible based on historical experience of similar taxes receivable.

D. Inventory and Related Property

Inventories and related property include inventory, operating materials and supplies, and forfeited property. Treasury values inventories at either standard cost or lower of cost or market, except for finished goods inventories, which are valued at weighted average unit cost. All operating materials and supplies are recorded as an expense when consumed in operations.

Forfeited property is recorded at estimated fair market value at the time of seizure as deferred revenue, and may be adjusted to reflect the current fair market value at the end of the fiscal year. Property forfeited in satisfaction of a taxpayers liability is recorded when title to the property passes to the U.S. government and a corresponding credit is made to the related taxes receivable. Direct and indirect holding costs are not capitalized for individual forfeited assets.

Mortgages and claims on forfeited assets are recognized as a valuation allowance and a reduction of deferred revenue from forfeited assets when the asset is forfeited. The allowance includes mortgages and claims on forfeited property held for sale and a minimal amount of claims on forfeited property previously sold.

Revenue from the forfeiture of property is deferred until the property is sold or transferred to a state, local or federal agency. Revenue is not recorded if the forfeited property is ultimately destroyed or cannot be legally sold.

E. Loans and Interest Receivable - from Other Federal Agencies

Intra-governmental entity Loans and Interest Receivable from other federal agencies represent loans and interest receivable held by Treasury. No subsidy costs were recorded for loans purchased from federal agencies or for guaranteed loans made to non-federal borrowers, because these are guaranteed (interest and principal) by those agencies.

Intra-governmental non-entity Loans and Interest Receivable from other federal agencies represent loans issued by Treasury to federal agencies on behalf of the U.S. government. Treasury acts as an intermediary issuing these loans, because the agencies receiving these loans will lend these funds to others to carry out various programs of the Federal Government. Because of Treasury's intermediary role in issuing these loans, Treasury does not record an allowance or subsidy costs related to these loans. Instead, loan loss allowances and subsidy costs are recognized by the ultimate lender, the federal agency that issued the loans.

F. Advances to the Black Lung Trust Fund

Advances have been provided to the Department of Labor's Black Lung Trust Fund from the General Fund of the U.S. government. The Bureau of Public Debt accounts for the advances on behalf of the General Fund of the U.S. government. Advances to the Black Lung Trust Fund are being accounted for pursuant to the Benefits Revenue Act which states: In the event that fund resources are not adequate to meet fund obligations, then, Advances, interest and principal are paid to the General Fund of the U.S. government when the Secretary of the Treasury determines that funds are available in the trust fund for such purposes. The Black Lung Trust Funds are repayable with interest at a rate determined by the Secretary of the Treasury to be equal to the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the anticipated period during which the advance will be outstanding. Advances made prior to 1982 carried rates of interest equal to the average rate borne by all marketable interest-bearing obligations of the United States then forming a part of the public debt. The Black Lung Trust Fund balance includes accrued interest.

G. Property, Plant and Equipment

Treasury's property, plant and equipment (PP&E) is recorded at cost and depreciated using the straight line method over the estimated useful lives of the assets. Major alterations and renovations are capitalized, while maintenance and repair costs are charged to expense as incurred. Treasury owns the Treasury building - a multi-use heritage asset. Multi-use heritage assets are assets of historical significance for which the predominant use is general government operations. All acquisition, reconstruction, and betterment costs for the Treasury building are capitalized as general PP&E and depreciated over their service life.

Treasury's bureaus are diverse both in size and in operating environment. Accordingly, Treasury's capitalization policy thresholds range from $25,000 to $50,000. Treasury also uses a capitalization threshold range for bulk purchases: $250,000 to $500,000 for non-manufacturing bureaus and $25,000 to $50,000 for manufacturing bureaus. Bureaus determine the individual items that comprise bulk purchases. In addition, Treasury's bureaus may expense bulk purchases if they conclude that total period costs would not be materially distorted and the cost of capitalization is not economically feasible.

H. Federal Debt

Debt and associated interest are reported on the accrual basis of accounting. Certain debt securities are issued at a discount or premium. Discounts and premiums are amortized over the term of the security using the effective interest rate method.

I. Pension Costs, Other Retirement Benefits, and Other Post Employment Benefits

Treasury recognizes the full costs of its employees' pension benefits. However, the liabilities associated with these costs are recognized by the Office of Personnel Management (OPM) rather than Treasury.

Most employees of Treasury hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS), to which Treasury contributes 8.51 % of salaries for regular CSRS employees.

On January 1, 1987, the Federal Employees' Retirement System (FERS) went into effect pursuant to Public Law 99-335. Employees hired after December 31, 1983, are automatically covered by FERS and Social Security. A primary feature of FERS is that it offers a savings plan to which Treasury automatically contributes 1 % of base pay and matches any employee contributions up to an additional 4 % of base pay. For most employees hired after December 31, 1983, Treasury also contributes the employer's matching share for Social Security. For the FERS basic benefit Treasury contributes 10.7 % for regular FERS employees.

Similar to federal retirement plans, OPM, rather than Treasury, reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program (FEHBP) and Federal Employees Group Life Insurance (FEGLI) Program. Treasury reports the full cost of providing other retirement benefits (ORB). Treasury also recognizes an expense and liability for other post employment benefits (OPEB), which includes all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents. Additionally, Treasury's Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTS) separately sponsor certain benefit plans for their employees. OCC sponsors a defined life insurance benefit plan for current and retired employees. Additionally, OTS provides certain health and life benefits for all retired employees that meet eligibility requirements.

J. Special Drawing Rights (SDR) Certificates Issued to Federal Reserve Banks

The Special Drawing Rights Act of 1968 authorized the Secretary of the Treasury to issue certificates, not to exceed the value of SDRs holdings, to the Federal Reserve Banks in return for interest free dollar amounts equal to the face value of certificates issued. The certificates may be issued to finance the acquisition of SDRs from other countries or to provide resources for financing other Exchange Stabilization Fund operations. Certificates issued are to be redeemed by Treasury at such times and in such amounts as the Secretary of the Treasury may determine. Certificates issued to Federal Reserve Banks are stated at their face value. It is not practical to estimate the fair value of Certificates Issued to Federal Reserve Banks since these certificates contain no specific terms of repayment.

K. Federal Employee Benefits Payable - FECA Actuarial Liability

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, and employees who have incurred a work-related injury or occupational disease. These 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.

L. Revenue and Financing Sources

Treasury's activities are financed either through exchange revenue it receives from others or through non-exchange revenue and financing sources (such as appropriations provided by the Congress and penalties, fines, and certain user fees collected). User fees primarily include Internal Revenue Service reimbursable costs to process installment agreements and accompanying photocopy and reproduction charges. Exchange revenues are recognized when earned; i.e. goods have been delivered or services have been rendered. Non-exchange revenues are recognized when received by the respective Treasury collecting bureau. Appropriations used are recognized as financing sources when related expenses are incurred or assets are purchased. Revenue from reimbursable agreements is recognized when the services are provided. Treasury also incurs certain costs that are paid in total or in part by other federal entities, such as pension costs. These subsidized costs are recognized on the Consolidated Statement of Net Cost, and the imputed financing for these costs is recognized on the Consolidated Statement of Changes in Net Position. As a result, there is no effect on net position. Other non-exchange financing sources such as donations and transfers of assets without reimbursements also are recognized for the period in which they occurred on the Consolidated Statement of Changes in Net Position.

Treasury recognizes revenue it receives from disposition of forfeited property as non-exchange revenue on the Consolidated Statement of Changes in Net Position. The costs related to the forfeiture fund program are reported on the Consolidated Statement of Net Cost.

M. Custodial Revenues and Collections

Non-entity revenue reported on Treasury's Statement of Custodial Activity includes cash collected and received by Treasury, primarily taxes. It does not include revenue collected by other Federal agencies, such as user fees and other receipts, which are remitted for general operating purposes of the U.S. government or are earmarked for certain trust funds. The Statement of Custodial Activity is presented on the "modified accrual basis." Revenues are recognized as cash is collected. The Balance Sheet includes an estimated amount for taxes receivable and payable to the General Fund of the U.S. government at September 30, 2005 and 2004.

N. Tax Assessments and Abatements

Under Internal Revenue Code Section 6201, Treasury is authorized and required to make inquiries, determinations, and assessments of all taxes which have not been duly paid (including interest, additions to the tax, and assessable penalties) under the law. Unpaid assessments result from taxpayers filing returns without sufficient payment, as well as from tax compliance programs, such as examination, under-reporter, substitute for return, and combined annual wage reporting. Treasury also has authority to abate the paid or unpaid portion of an assessed tax, interest, and penalty. Abatements occur for a number of reasons and are a normal part of the tax administration process. Abatements may result in claims for refunds or a reduction of the unpaid assessed amount.

O. Permanent and Indefinite Appropriations

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

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

Additionally, Treasury receives other permanent and indefinite appropriations to make certain payments on behalf of the U.S. government. These appropriations are provided to make payments to the Federal Reserve for services provided. They also include appropriations provided to make other disbursements on behalf of the U.S. government, including payments made to various individuals as the result of certain claims and judgments rendered against the United States.

P. Imputed Costs/Financing Sources

U.S. government entities often receive goods and services from other U.S. government entities without reimbursing the providing entity for all the related costs. These constitute subsidized costs which are recognized by the receiving entity. An offsetting imputed financing source is also recognized by the receiving entity. Treasury recognized imputed costs and financing sources in fiscal years 2005 and 2004 to the extent directed by the OMB, such as: employees' pension, post-retirement health and life insurance benefits; other post-employment benefits for retired, terminated, and inactive employees, which includes unemployment and workers compensation under the Federal Employee's Compensation Act; and losses in litigation proceedings.

Q. Reclassifications

Certain 2004 balances have been reclassified to conform to the 2005 presentation.

R. Income Taxes

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

S. Use of Estimates

Treasury has made certain estimates and assumptions relating to the reporting of assets, liabilities, revenues, expenses, and the disclosure of contingent liabilities to prepare these financial statements. Actual results could differ from these estimates. Financial statement line items subject to estimates include tax receivables; depreciation; imputed costs; cost and earned revenue allocations; and, credit reform subsidy costs.

T. Credit Risk

Credit risk is the potential, no matter how remote, for financial loss from a failure of a borrower or a counterparty to perform in accordance with underlying contractual obligations. The Treasury takes on possible credit risk when it makes direct loans or credits to foreign entities or becomes exposed to institutions which engage in financial transactions with foreign countries. Given the history of the Treasury with respect to such exposure and the financial policies in place in the U. S. government and other institutions in which the United States participates, Treasury has no expectation that credit losses will be incurred in the foreseeable future. Treasury also takes on credit risk related to loan guarantees, committed but undisbursed direct loans and its Terrorism Risk Insurance Program. The extent of the risk assumed by the Department is described in more detail in the notes to the financial statements.

U. Liability for Loan Guarantees

Treasury operates a loan guarantee program administered by the Air Transportation Stabilization Board. The purpose of the program is to assist air carriers that suffered losses as a result of the terrorist attacks on the United States that occurred on September 11, 2001. The program is accounted for in accordance with the provisions of the Federal Credit Reform Act of 1990, as amended. The authority to issue loan guarantees expired on September 30, 2004. The Liability for Loan Guarantees represents the present value of future projected cash outflows from the Department, net of inflows, such as fees, and other collections. A subsidy cost for the liability for loan guarantees is recognized as a cost in the year the guaranteed loan is disbursed. Subsidy costs are an estimate of the long-term cost to the U.S. Government. The subsidy costs represent the calculation of the present value of the estimated cash outflows over the life of the loan guarantee minus the present value of the estimated cash inflows, discounted at the applicable Treasury interest rate. The subsidy cost is reestimated on an annual basis. Administrative costs such as salaries and contractual fees are not included in the subsidy cost.

Each air carrier has material cash flows that are not considered appropriate to average with those of other air carriers, with the result that each air carrier guarantee has its own subsidy rate. The fluctuations in subsidy rates for the respective air carriers depend upon several risk factors, including current credit rating and default rates. Other factors that may affect the estimated subsidy rates include changes in loan terms (modifications, prepayments, etc.), appraised collateral/liquidation values, interest payments, outstanding balances, and other economic, legal and financial conditions specific to each individual air carrier (see Note 15).

2. Fund Balance

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

Fund Balances

As of September 30, 2005 and September 30, 2004, fund balances consisted of the following (in millions):

	2005	2004
Appropriated Funds	$63,793	$57,614
Revolving Funds	1,761	1,641
Deposit Funds	457	415
Special Funds	315	268
Other Funds	8	8
Total Fund Balances	**$66,334**	**$59,946**

As of September 30, 2005 and September 30, 2004, the status of fund balances consisted of the following (in millions):

	2005	2004
Unobligated Balance - Available	$30,479	$35,743
Unobligated Balance - Unavailable	10,014	10,179
Obligated Balance not yet Disbursed	45,704	41,431
Subtotal	**86,197**	**87,353**
Adjustment for Non Budgetary Funds	462	435
Adjustment for Borrowing Authority	(5,720)	(5,672)
Adjustment for Intra-Treasury Investments	(4,732)	(2,584)
Adjustment for Imprest Funds	(4)	(3)
Adjustment for Other Budgetary Resources Not in Fund		
Balance - Cash & Other Assets	(13,427)	(19,583)
Authority Unavailable for Obligation	3,558	0
Total Status of Fund Balances	**$66,334**	**$59,946**

The above balances do not include unobligated balances related to the Exchange Stabilization Fund (ESF). While ESF balances are included on the Statement of Budgetary Resources (SBR), they are not a component of the Fund Balance with the Treasury. The ESF balances displayed on the SBR are components of cash, foreign currency, and other monetary assets (see Note 5).

At September 30, 2005 and September 30, 2004, Treasury did not have any budgetary authority in fund balance that was specifically withheld from apportionment by OMB. The balances in non-entity funds, such as deposit funds, are being held in a fiduciary capacity by Treasury for the public or for another federal entity, such as the General Fund of the U.S. government. Such funds have an offsetting liability equal to fund balance. See Note 8 regarding restrictions related to the letter of credit balances.

3. Loans and Interest Receivable

Entity Intra-governmental

As of September 30, 2005 and September 30, 2004, intra-governmental loans (issued by the Federal Financing Bank) and interest receivable consisted of the following (in millions):

	2005 Loans & Interest Receivable	2004 Loans & Interest Receivable
Agency Loans Purchased	$0	$5,150
Direct Loans	0	1,800
Guaranteed Loans	27,774	22,376
Interest Receivable	183	250
Less: Allowance & Discounts	0	(614)
Subtotal- Entity	**$27,957**	**$28,962**

The Federal Financing Bank (Bank) issues the above loans to federal agencies for their own use or to private sector borrowers, whose loans are guaranteed by the federal agencies. When a federal agency has to honor its guarantee because a private sector borrower defaults, the federal agency that guaranteed the loan must obtain an appropriation or use other resources to repay the Bank. Loan principal and interest are backed by the full faith and credit of the U.S. government, except for loans to the U.S. Postal Service. The Bank has not incurred and does not expect to incur any credit-related losses on its loans and accordingly, has not recorded an allowance for uncollectible intra-governmental loans.

Non-Entity Intra-governmental

	Loans Receivable	Interest Receivable	2005 Total	Loans Receivable	Interest Receivable	2004 Total
Department of Agriculture	$60,385	$323	$60,708	$46,821	$68	$46,889
Department of Interior	392	823	1,215	410	888	1,298
Federal Communications Commission	1,274	0	1,274	3,941	0	3,941
Department of Veterans Affairs	2,193	(3)	2,190	2,618	0	2,618
Railroad Retirement Board	2,973	69	3,042	2,962	64	3,026
Small Business Administration	7,695	0	7,695	8,546	0	8,546
Department of Housing & Urban Development	7,787	45	7,832	8,838	82	8,920
Department of Energy	2,777	13	2,790	2,900	13	2,913
Department of Education	104,471	2	104,473	96,530	2	96,532
Export Import Bank of the U. S.	5,848	0	5,848	7,237	0	7,237
Other agencies	3,459	8	3,467	3,170	13	3,183
Subtotal—Non-Entity	**$199,254**	**$1,280**	**$200,534**	**$183,973**	**$1,130**	**$185,103**
Total Intra-governmental Loans and Interest Receivable — Entity and Non-Entity			**$228,491**			**$214,065**

Entity and Non-Entity Non-Federal

As of September 30, 2005 and September 30, 2004, loans and interest receivable from non-federal entities consisted of the following (in millions):

	Entity	Non-entity	2005 Total	Entity	Non-entity	2004 Total
Direct Loans	$187	$464	$651	$57	$729	$786
Interest Receivable	0	142	142	0	212	212
Less: Allowance and Subsidy Cost	(123)	0	(123)	(21)	0	(21)
Total Non-Federal Loans and Related Interest Receivable	**$64**	**$606**	**$670**	**$36**	**$941**	**$977**

These amounts include certain loans and credits issued by the United States to various foreign governments. The agreements with each debtor government vary as to dates, interest rates, method of payment, and billing procedures. All such loans and credits represent legally valid and outstanding obligations of foreign governments, and the U.S. government has not waived or renounced its rights with respect to any of them. The loans are due and payable in U.S. denominations.

4. Due from the General Fund and Due to the General Fund

Treasury is responsible for managing various assets and liabilities on behalf of the U.S. government as a whole. Due from the General Fund represents amounts required to fund liabilities managed by Treasury on behalf of the U.S. government. Liabilities managed by Treasury are comprised primarily of the federal debt. Due to the General Fund represents assets held for the General Fund of the U.S. government.

As of September 30, 2005 and September 30, 2004, Due from and Due to the General Fund, included the following non-entity assets and liabilities (in millions):

	2005	2004
Liabilities Requiring Funding from the General Fund:		
Federal Debt and Interest Payable	$4,600,668	$4,305,302
Federal Debt and Interest Payable - Intra-governmental	3,354,905	3,097,949
Refunds Payable	1,952	1,808
Adjustment for Eliminated Liabilities	20,556	15,433
Total Due from the General Fund	**$7,978,081**	**$7,420,492**
Assets to be Distributed to the General Fund:		
Fund Balance	$170	$129
Advances to the Black Lung Trust Fund	9,186	8,741
Operating Cash of the Federal Government	28,344	31,029
Cash, Foreign Currency and Other Monetary Assets	39	60
Gold and Silver Reserves	9	9
Loans and Interest Receivable - Intra-governmental	200,534	185,103
Loans and Interest Receivable	606	941
Accounts Receivable - Intragovernmental	501	543
Tax and Other Non-Entity Receivables	21,331	20,428
Miscellaneous Assets	162	3
Adjustment for Eliminated Assets	12,669	29,450
Total Due to the General Fund	**$273,551**	**$276,436**

The Adjustment for Eliminated Intra-Treasury liabilities mainly represents investments in U.S. government securities held by Treasury reporting entities that were eliminated against federal debt. The Adjustment for Eliminated Intra-Treasury assets mainly represents loans and interest payable owed by reporting entities that are consolidated with Treasury, which were eliminated against Loans and Interest Receivable held by the Bureau of the Public Debt.

On the Balance Sheet, Treasury reported $21,430 million in Tax, Other, and Related Interest Receivables as of September 30, 2005 ($20,520 million as of September 30, 2004). However, only $21,331 million is reported as due to the General Fund of the U.S. government ($20,428 million as of September 30, 2004). The difference is attributable to the exclusion of amounts which will be paid to others outside the U.S. government, and miscellaneous entity receivables (see Note 10).

5. Cash, Foreign Currency, and Other Monetary Assets

Cash, foreign currency, and other monetary assets held as of September 30, 2005 and September 30, 2004 were as follows (in millions):

	2005	2004
Entity:		
Cash	$4	$4
Foreign Currency:		
Japanese Yen	2,719	1,435
European Euro	7,413	7,450
Other	14	19
Other Monetary Assets:		
Special Drawing Rights	8,245	12,824
Other	227	135
Subtotal - Entity	**$18,622**	**$21,867**
Non-Entity:		
Operating Cash of the Federal Government	$27,857	$30,735
Foreign Currency	89	128
Other	1,010	431
Subtotal - Non-Entity	**28,956**	**31,294**
Total Cash, Foreign Currency, and Other Monetary Assets	**$47,578**	**$53,161**

Operating Cash & Other Cash of the Federal Government held by Treasury Consisted of the following (in millions):

	2005	2004
U.S. Operating Cash Accounts	$31,299	$30,362
Operating Cash - Federal Reserve Account	4,509	6,087
Subtotal	**$35,808**	**$36,449**
Outstanding Checks	(7,951)	(5,714)
Total Operating Cash	**$27,857**	**$30,735**
Other Miscellaneous Items	487	294
Total Cash Held by the Treasury for Government-wide Operations	**$28,344**	**$31,029**

Entity

Entity cash, foreign currency, and other monetary assets primarily include foreign currency denominated assets (FCDA), special drawing rights (SDRs), and forfeited cash. SDRs and FCDAs are valued as of September 30, 2005 and September 30, 2004, using current exchange rates plus accrued interest, at September 30, 2005 and 2004. "Other" includes U.S. dollars restricted for use by the International Monetary Fund (IMF), which are maintained in two accounts at the Federal Reserve Bank of New York. FCDAs represent Foreign Currency Agreements (swap agreements) between Treasury and various countries that provide for drawing of dollars by those countries and/or drawing of foreign currency by Treasury. Treasury enters into these agreements through the Exchange Stabilization Fund.

The foreign currency holdings are normally invested in interest bearing securities issued by or held through foreign governments or monetary authorities. FCDAs with original maturities of three months or less, (except for foreign currencies under swap agreements with developing countries) were valued at $6.6 billion as of September 30, 2005 ($5.3 billion as of September 30, 2004). Other FCDAs with maturities greater than three months are also held and may at times include foreign currencies acquired under swap agreements with developing countries. As of September 30, 2005, FCDAs with maturities greater than three months were valued at $3.6 billion ($3.6 billion as of September 30, 2004).

The SDR is an international reserve asset created by the IMF. It was created as a supplement to existing reserve assets and on several occasions SDRs have been allocated by the IMF to members participating in the IMF's SDR department. The SDR's value as a reserve asset derives, essentially, from the commitments of participants to hold and accept SDRs and to honor various obligations connected with its proper functioning as a reserve asset.

The Special Drawing Rights Act of 1968 authorizes the Secretary of Treasury to issue certificates, not to exceed the value of SDR holdings, to the Federal Reserve Bank in return for interest free dollar amounts equal to the face value of certificates issued. The certificates may be issued for the purpose of financing the acquisition of SDRs from other countries or to provide resources for the financing of Treasury's Exchange Stabilization Fund's activities. Certificates issued are to be redeemed by the Department at such times and in such amounts as the Secretary of the Treasury may determine. As of September 30, 2005, the value of the certificates issued to Federal Reserve Banks amounted to $2.2 billion ($2.2 billion as of September 30, 2004).

On a daily basis, the IMF calculates the value of the SDR using the market value, in terms of the U.S. dollar, from the amounts of each of four freely usable weighted currencies, as defined by the IMF. These currencies are the U.S. dollar, the European euro, the Japanese yen, and the British pound sterling. Treasury's SDR holdings (assets resulting from various SDR related activities including remuneration received on interest earned on the U.S. reserve position – see note 8) and allocations from the IMF (liabilities of the U.S. coming due only in the event of a liquidation of, or U.S. withdrawal from the SDR department of the IMF, or cancellation of SDRs) are revalued monthly based on the SDR valuation rate calculated by the IMF.

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

a. canceled by the Board of Governors based on an 85 % majority decision of the total voting power of the Executive Board of the IMF;
b. the SDR Department of the IMF is liquidated;
c. the IMF is liquidated; or
d. the United States chooses to withdraw from the IMF or terminate its participation in the SDRs.

Except for the payment of interest and charges on SDRs allocations to the United States, the payment of Treasury's commitment related to the SDRs allocations is conditional on events listed above, in which the United States has a substantial or controlling voice. Allocations of SDRs were made on January 1, 1970, 1971, 1972, 1979, 1980 and 1981. Since 1981, the IMF has made no further allocations of SDRs. As of September 30, 2005, the amount of SDR holdings of the United States was the equivalent of $8.2 billion and the amount of SDR allocations to the United States was the equivalent of $7.1 billion. As of September 30, 2004, the amount of SDR holdings of the United States was the equivalent of $12.8 billion and the amount of SDR allocations to the United States was the equivalent of $7.2 billion.

During FY 2005, Treasury received remuneration on the U.S. reserve position in the IMF, at the prevailing rates, $316 million equivalent of SDRs ($300 million equivalent of SDRs during FY 2004), and paid the General Fund of the Federal Government $.5 million ($.4 million in FY 2004) in interest on these funds until they were transferred to the General Fund.

Non-Entity

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

The Operating Cash of the U.S. government represents balances from tax collections, other revenues, federal debt receipts, time deposits, and other various receipts net of checks outstanding, which are held in the Federal Reserve Banks, foreign and domestic financial institutions, and in U.S. Treasury tax and loan accounts at commercial banks.

The Operating Cash of the U.S. Government also includes other cash representing the balances of petty cash and funds held in other Federal agencies' books. With the passage of the Consolidated Appropriation Act of 2004, Treasury received a permanent and indefinite appropriation to compensate banks for services rendered. Therefore, compensating balances and depository compensation securities accounts were closed. Operating Cash of the U.S. Government is either insured (for balances up to $100,000) by the Federal Deposit Insurance Corporation (FDIC) or collateralized by securities pledged by the depository institutions and held by the Federal Reserve Banks.

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

Treasury is responsible for safeguarding most of the U.S. government's gold and silver reserves in accordance with 31 USC 5117. The consolidated Balance Sheet also reflects gold being held in the Federal Reserve Bank of New York.

Gold reserves being held by Treasury are offset by a liability for gold certificates issued by the Secretary of the Treasury to the Federal Reserve as provided in 31 USC 5117. Since 1934, Gold certificates have been issued in non-definitive or book-entry form to the Federal Reserve. Treasury's liability incurred by issuing the Gold Certificates is limited to the gold being held by Treasury at the legal standard value established by law. Upon issuance of gold certificates to the Federal Reserve, the proceeds from the certificates are deposited into the operating cash of the U.S. government. All of Treasury's certificates issued are payable to the Federal Reserve.

Absent historical cost records to determine acquisition cost of the gold and silver over the decades, the statutory rates of $42.2222 per fine troy ounce (FTO) for gold and $1.292929292 per FTO for silver are used to value the entire custodial reserves, which are in the custody of the U.S. Mint and the Federal Reserve Bank of New York. As of September 30, 2005 and September 30, 2004, the gold and silver reserves consisted of the following (in millions):

	FTO's	Statutory Rate	9/30/05 Statutory Value	Market Rate	9/30/05 Market Value
Gold	245,262,897	$42.2222	$10,356	$473.25	$116,071
Gold Held by Federal Reserve	13,450,413	42.2222	568	473.25	6,366
Subtotal - Gold	**258,713,310**		**$10,924**		**$122,437**
Silver	7,075,171	1.292929292	9	7.53	53
Total Gold and Silver Reserves			**$10,933**		**$122,490**

	FTOs	Statutory Rate	9/30/04 Statutory Value	Market Rate	9/30/04 Market Value
Gold	245,262,897	$42.2222	$10,356	$415.65	$101,944
Gold Held by Federal Reserve	13,450,413	42.2222	568	415.65	5,591
Subtotal - Gold	**258,713,310**		**$10,924**		**$107,535**
Silver	7,075,171	1.292929292	9	6.67	47
Total Gold and Silver Reserves			**$10,933**		**$107,582**

7. Investments and Related Interest

Investments in U.S. government Securities held by Treasury entities have been eliminated against the federal debt liability for financial reporting purposes (See Note 4). The Exchange Stabilization Fund holds most of Treasury's other investments. Securities that Treasury has both the positive intent and ability to hold to maturity are classified as investment securities held to maturity and are carried at historical cost, adjusted for amortization of premiums and accretion of discounts. As of September 30, 2005 and September 30, 2004, entity investments consisted of the following (in millions):

Type of Investment	Cost/ Acquisition Value	Unamortized (Premium)/ Discount	Net Investment	Interest Receivable	9/30/05 Investment Balance	9/30/05 Market Value
Euro Bonds	$3,398	$95	$3,493	$104	$3,597	$3,677
Japanese Financing Bills	874	0	874	0	874	873
Japanese T Bills	1,986	0	1,986	0	1,986	1,986
Japanese Government Bond	2,751	8	2,759	0	2,759	2,756
Other	191	(3)	188	0	188	188
Total Non-Federal	**$9,200**	**$100**	**$9,300**	**$104**	**$9,404**	**$9,480**

Type of Investment	Cost/ Acquisition Value	Unamortized (Premium)/ Discount	Net Investment	Interest Receivable	9/30/04 Investment Balance	9/30/04 Market Value
Euro Bonds	$3,395	$106	$3,501	$108	$3,609	$3,670
Japanese Financing Bills	3,462	0	3,462	0	3,462	3,462
Japanese T Bills	3,675	0	3,675	0	3,675	3,675
Other	127	(3)	124	0	124	125
Total Non-Federal	**$10,659**	**$103**	**$10,762**	**$108**	**$10,870**	**$10,932**

8. Reserve Position in the International Monetary Fund

The United States participates in the IMF through a quota subscription. Quota subscriptions are paid partly through the transfer of reserve assets, such as foreign currencies or SDRs, which are international reserve currency assets created by the IMF, and partly by making domestic currency available as needed through a non-interest-bearing letter of credit. This letter of credit, issued by Treasury and maintained by the Federal Reserve Bank of New York (FRBNY), represents the bulk of the IMF's holdings of dollars. Approximately one quarter of 1 % of the U.S. quota is maintained in cash balances in an IMF account at FRBNY.

While resources for transactions between the IMF and the United States are appropriated, they do not result in net budgetary outlays. This is because U.S./IMF quota transactions constitute an exchange of monetary assets in which the United States receives an equal offsetting claim on the IMF in the form of an increase in the U.S. reserve position in the IMF, which is interest-bearing and can be drawn at any time for balance of payments needs. When the IMF draws dollars from the letter of credit to finance its operations and expenses, the drawing does not represent a net budget outlay on the part of the United States because there is a commensurate increase in the U.S. reserve position. When the IMF repays dollars to the United States, no net budget receipt results because the U.S. reserve position declines concurrently in an equal amount.

As of September 30, 2005, the U.S. quota in the IMF was 37.1 billion SDRs, valued at approximately $53.8 billion. (The quota as of September 30, 2004 was 37.1 billion SDRs, valued at approximately $54.6 billion.) The quota consisted of the following (in millions):

	2005	2004
Letter of Credit /1	$40,419	$34,995
U.S. Dollars Held in Cash by the IMF /1	181	135
Reserve Position /2	13,247	19,442
U.S Quota in the IMF	**$53,847**	**$54,572**

/1 This amount is included in entity appropriated funds under Note 2, Fund Balance with Treasury, and unexpended appropriations - Obligations/Undelivered orders.

/2 This amount is included in the Cumulative Results of Operations.

The U.S. reserve position is denominated in SDRs, as is the U.S. quota. Consequently, fluctuations in the value of the dollar with respect to the SDR results in valuation changes in dollar terms for the U.S. reserve position in the IMF as well as the IMF letter of credit. Treasury periodically adjusts these balances to maintain the SDR value of the U.S. quota and records the change as a deferred gain or loss in its cumulative results of operations. These adjustments, known as maintenance of value adjustments, are settled annually after the close of the IMF financial year on April 30. Such adjustments do not involve a flow of funds. At April 30, 2005, the annual settlement with the IMF resulting from the depreciation of the dollar against the SDR since April 30, 2004, called for an upward adjustment of the U.S. quota by $1.523 billion (at April 30, 2004, the depreciation of the dollar against the SDR since April 30, 2003, called for an upward adjustment of the U.S. quota by $1.375 billion) and a corresponding increase to Unexpended Appropriations on the Statement of Changes in Net Position. The dollar balances shown above for the U.S. quota include accrued valuation adjustments. At September 30, 2005, Treasury recorded a net deferred valuation loss in the amount of $54.1 million ($647 million valuation gain as of September 30, 2004) for deferred maintenance of value adjustments needed at year end.

The United States earns "remuneration" (interest) on its reserve position in the IMF except for the portion of the reserve position originally paid in gold. Remuneration is paid quarterly and is calculated on the basis of the SDR interest rate. (The SDR interest rate is a market-based interest rate determined on the basis of a weighted average of interest rates on short-term instruments in the markets of the currencies included in the SDR valuation basket.) Payment of a portion of this remuneration is deferred as part of a mechanism for creditors and debtors to share the financial consequences of overdue obligations to the IMF, such as unpaid overdue interest, and to similarly share the burden of establishing any contingency accounts deemed necessary to reflect the possibility of non-repayment of relevant principal amounts. As overdue interest is paid, previously deferred remuneration corresponding to the creditors' share of the burden of earlier nonpayment is included in the next payment of remuneration. The deferred remuneration corresponding to the creditors' share of establishing the contingency accounts is usually paid when there are no longer any relevant overdue obligations or when the IMF Executive Board determines. There were no deductions in the remuneration paid by the IMF as a result of burden-sharing during FY 2005 and 2004. For FY 2005 and 2004, Treasury received $316.0 million and $300 million as remuneration (see note 5).

In addition to quota subscriptions, the IMF maintains borrowing arrangements to supplement its resources in times of crisis when IMF liquidity is low. The United States currently participates in two such arrangements – the General Arrangements to Borrow (GAB) and the New Arrangements to Borrow (NAB). There were no U.S. loans outstanding under these arrangements in FY 2005 and FY 2004. The dollar equivalent of SDR 6.7 billion has been appropriated to finance U.S. participation in the GAB and NAB; as of September 30, 2005, and September 30, 2004, this amounted to $9.7 billion and $9.9 billion, respectively, in standing appropriations available for lending through the GAB or NAB, as needed. As is the case for the U.S. quota in the IMF, budgetary treatment of U.S. participation in the GAB and NAB does not result in net budgetary outlays, since transactions under the GAB or NAB result in concurrent adjustments to the U.S. reserve position in the IMF.

9. Investments in International Financial Institutions

Treasury participates in Multilateral Development Banks (MDBs) to support poverty reduction, private sector development, transition to market economies and sustainable economic growth and development, thereby advancing United States' economic, political, and commercial interests abroad. The MDBs consist of the World Bank Group (International Bank for Reconciliation & Development, International Finance Corporation, and Multilateral Investment Guarantee Agency), and five regional development banks (the African, Asian, European, Inter-American, and North American institutions), as enumerated in the table below. These investments are non-marketable equity investments valued at cost.

As of September 30, 2005 and September 30, 2004, investments in international financial institutions consisted of the following (in millions):

	2005	2004
African Development Bank	$165	$160
Asian Development Bank	458	450
European Bank for Reconstruction & Development	593	558
Inter-American Development Bank	1,475	1,462
International Bank for Reconstruction & Development	1,985	1,985
International Finance Corporation	569	569
Multilateral Investment Guarantee Agency	44	44
North American Development Bank	175	175
Total	**$5,464**	**$5,403**

Refer to Note 17 for a description of the contingent liability to these institutions.

10. Accounts Receivable and Related Interest

A. Tax, Other, and Related Interest Receivables, Net

Tax, other, and related interest receivables include receivables from tax assessments, excise taxes, fees, penalties, and interest assessed and accrued that were not paid or abated, reduced by an estimate for uncollectible amounts. Also included is interest income due on monies deposited in Federal Reserve Banks.

As of September 30, 2005 and September 30, 2004, tax, other, and related interest receivables, net, consisted of the following (in millions):

	2005	2004
Non-Entity:		
IRS Federal Tax Receivable, Gross	$88,019	$89,137
Less Allowance on Taxes Receivable	(67,008)	(69,117)
Receivable, Deposit of Earnings, Federal Reserve	312	412
Other Receivable & Interest	20	50
Less: Allowance on Other & Related Interest Receivable	(6)	(40)
Total Tax, and Other Non-Entity Receivables, Net	**$21,337**	**$20,442**
Entity: **Miscellaneous Entity Receivables & Related Interest**	**93**	**78**
Total Tax, Other & Related Interest Receivables, Net	**$21,430**	**$20,520**

IRS federal taxes receivable constitute the largest portion of the receivables. IRS federal taxes receivable consists of tax assessments, penalties, and interest which were not paid or abated, and which were agreed to by either the taxpayer and IRS, or the courts. An allowance for doubtful accounts is established for the difference between the gross receivables and the portion deemed collectible. The portion of tax receivables estimated to be collectible and the allowance for doubtful accounts are based on projections of collectability from a statistical sample of taxes receivable. Treasury does not establish an allowance for the receivable on deposits of Federal Reserve earnings.

B. Intra-governmental Accounts and Related Interest Receivable

Intra-governmental accounts receivable and interest mainly represents non-entity payments made by Treasury under the Contract Disputes Act ($501 million of the $626 million and $543 million of the $632 million displayed for 2005 and 2004, respectively). Unlike Judgment Fund payments, other federal agencies are required to reimburse Treasury for payments made to contractors or federal employees, on their behalf, under the Act. These amounts remain a receivable on Treasury's books of the Financial Management Service and a payable on the other federal agencies' books until reimbursement is made. The remaining amount displayed as intra-governmental accounts receivable and interest is related to miscellaneous intra-governmental transactions.

11. Inventory and Related Property, Net

Inventory and related property includes inventory, operating materials and supplies, and forfeited property held by Treasury. Treasury's operating materials and supplies are maintained for the production of bureau products. Treasury maintains inventory accounts or balances (e.g., metals, paper, etc.) for use in manufacturing currency and coins. The cost of these items is included in inventory costs, and is recorded as cost of goods sold upon delivery to customers. Inventory for check processing activities is also maintained.

As of September 30, 2005 and September 30, 2004, inventory and related property consisted of the following (in millions):

	2005	2004
Operating materials and supplies held for use	$16	$14
Operating materials and supplies held in reserve for future use	22	21
Forfeited property	57	46
Other related property	388	387
Total allowance for inventories and related property	(15)	(9)
Total Inventories and Related Property	**$468**	**$459**

12. Property, Plant, and Equipment, Net

As of September 30, 2005 and 2004, plant, property, and equipment consisted of the following (in millions):

	Depreciation Method	Service Life	Cost	Accumulated Depreciation	2005 Net Book Value
Buildings, structures and facilities	S/L	3 - 50 years	$583	($216)	$367
Furniture, fixtures and equipment	S/L	2 - 20 years	2,602	(1,796)	806
Construction in progress	N/A	N/A	172	0	172
Land and land improvements	N/A	N/A	11	0	11
ADP software	S/L	2 - 10 years	901	(285)	616
Assets under capital lease	S/L	2 - 25 years	86	(48)	38
Leasehold improvements	S/L	2 - 25 years	461	(245)	216
Other	S/L	2 - 30 years	584	(412)	172
Total			**$5,400**	**($3,002)**	**$2,398**

	Depreciation Method	Service Life	Cost	Accumulated Depreciation	2004 Net Book Value
Buildings, structures and facilities	S/L	3 - 50 years	$567	($219)	$348
Furniture, fixtures and equipment	S/L	2 - 20 years	2,480	(1,601)	879
Construction in progress	N/A	N/A	158	0	158
Land and land improvements	N/A	N/A	10	0	10
ADP software	S/L	2 - 10 years	354	(142)	212
Assets under capital lease	S/L	2 - 25 years	129	(51)	78
Leasehold improvements	S/L	2 - 25 years	417	(184)	233
Other	S/L	2 - 30 years	1,165	(338)	827
Total			**$5,280**	**($2,535)**	**$2,745**

Treasury leases land and buildings from the General Services Administration (GSA) to conduct most of its operations. GSA charges a standard level users fee which approximates commercial rental rates for similar properties. The service life ranges are large due to Treasury's diversity of held plant, property, and equipment.

The Treasury Complex (Main Treasury Building and Annex) was declared a national historical landmark in 1972. The Treasury Complex is treated as a multi-use heritage asset and is expected to be preserved indefinitely.

13. Non-Entity Assets

As of September 30, 2005 and September 30, 2004, non-entity assets consisted of the following (in millions):

	2005	2004
Intra-governmental Assets:		
Fund Balance (Note 2)	$776	$834
Loans and Interest Receivable (Note 3)	200,534	185,103
Accounts Receivable and Related Interest	501	543
Advances to the Black Lung Trust Fund (Note 4)	9,186	8,741
Due from the General Fund (Note 4)	7,978,081	7,420,492
Total Non-Entity Intra-governmental Assets	**$8,189,078**	**$7,615,713**
Cash, Foreign Currency and Other Monetary Assets (Note 5)	$28,956	$31,294
Gold & Silver Reserves (Note 6)	10,933	10,933
Loans and Interest Receivable (Note 3)	606	941
Tax, Other, and Related Interest Receivable, Net (Note 10)	21,337	20,442
Miscellaneous Assets	161	3
Total Non-Entity Assets	**$8,251,071**	**$7,679,326**

Non-entity assets are those that are held by Treasury but are not available for use by Treasury. Non-entity fund balance with Treasury represents unused balances of appropriations received by various Treasury entities to conduct custodial operations such as the payment of interest on the Federal debt and refunds of taxes and fees. Non-entity loans and interest receivable represents loans managed by Treasury on behalf of the U.S. government. These loans are provided to federal agencies, and Treasury is responsible for collecting these loans and transferring the proceeds to the General Fund of the U.S. government. Non-entity cash, foreign currency, and other monetary assets include the operating cash of the U.S. government, managed by Treasury. It also includes foreign currency maintained by various U.S. and military disbursing offices, as well as seized monetary instruments.

14. Federal Debt & Interest Payable

Treasury is responsible for administering the federal debt on behalf of the U.S. government. The federal debt includes borrowings from the public as well as borrowings from federal agencies. The federal debt managed by Treasury does not include debt issued by other governmental agencies such as the Tennessee Valley Authority, or the Department of Housing and Urban Development. The federal debt as of September 30, 2005 and September 30, 2004 was as follows (in millions):

Intra-governmental	FY 2005	FY 2004
Beginning Balance	$3,056,484	$2,843,770
New Borrowings/Repayments	240,626	212,714
Subtotal at Par Value	**$3,297,110**	**$3,056,484**
Premium/Discount	14,597	(739)
Interest Payable Covered by Budgetary Resources	43,198	42,204
Total	**$3,354,905**	**$3,097,949**

Owed to the Public	FY 2005	FY 2004
Beginning Balance	$4,307,345	$3,924,090
New Borrowings/Repayments	293,894	383,255
Subtotal at Par Value	**$4,601,239**	**$4,307,345**
Premium/Discount	(35,532)	(34,778)
Interest Payable Covered by Budgetary Resources	34,961	32,735
Total	**$4,600,668**	**$4,305,302**

Debt held by the public approximates the U.S. government's competition with other sectors in the credit markets. In contrast, debt held by federal entities, primarily trust funds, represents the cumulative annual surpluses of these funds (i.e. excess of receipts over disbursements plus accrued interest) that have been used to finance general government operations.

Federal Debt held by Other Federal Agencies

Certain federal agencies are allowed to invest excess funds in debt securities issued by Treasury on behalf of the U.S. government. The terms and the conditions of debt securities issued are designed to meet the cash needs of the U.S. government. The vast majority is non-marketable securities issued at par value, but some are issued at market prices whose prices and interest rates reflect market terms. The average interest rate for debt held by the federal entities in FY 2005 was 5.2 % (5.4 % in FY 2004).

The federal debt also includes intra-governmental marketable debt securities that certain agencies are permitted to buy and sell on the open market. The debt, at par value (not including interest receivable), owed to federal agencies as of September 30, 2005 and September 30, 2004 was as follows (in millions):

	FY 2005	FY 2004
Social Security Administration*	$1,809,422	$1,635,398
Office of Personnel Management*	688,767	670,741
Department of Defense Agencies	234,916	217,541
Department of Health and Human Services	296,658	283,851
All Other Federal Entities - Consolidated	267,347	248,953
Total Federal Debt Held by Federal Entities	**$3,297,110**	**$3,056,484**

The above balances do not include premium/discount and interest payable.

* These amounts include marketable Treasury securities as well as non-marketable debt securities as follows (in millions):

	Non-Marketable Debt Securities	Marketable Securities**	2005 Total
Civil Service Retirement and Disability Fund, Par Value	$646,750	$0	$646,750
Federal Disability Insurance Trust Fund, Par Value	$193,263	$0	$193,263

**** The marketable securities were called on February 15, 2005, and the proceeds were rolled over as investments in GAS securities.**

	Non-Marketable Debt Securities	Marketable Securities	2004 Total
Civil Service Retirement and Disability Fund, Par Value	$631,749	$111	$631,860
Federal Disability Insurance Trust Fund, Par Value	$182,769	$30	$182,799

Federal Debt Held by the Public

As of September 30, 2005 and September 30, 2004, Federal Debt held by the Public consisted of the following:

(at par value, in millions)	Term	Average Interest Rates	2005
Marketable:			
Treasury Bills	1 Year or Less	3.4%	$910,323
Treasury Notes	Over 1 Year - 10 Years	3.7%	2,328,212
Treasury Bonds	Over 10 Years	7.9%	520,507
Treasury Inflation Protected Securities (TIPS)	More than 5 Years	2.4%	307,011
Total Marketable			**$4,066,053**
Non-Marketable	On Demand to Over 10 Years	4.9%	535,186
Total Federal Debt (Public)			**$4,601,239**

(at par value, in millions)	Term	Average Interest Rates	2004
Marketable:			
Treasury Bills	1 Year or Less	1.6%	$961,449
Treasury Notes	Over 1 Year - 10 Years	3.5%	2,109,494
Treasury Bonds	Over 10 Years	8.0%	551,904
Treasury Inflation Protected Securities (TIPS)	More than 5 Years	2.8%	223,008
Total Marketable			**$3,845,855**
Non-Marketable	On Demand to Over 10 Years	5.1%	461,490
Total Federal Debt (Public)			**$4,307,345**

The above balances do not include premium/discount and interest payable.

Treasury issues marketable bills at a discount and pays the par amount of the security upon maturity. The average interest rate on Treasury bills represents the original issue effective yield on securities outstanding as of September 30, 2005 and 2004, respectively. Treasury bills are issued with a term of one year or less.

Treasury issues marketable notes and bonds as long-term securities that pay semi-annual interest based on the securities' stated interest rates. These securities are issued at either par value or at an amount that reflects a discount or a premium. The average interest rate on marketable notes and bonds represents the stated interest rate adjusted by any discount or premium on securities outstanding as of September 30, 2005 and 2004. Treasury notes are issued with a term of over one year to 10 years and Treasury bonds are issued with a term of more than 10 years. Treasury also issues inflation–indexed securities (TIPS) that have interest and redemption payments, which are tied to the Consumer Price Index, the leading measurement of inflation. TIPS are issued with a term of more than five years. At maturity, TIPS are redeemed at the inflation-adjusted principal amount, or the original par value, whichever is greater. TIPS pay a semi-annual fixed rate of interest applied to the inflation-adjusted principal.

Other Debt and Interest Payable

Borrowings outstanding are with the Civil Service Trust Fund, which is administered by the Office of Personnel Management. The interest rates on these borrowings range from 4.62 % to 5.62 %, and the maturity dates range from June 30, 2009 to June 30, 2019. Borrowings began in 2005.

15. Liability for Loan Guarantees

The liability for loan guarantees is associated with the Air Transportation Stabilization Program which guarantees loans to assist air carriers that suffered losses as a result of the terrorist attacks on the United States that occurred on September 11, 2001.

Liabilities for loan guarantees represent the present value of future projected cash outflows from the Department, net of inflows, such as fees, and other collections. Related details for FY 2005 and FY 2004 are provided below.

(In Millions)	2005	2004
Loan Guaranteed		
Face value of loans outstanding	$879	$1,255
Amount guaranteed by the government	799	1,122
Loans disbursed	0	30
Defaulted Guaranteed Loan		
Loan Amount	$125	$0
Subsidy transferred from liability	103	0
Subsidy reestimate	(3)	0
Subsidy Expense		
Components of Current Year Subsidy:		
Defaults, Net of Recoveries	$0	2
Fees	0	(5)
Reestimates**	(143)	330
Administrative Expenses	**$5**	**$2**

Schedule for Reconciling Loan Guarantee Liability Balances:	2005	2004
Beginning balance of the liability for loan guarantee liability	$724	$353
Other subsidy costs	0	(2)
	724	**351**
Payment of defaulted loan	(124)	0
Loan guarantee modifications	0	(39)
Net defaulted loan assets	22	0
Fees received	69	68
Interest accumulation on the liability balance	7	14
Ending balance of the loan guarantee liability before reestimates	**698**	**394**
Reestimate of subsidy	(143)	330
Ending balance of loan guarantee liability*	**$555**	**$724**

*This amount is included in "Other Liabilities with the Public" (Note 18).

** The reduction in the subsidy expense in FY 2005 is associated with two guaranteed loans that were paid off.

16. D.C. Pensions Liability

Pursuant to Title XI of the Balanced Budget Act of 1997, as amended (the Act), on October 1, 1997, Treasury became responsible for certain District of Columbia retirement plans. The Act was intended to relieve the District of Columbia Government of the burden of unfunded pension liabilities transferred to the District by the U.S. government in 1979. Prior to December 23, 2004, the Act established the District of Columbia Federal Pension Liability Trust Fund (the Trust Fund), the District of Columbia Judicial Retirement and Survivors Annuity Fund (the Judicial Retirement Fund), and the Federal Supplemental District of Columbia Pension Fund (the Supplemental Fund).

The purpose of the Trust Fund was to make federal benefit payments and pay necessary administrative expenses for the District of Columbia Police Officers, Firefighters, and Teachers Retirement Plans for benefits earned based upon service on or before June 30, 1997. The purpose of the Judicial Retirement Fund was to make federal benefit payments and pay necessary administrative expenses of the Judges' Retirement Plan for all benefits earned. The purpose of the Supplemental Fund was to accumulate funds to finance Federal Benefit Payments and necessary administrative expenses for the Police Officers, Firefighters, and Teachers Retirement Plans after funds in the Trust Fund were depleted.

On December 23, 2004, the President signed into law the District of Columbia Retirement Protection Improvement Act of 2004. This amendment to the Act terminated the Trust Fund and the Supplemental Fund and transferred the assets to the D.C. Teachers, Police Officers and Firefighters Federal Pension Fund (the D.C. Federal Pension Fund) effective as of October 1, 2004.

Treasury is required to make annual amortized payments from the General Fund of the U.S. government to the Judicial Retirement Fund and as of FY 2005, the D.C. Federal Pension Fund (prior to FY 2005, payments were made to the Supplemental Fund.) The amount paid into the D.C. Federal Pension Fund from the General Fund of the U.S. government was $277 million during FY 2005. The Supplemental Fund received $270 million from the General Fund of the U.S. government during FY 2004. The amount paid into the Judicial Retirement Fund from the General Fund of the U.S. government was $7.0 million during FY 2005 (and $7.5 million during FY 2004).

As of September 30, 2005, the unobligated budgetary resources of the two funds were approximately $3.6 billion, and the pension liability was $8.5 billion, resulting in an unfunded liability of $4.9 billion. (As of September 30, 2004, the assets of the three funds were approximately $4 billion, and the pension liability was $8.4 billion, resulting in an unfunded liability of $4.4 billion.) The actuarial cost method used to determine costs for the retirement plans is the Aggregate Entry Age Normal Actuarial Cost Method. The actuarial liability is based upon long term assumptions selected by Treasury. In FY 2005, the assumption for the annual rate of investment return was 6% for the Judicial Fund and 4.8% for the D.C. Federal Pension Fund with a gradual increase to 6% by FY 2011 and the annual rate of inflation and cost-of-living adjustments were 3%. In FY 2004, the assumption for the annual rate of investment return and the annual rate of inflation and cost-of-living adjustments were 6% and 3%, respectively. In FY 2005, the assumption for the annual rate of salary increases was 6.5% for police officers and firefighters, 5.5% for teachers, and 3.5% for judges. In FY 2004, the assumption for the annual rate of salary increases was 6.5% for police officers and firefighters, 5.5% for teachers, and 3.5% for judges. The pension benefit costs incurred by the plans are included on the Consolidated Statements of Net Cost.

17. Commitments and Contingencies

Treasury is subject to contingent liabilities which include litigation cases. These contingent liabilities arise in the normal course of operations and their ultimate disposition is unknown. Based on information currently available, however, it is management's opinion that the expected outcome of these matters, individually or in the aggregate, will not have a materially adverse effect on the financial statements, except for the litigation described below.

Treasury is a party in various administrative proceedings, legal actions, and claims brought by or against it. At September 30, 2005 and 2004, no claims were reported in which a loss is probable, and no contingencies existed relative to proceedings and claims for which it is reasonably possible that a loss may be incurred.

Pending Legal Actions

Based on the information provided by legal counsel and in the opinion of management, the ultimate resolution of the following legal actions, for which a range of potential loss could not be determined, may materially affect Treasury's financial position or results. These specific cases are summarized as follows:

Cobell v. Norton (formerly Cobell v. Babbitt): Native Americans allege that the Departments of Interior and Treasury have breached trust obligations with respect to the management of the plaintiffs' individual Indian monies. The plaintiffs have not made claims for specific dollar amounts in the Federal district court proceedings, but in public statements have asserted that the class is owed $27.487 billion.

Tribal Trust Fund Cases: Numerous cases have been filed in which Native American Tribes seek a declaration that the U.S. has not provided the tribes with a full and complete accounting of their trust funds, and seek an order requiring the government to provide such an accounting. In addition, there are a number of other related cases for damages which do not name Treasury as a defendant. It is probable that additional tribes may file claims. It is not possible at this time to determine the number of suits that may be filed or the amount of damages that may be claimed.

Cruz v. United States, de la Torre v. United States, Barba v. United States and Chavez v. United States: These are claims that Mexican workers who were employed in the United States, beginning in 1942, did not receive funds which were withheld from the workers, nor did they receive an accounting for such funds.

Ferreiro v. United States: Plaintiffs claim allegedly past due civil service retirement benefits relating to individuals' employment by the U.S. government in Cuba prior to 1963.

The Department also had employment cases (e.g., discrimination, Equal Employment Opportunity Commission, Merit System Protection Board, etc.) in which a loss is reasonably possible, but for which a range of potential loss could not be determined.

Possible Legal Actions

In 2005 an association of banks presented to the Department a written letter and legal memorandum asserting claims related to certain Iraqi accounts of its member banks that were vested pursuant to Executive Order 13290 of 2003. This letter is silent regarding the amount of their claim. However, representatives of the association stated in a 2004 meeting they are entitled to compensation totaling approximately $ 1.4 billion. As no case has been filed, an opinion regarding the likelihood of unfavorable outcome is not practicable.

Other Contingencies

Multilateral Development Banks (MDBs): Treasury has subscribed to capital for certain MDBs, portions of which are callable under certain limited circumstances to meet the obligations of the respective MDBs. There has never been, nor is there anticipated, a call on Treasury's subscriptions. As of September 30, 2005 and September 30, 2004, U.S. callable capital in MDBs was as follows (in millions):

	2005	2004
African Development Bank	$1,428	$1,348
Asian Development Bank	5,911	5,911
European Bank for Reconstruction and Development	1,800	1,555
Inter-American Development Bank	28,687	28,687
International Bank for Reconstruction and Development	22,642	22,642
Multilateral Investment Guarantee Agency	285	285
North American Development Bank	1,275	1,275
Total	**$62,028**	**$61,703**

Terrorism Risk Insurance Program: The Terrorism Risk Insurance Act of 2002 provided Treasury an appropriation to compensate insurance companies for commercial property and casualty insurance losses resulting from certified acts of terrorism. Under the program, the U.S. government is responsible for paying 90 % of the insured losses arising from future acts of terrorism above the applicable insurer deductibles and below the annual cap of $100 billion. Any claims would be paid from permanent, indefinite budget authority and would not require subsequent appropriations. The Act sunsets on December 31, 2005. The Terrorism Risk Insurance Program is activated upon the certification of an "act of terrorism" by the Secretary of the Treasury in concurrence with the Secretary of State and the Attorney General.

18. Liabilities

Liabilities Not Covered by Budgetary and Other Resources

As of September 30, 2005 and September 30, 2004, liabilities not covered by budgetary and other resources consisted of the following (in millions):

	2005	2004
Intra-governmental Liabilities Not Covered by Budgetary & Other Resources:		
Federal Debt Principal, Premium/Discount (Note 14)	$3,311,707	$3,055,745
Other Intra-governmental Liabilities	97	313
Total Intra-governmental Liabilities Not Covered by Budgetary & Other Resources	**$3,311,804**	**$3,056,058**
Federal Debt Principal, Premium/Discount (Note 14)	4,565,707	4,272,567
D.C. Pension Liability (Note 16)	4,851	4,420
Other Liabilities	1,072	963
Total Liabilities Not Covered by Budgetary & Other Resources	**$7,883,434**	**$7,334,008**

Other Liabilities with the Public

Total "Other Liabilities" displayed on the Balance Sheet consists of both liabilities that are covered and not covered by budgetary resources. The amounts displayed of $4,665 million and $4,146 million, respectively, at September 30, 2005, and September 30, 2004 consisted of the following (in millions):

	2005	2004
Actuarial Liability for the Federal Workers Compensation Program (FECA)	$504	$680
Liability for Deposit Funds (Funds Held by the Federal Government for Others) & Suspense Accounts	843	365
ATSB Loan Guarantee Liabilities (Note 15)	555	724
Accrued Funded Payroll and Benefits	326	297
Capital Lease Liabilities	26	54
Accounts Payable & Other Accrued Liabilities	2,411	2,026
Total	**$4,665**	**$4,146**

19. Net Position

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

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

The amount reported as "appropriations received" are appropriated from Treasury General Fund of the U.S. government receipts, such as income taxes, that are not earmarked by law for a specific purpose. This amount will not necessarily agree with the "appropriation received" amount reported on the Statement of Budgetary Resources (SBR) because of differences between proprietary and budgetary accounting concepts and reporting requirements. For example, certain dedicated and earmarked receipts are recoded as "appropriations received" on the SBR, but are recognized as exchange or non-exchange revenue (i.e. typically in special and non-revolving trust funds) and reported on the Statement of Changes in Net Position in accordance with SFFAS No.7.

The amount reported as "Transfers to the General Fund and Other" on the Consolidated Statement of Changes in Net Position under "Other Financing Sources" mainly represents the distribution of interest revenue to the General Fund of the U.S. Government of $12,034 million and $12,655 million, for the years ended September 30, 2005 and September 30, 2004, respectively. The interest revenue is accrued on inter-agency loans held by Treasury on behalf of the U.S. Government. A corresponding balance is reported on the Consolidated Statement of Net Cost under "Federal Costs: Less Interest Revenue from Loans." The amount reported on the Consolidated Statement of Net Cost is reduced by eliminations with Treasury bureaus.

Treasury also includes seigniorage in "Transfers to the General Fund and Other." Seigniorage is the face value of newly minted circulating coins less the cost of production. The United States Mint is required to distribute the seigniorage that it recognizes to the General Fund of the U.S. government. The distribution is also included in "Transfers to the General Fund and Other." In any given year, the amount recognized as seigniorage may differ with the amount distributed by an insignificant amount.

Seigniorage in the amounts of $745 million and $586 million was recognized, respectively, for the years ended September 30, 2005 and September 30, 2004.

20. Consolidated Statement of Net Cost & Net Costs of Treasury Sub-organizations

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

\The classification of sub-organizations has been determined in accordance with Statement of Federal Financial Accounting Standards (SFFAS) No. 4 which states that the predominant factor is the reporting entity's organization structure and existing responsibility components, such as bureaus, administrations, offices, and divisions within a department.

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

Intra-Departmental costs/revenues resulting from the provision of goods and/or services on a reimbursable basis among Departmental sub-organizations are reported as costs by providing sub-organizations. Accordingly, such costs/revenues are eliminated in the consolidation process.

To the extent practical or reasonable to do so, earned revenue is deducted from the gross costs of the programs to determine their net cost. There are no precise guidelines to determine the degree to which earned revenue can reasonably be attributed to programs. The attribution of earned revenues requires the exercise of managerial judgment.

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

Other federal costs for the years ended September 30, 2005 and 2004 consisted of the following (in millions):

	2005	2004
Temporary State Fiscal Relief/Assistance Fund	$0	$5,000
Credit Reform Interest on Uninvested Funds (Intra-governmental)	4,405	3,698
Resolution Funding Corporation	2,130	2,187
Judgments Claims and Contract Disputes	973	746
Corporation for Public Broadcasting	466	437
Legal Services Corporation	299	301
Refunds of Moneys Erroneously Received	27	5
Presidential Election Campaign	0	178
All Other Payments	373	363
Total	**$8,673**	**$12,915**

The Temporary State Fiscal Relief /Assistance Fund was established in FY 2003 under Public Law 108-27 and expired at the end of FY 2004.

Pricing Policies – Exchange Revenues – Reimbursable Services

A portion of the earned revenue displayed on Treasury's Statement of Net Cost is generated by the provision of goods or services to the public or to other Federal entities.

Exchange revenues resulting from work performed for other Treasury sub-organizations or federal entities represent reimbursements for the full costs incurred by the performing entity. Reimbursable work between federal entities is subject to the Economy Act (31 U.S.C. 1535) or other statutes authorizing reimbursement. Prices associated with revenue earned from the public are based on recovery of full cost or are set at a market price. Treasury does not incur losses on the provision of goods or services on a reimbursable basis.

The tables on the following pages present Treasury's earned revenues, gross costs, and net cost of operations by program and by responsibility segment (in millions):

20. Supporting Net Cost Schedule by Strategic Plan Goal (In Millions):

	Economic Program		Financial Program		Management Program	
Treasury Sub-organization	**Promote Prosperous U.S. & World Economies**	**Promote Stable U.S. and World Economies**	**Preserve the Integrity of Financial Systems**	**Manage the U.S. Government's Finances Effectively**	**Ensure Professionalism, Excellence, Integrity, and Accountability in the Management and Conduct of the Department of the Treasury**	**2005 Totals**
Bureau of Engraving and Printing	$0	$0	$34	$0	$0	34
Bureau of the Public Debt	0	0	0	312	0	312
Departmental Offices	137	1,783	192	(1,206)	211	1,117
Financial Crimes Enforcement Network	0	0	90	0	0	90
Financial Management Service	0	0	0	872	0	872
Internal Revenue Service	0	0	192	11,268	0	11,460
U.S. Mint	0	0	(31)	0	0	(31)
Office of the Comptroller of the Currency	(12)	0	(64)	0	0	(76)
Office of Thrift Supervision	(2)	0	(12)	0	0	(14)
Alcohol and Tobacco Tax and Trade Bureau	0	44	0	42	0	86
Combined Goal Net Cost	**$123**	**$1,827**	**$401**	**$11,288**	**$211**	**$13,850**
Eliminations & Adjustments		334		(596)	206	(56)
Consolidated Program Net Cost		**$2,284**		**$11,093**	**$417**	**$13,794**

(continued)

20. Supporting Net Cost Schedule by Strategic Plan Goal (In Millions):

	Economic Program		Financial Program		Management Program	
Treasury Sub-organization	**Promote Prosperous U.S. & World Economies**	**Promote Stable U.S. and World Economies**	**Preserve the Integrity of Financial Systems**	**Manage the U.S. Government's Finances Effectively**	**Ensure Professionalism, Excellence, Integrity, and Accountability in the Management and Conduct of the Department of the Treasury**	**2004 Totals**
Bureau of Engraving and Printing	$0	$0	$44	$0	$0	$44
Bureau of the Public Debt	0	0	0	315	0	315
Departmental Offices	135	1,021	177	(457)	212	1,088
Financial Crimes Enforcement Network	0	0	56	0	0	56
Financial Management Service	0	0	0	710	0	710
Internal Revenue Service	0	0	186	10,213	0	10,399
U.S. Mint	0	0	(53)	0	0	(53)
Office of the Comptroller of the Currency	(6)	0	(19)	0	0	(25)
Office of Thrift Supervision	0	0	1	0	0	1
Alcohol and Tobacco Tax and Trade Bureau	0	53	0	24	0	77
Combined Goal Net Cost	**$129**	**$1,074**	**$392**	**$10,805**	**$212**	**$12,612**
Eliminations & Adjustments		129		(1,171)	210	(832)
Consolidated Program Net Cost		**$1,332**		**$10,026**	**$422**	**$11,780**

20. Consolidated Statement of Net Cost & Net Costs of Treasury Sub-organizations (In Millions)

For FYE September 30, 2005	Bureau of Engraving & Printing	Bureau of the Public Debt	Departmental Offices	Fin. Crimes Enforcement Network	Financial Management Service	Internal Revenue Service	U.S. Mint	Office of the Comptroller of the Currency	Office of Thrift Supervision	Alcohol and Tobacco Tax and Trade Bureau	Combined Total	Eliminations/ Adjustments	9/30/2005 Consolidated
Program Costs:													
Economic Program:													
Intragovernmental Gross Costs	$0	$0	$669	$0	$0	$0	$0	$12	$2	$16	**$699**	**($11)**	**$688**
Less: Earned Revenue	0	0	(346)	0	0	0	0	(3)	(1)	0	**(350)**	**345**	**(5)**
Intragovernmental Net Costs	0	0	323	0	0	0	0	9	1	16	**349**	**334**	**683**
Gross Costs with the public	0	0	2,260	0	0	0	0	72	17	29	**2,378**	**0**	**2,378**
Less: Earned Revenue	0	0	(663)	0	0	0	0	(93)	(20)	(1)	**(777)**	**0**	**(777)**
Net Costs with the public	0	0	1,597	0	0	0	0	(21)	(3)	28	**1,601**	**0**	**1,601**
Net Cost: Economic Program	**0**	**0**	**1,920**	**0**	**0**	**0**	**0**	**(12)**	**(2)**	**44**	**1,950**	**334**	**2,284**
Financial Program:													
Intragovernmental Gross Costs	82	74	905	49	166	3,856	55	57	22	15	**5,281**	**(1,423)**	**3,858**
Less: Earned Revenue	(21)	(7)	(2,688)	(1)	(133)	(118)	(7)	(14)	(9)		**(2,998)**	**827**	**(2,171)**
Intragovernmental Net Costs	61	67	(1,783)	48	33	3,738	48	43	13	15	**2,283**	**(596)**	**1,687**
Gross Costs with the public	464	248	768	42	840	7,879	941	360	152	28	**11,722**	**0**	**11,722**
Less: Earned Revenue	(491)	(3)	1	0	(1)	(157)	(1,020)	(467)	(177)	(1)	**(2,316)**	**0**	**(2,316)**
Net Costs with the public	(27)	245	769	42	839	7,722	(79)	(107)	(25)	27	**9,406**	**0**	**9,406**
Net Cost: Financial Program	**34**	**312**	**(1,014)**	**90**	**872**	**11,460**	**(31)**	**(64)**	**(12)**	**42**	**11,689**	**(596)**	**11,093**
Management Program:													
Intragovernmental Gross Costs	0	0	124	0	0	0	0	0	0	0	**124**	**(19)**	**105**
Less: Earned Revenue	0	0	(964)	0	0	0	0	0	0	0	**(964)**	**225**	**(739)**
Intragovernmental Net Costs	0	0	(840)	0	0	0	0	0	0	0	**(840)**	**206**	**(634)**
Gross Costs with the public	0	0	1,051	0	0	0	0	0	0	0	**1,051**	**0**	**1,051**
Less: Earned Revenue	0	0	0	0	0	0	0	0	0	0	**0**	**0**	**0**
Net Costs with the public	0	0	1,051	0	0	0	0	0	0	0	**1,051**	**0**	**1,051**
Net Cost: Management Program	**0**	**0**	**211**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**211**	**206**	**417**
Total Program Costs, Net	**$34**	**$312**	**$1,117**	**$90**	**$872**	**$11,460**	**($31)**	**($76)**	**($14)**	**$86**	**$13,850**	**($56)**	**$13,794**

20. Consolidated Statement of Net Cost & Net Costs of Treasury Sub-organizations (In Millions)

For FYE September 30, 2004	Bureau of Engraving & Printing	Bureau of the Public Debt	Departmental Offices	Fin. Crimes Enforcement Network	Financial Management Service	Internal Revenue Service	U.S. Mint	Office of the Comptroller of the Currency	Office of Thrift Supervision	Alcohol and Tobacco Tax and Trade Bureau	Combined Total	Eliminations/ Adjustments	9/30/2004 Consolidated
Program Costs:													
Economic Program:													
Intragovernmental Gross Costs	$0	$0	$68	$0	$0	$0	$0	$11	$2	$22	**$103**	**($9)**	**$94**
Less: Earned Revenue	0	0	(139)	0	0	0	0	(2)	(1)	0	**(142)**	**138**	**(4)**
Intragovernmental Net Costs	0	0	(71)	0	0	0	0	9	1	22	**(39)**	**129**	**90**
Gross Costs with the public	0	0	2,808	0	0	0	0	69	16	32	**2,925**	**0**	**2,925**
Less: Earned Revenue	0	0	(1,581)	0	0	0	0	(84)	(17)	(1)	**(1,683)**	**0**	**(1,683)**
Net Costs with the public	0	0	1,227	0	0	0	0	(15)	(1)	31	**1,242**	**0**	**1,242**
Net Cost: Economic Program	**0**	**0**	**1,156**	**0**	**0**	**0**	**0**	**(6)**	**0**	**53**	**1,203**	**129**	**1,332**
Financial Program:													
Intragovernmental Gross Costs	86	77	1,433	22	167	3,374	55	56	21	10	**5,301**	**(1,446)**	**3,855**
Less: Earned Revenue	(23)	(6)	(2,390)	(1)	(128)	(123)	(6)	(10)	(7)	0	**(2,694)**	**275**	**(2,419)**
Intragovernmental Net Costs	63	71	(957)	21	39	3,251	49	46	14	10	**2,607**	**(1,171)**	**1,436**
Gross Costs with the public	483	247	685	36	671	7,311	956	337	142	14	**10,882**	**0**	**10,882**
Less: Earned Revenue	(502)	(3)	(8)	(1)	0	(163)	(1,058)	(402)	(155)	0	**(2,292)**	**0**	**(2,292)**
Net Costs with the public	(19)	244	677	35	671	7,148	(102)	(65)	(13)	14	**8,590**	**0**	**8,590**
Net Cost: Financial Program	**44**	**315**	**(280)**	**56**	**710**	**10,399**	**(53)**	**(19)**	**1**	**24**	**11,197**	**(1,171)**	**10,026**
Management Program:													
Intragovernmental Gross Costs	0	0	113	0	0	0	0	0	0	0	**113**	**(16)**	**97**
Less: Earned Revenue	0	0	(746)	0	0	0	0	0	0	0	**(746)**	**226**	**(520)**
Intragovernmental Net Costs	0	0	(633)	0	0	0	0	0	0	0	**(633)**	**210**	**(423)**
Gross Costs with the public	0	0	850	0	0	0	0	0	0	0	**850**	**0**	**850**
Less: Earned Revenue	0	0	(5)	0	0	0	0	0	0	0	**(5)**	**0**	**(5)**
Net Costs with the public	0	0	845	0	0	0	0	0	0	0	**845**	**0**	**845**
Net Cost: Management Program	**0**	**0**	**212**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**212**	**210**	**422**
Total Program Costs, Net	**$44**	**$315**	**$1,088**	**$56**	**$710**	**$10,399**	**($53)**	**($25)**	**$1**	**$77**	**$12,612**	**($832)**	**$11,780**

21. Additional Information Related to the Statement of Budgetary Resources

Federal agencies are required to disclose additional information related to the Combined Statement of Budgetary Resources (per OMB Circular A-136, *"Financial Reporting Requirements."*) The information for the fiscal years ended September 30, 2005 and September 30, 2004 was as follows (in millions):

	2005	2004
Net Amount of Budgetary Resources Obligated for Undelivered Orders	$44,896	$37,557
Available Borrowing and Contract Authority at the end of the period	5,669	5,720
Adjustments During the Reporting Period to Budgetary Resources, Available at the Beginning of the Year	1	59

Apportionment Categories of Obligations Incurred	2005	2004
Obligations Incurred		
Direct - Category A	$6,457	$12,117
Direct - Category B	13,704	13,210
Direct - Exempt from Apportionment	364,692	331,719
Total Direct	**384,853**	**357,046**
Reimbursable - Category B	2,872	2,815
Reimbursable - Exempt from Apportionment	937	924
Total Reimbursable	**3,809**	**3,739**
Total Direct and Reimbursable	**$388,662**	**$360,785**

The *Budget of the United States* (also known as the President's Budget), with actual numbers for FY 2005, was not published at the time that these financial statements were issued. The President's Budget is expected to be published in January 2006. It will be available from the United States Government Printing Office.

For FY 2004 reporting, Treasury had a temporary waiver from the Office of Management and Budget (OMB) with regard to reporting certain distributed offsetting receipts. Upon further review, OMB and Treasury determined that certain offsetting receipts that are distributed and credited to Treasury should be reported beginning in FY 2005. As a result, "Offsetting Receipts" of $15,649 reported on the Statement of Budgetary Resources (SBR), and $15,677 included in the Statement of Financing as "Other" in Budgetary Offsetting Collections, includes these additional offsetting receipts required to be reported in FY 2005 in accordance with guidance provided by OMB.

The following chart displays the differences between the Combined Statement of Budgetary Resources (SBR) in the FY 2004 Performance and Accountability Report and the actual FY 2004 balances included in the FY 2006 President's Budget (PB).

Reconciliation of FY 2004 Statement of Budgetary Resources to the 2006 President's Budget (In Millions)

	Budgetary Resources	Outlays	Offsetting Receipts
Statement of Budgetary Resource	**$430,697**	**$346,410**	**$1,828**
Included in the President's Budget (PB) but not in the Statement of Budgetary Resources (SBR):			
IRS non-entity tax credit payments (1)	47,195	47,195	
Tax and Trade Bureau (TTB) non-entity collections for Puerto Rico	336	336	
Non-Treasury offsetting receipts included in Treasury chapter of PB (2)			13,519
Treasury offsetting receipts considered to be "General Fund" transactions for reporting purposes (3)			1,798
Other			69
Subtotal	**47,531**	**47,531**	**15,386**
Included in the SBR but not in the PB:			
Treasury resources shown in non-Treasury chapters of the PB, included in SBR (4)	(53,045)	(3,371)	
Offsetting collections net of collections shown in PB Treasury offsetting receipts	(5,811)		
Treasury offsetting receipts shown in other chapters of PB, part of which is in the SBR			271
Unobligated Balance carried forward, recoveries of prior year funds and expired accounts	(2,495)		
Exchange Stabilization Fund resources not shown in PB	(23,649)	1,041	
Other	(253)	296	(1)
Subtotal	**(85,253)**	**(2,034)**	**270**
President's Budget Amounts*	**$392,975**	**$391,907**	**$17,484**

1. These are primarily Earned Income Tax Credit and Child Tax Credit payments that are reported with refunds as custodial activities in Treasury's financial statements, and thus are not reported as budgetary resources.
2. These are other agencies' receipt accounts that are managed by those agencies and that Treasury believes should be reported in those agencies' financial statements.
3. These are receipt accounts that Treasury manages on behalf of other agencies, and are considered to be "General Fund" of the U.S. government receipts, rather than receipts of the Treasury reporting entity.
4. The largest of these is Treasury's International Assistance Programs (over $49 billion).

* Per President's Budget for FY 2006 - Budgetary Resources and Outlays are from the Analytical Perspective, and Offsetting Receipts are from the Appendix.

NOTE: The reporting for the items described in notes 2 and 3 above was under review by OMB during FY 2005, and will be revised in future years to reflect additional OMB guidance.

Legal Arrangements Affecting Use of Unobligated Balances

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

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

22. Collection and Disposition of Custodial Revenue

The Department collects the majority of federal revenue from income and excise taxes. Collection activity, by revenue type and tax year, was as follows for the fiscal years ended September 30, 2005 and September 30, 2004 (in millions):

	Tax Year				
	2005	**2004**	**2003**	**Pre-2003**	**2005 Collections**
Individual Income and FICA Taxes	$1,211,866	$620,914	$13,873	$18,034	$1,864,687
Corporate Income Taxes	209,398	83,098	1,178	13,195	306,869
Estate and Gift Taxes	77	16,616	1,278	7,634	25,605
Excise Taxes	52,330	18,954	104	582	71,970
Railroad Retirement Taxes	3,464	1,071	1	3	4,539
Unemployment Taxes	4,915	1,890	37	106	6,948
Federal Reserve Earnings	14,208	5,089	0	0	19,297
Fines, Penalties, Interest & Other Revenue	3,192	360	0	0	3,552
Subtotal	**1,499,450**	**747,992**	**16,471**	**39,554**	**2,303,467**
Less Amounts Collected for Non-Federal Entities					(454)
Total					**$2,303,013**

	Tax Year				
	2004	2003	2002	Pre-2002	2004 Collections
Individual Income and FICA Taxes	$1,128,068	$540,956	$13,156	$13,032	$1,695,212
Corporate Income Taxes	150,572	67,310	1,082	11,413	230,377
Estate and Gift Taxes	85	16,891	1,088	7,516	25,580
Excise Taxes	50,465	18,551	96	440	69,552
Railroad Retirement Taxes	3,356	1,063	0	2	4,421
Unemployment Taxes	4,943	1,641	35	99	6,718
Federal Reserve Earnings	13,088	6,564	0	0	19,652
Fines, Penalties, Interest & Other Revenue	2,388	68	0	0	2,456
Subtotal	**1,352,965**	**653,044**	**15,457**	**32,502**	**2,053,968**
Less Amounts Collected for Non-Federal Entities					(612)
Total					**$2,053,356**

Amounts reported for Corporate Income Taxes collected in FY 2005 include corporate taxes of $9 billion for tax year 2006. (Similarly, amounts reported for Corporate Income Taxes collected in fiscal year 2004 include corporate taxes of $7 billion for tax year 2005.) Individual Income and FICA Taxes, includes $68 billion in payroll taxes collected from other federal agencies. Of this amount, $11 billion represents the portion paid by the employers. (The comparable amounts for FY 2004 are $63 billion in payroll taxes collected from other federal agencies and $11 billion paid by the employers.)

Amounts Provided to Fund the Federal Government

For the fiscal years ended September 30, 2005 and September 30, 2004, collections of custodial revenue transferred to other entities were as follows (in millions):

	2005	2004
General Fund	$2,035,673	$1,774,704
Department of Interior	226	216
Total	**$2,035,899**	**$1,774,920**

Federal Tax Refunds Paid

Refund activity, broken out by revenue type and by tax year, was as follows for the fiscal years ended September 30, 2005 and September 30, 2004 (in millions):

	Tax Year				
	2005	2004	2003	Pre-2003	2005 Refunds
Individual Income and FICA Taxes	$586	$211,102	$12,842	$5,489	$230,019
Corporate Income Taxes	970	7,167	5,500	21,458	35,095
Estate and Gift Taxes	0	257	373	253	883
Excise Taxes	329	337	46	283	995
Railroad Retirement Taxes	0	2	0	2	4
Unemployment Taxes	1	73	13	31	118
Fines, Penalties, Interest & Other Revenue	0	0	0	0	0
Total	**$1,886**	**$218,938**	**$18,774**	**$27,516**	**$267,114**

	Tax Year				
	2005	2004	2003	Pre-2003	2005 Refunds
Individual Income and FICA Taxes	$583	$209,916	$12,569	$6,966	$230,034
Corporate Income Taxes	1,448	8,931	6,646	29,540	46,565
Estate and Gift Taxes	0	228	310	245	783
Excise Taxes	265	359	62	184	870
Railroad Retirement Taxes	0	1	1	4	6
Unemployment Taxes	0	71	15	43	129
Fines, Penalties, Interest & Other Revenue	49	0	0	0	49
Total	**$2,345**	**$219,506**	**$19,603**	**$36,982**	**$278,436**

Federal Tax Refunds Payable

As of September 30, 2005 and September 30, 2004, refunds payable to taxpayers consisted of the following (in millions):

	2005	2004
Alcohol and Tobacco Tax and Trade Bureau	6	7
Internal Revenue Service	1,946	1,801
Total	**$1,952**	**$1,808**

Required Supplemental Information (Unaudited)

Introduction

This section provides the Required Supplemental Information as prescribed by Office of Management and Budget (OMB) Circular A-136, *"Financial Reporting Requirements."*

Segment Information

OMB Circular A-136, *"Financial Reporting Requirements."* requires the reporting of each franchise fund and other intra-governmental support revolving fund that is not separately reported on the agency's principal statements. The following tables represent the Treasury's Franchise Fund activities and the Working Capital Fund activities.

Franchise Fund

The Treasury Department Appropriation Act of 1997 (P.L. 104-208), as amended, provides the current authority for the Treasury Franchise Fund. The Department's Franchise Fund is a fee-for-service organization that is fully reimbursable and competitive. The fund currently consists of three business activities: 1) Financial Management and Administrative Support, 2) Financial Systems, Consulting and Training, and 3) Consolidated/Integrated Administrative Management.

The following table presents the financial position of the Franchise Fund as of September 30, 2005 and September 30, 2004 (in millions):

	2005	2004
Fund Balance with Treasury	$84	$65
Accounts Receivable	119	84
Property, Plant and Equipment	2	3
Total Assets	**$205**	**$152**
Accounts Payable	27	$16
Other Liabilities	122	91
Total Liabilities	**149**	**107**
Cumulative Results of Operations	**56**	**45**
Total Liabilities and Net Position	**$205**	**$152**

The following tables present the revenues, financing sources and costs by business activity (in millions):

	Consolidated/Integrated Admin. Management	Financial Systems, Consulting and Training	Financial Management Admin. Support Services	2005 Total
Costs	$688	$12	$73	$773
Less: Earned Revenue	(697)	(13)	(70)	(780)
Net Cost	(9)	(1)	3	(7)
Other Financing Sources	(1)	(1)	(3)	(5)
Total	**($10)**	**($2)**	**$0**	**($12)**

	Consolidated/Integrated Admin. Management	Financial Systems, Consulting and Training	Financial Management Admin. Support Services	2004 Total
Costs	$471	$11	$69	$551
Less: Earned Revenue	(480)	(13)	(65)	(558)
Net Cost	(9)	(2)	4	(7)
Other Financing Sources	0	0	(2)	(2)
Total	**($9)**	**($2)**	**$2**	**($9)**

Working Capital Fund

The Department's Working Capital Fund (within Departmental Offices) is a fee-for-service organization that is fully reimbursable.

Program services are provided to various Treasury bureaus and include telecommunications, payroll/personnel systems, printing, and other.

The following table presents the financial position of the Working Capital Fund for the years ended September 30, 2005 and September 30, 2004 (in millions):

	2005	2004
Fund Balance with Treasury	$144	$181
Accounts Receivable	1	1
Property, Plant and Equipment	7	12
Other Assets	2	1
Total Assets	**$154**	**$195**
Accounts Payable	$4	$7
Other Liabilities	156	188
Total Liabilities	**160**	**195**
Cumulative Results of Operations	**(6)**	**0**
Total Liabilities and Net Position	**$154**	**$195**
Total Costs	**$210**	**$210**
Exchange Revenue	(204)	(210)
Excess of Costs Over Revenues and Financing Sources	**$6**	**$0**

Other Claims for Refunds

The Department has estimated that $23 billion may be payable as other claims for tax refunds. This estimate represents amounts (principal and interest) that may be paid for claims pending judicial review by the Federal courts or internally. The total estimated payout (including principal and interest) for claims pending judicial review by the federal courts is $11.9 billion and by Appeals is $11.1 billion. Although these refund claims have been deemed to be probable, they do not meet the criteria in SFFAS No. 5 for reporting the amounts in the Balance Sheet or for disclosure in the notes to the financial statements. However, they meet the criteria in SFFAS No. 7 for inclusion as supplemental information.

Unpaid Assessments

In accordance with SFFAS No. 7, some unpaid tax assessments do not meet the criteria for financial statement recognition as discussed in the Note 1 to the financial statements. Although compliance assessments and write-offs are not considered receivables under federal accounting standards, they represent legally enforceable claims of the federal government. There is, however, a significant difference in the collection potential between compliance assessments and receivables.

The components of the total unpaid assessments at September 30, 2005 were as follows (in billions):

Gross Unpaid Assessments	$230
Less: Compliance Assessments and Write-offs	(142)
Net Amount	**$88**

To eliminate double counting, the compliance assessments reported above exclude trust fund recovery penalties, totaling $13 billion, assessed against officers and directors of businesses who were involved in the non-remittance of federal taxes withheld from their employees. The related unpaid assessments of those businesses are reported as taxes receivable or write-offs, but the Department may also recover portions of those businesses' unpaid assessments from any and all individual officers and directors against whom a trust fund recovery penalty is assessed.

Internal Revenue Service (IRS)

Of the $230 billion of unpaid assessments, $98 billion represents write-offs. The unpaid assessments balance represents assessments resulting from taxpayers filing returns without sufficient payment; as well as from the IRS's enforcement programs such as examination, under-reporter, substitute for return, and combined annual wage reporting. A significant portion of this balance is not considered a receivable. Also, a substantial portion of the amounts considered receivables is largely uncollectible.

Under federal accounting standards, unpaid assessments require taxpayer or court agreement to be considered federal taxes receivable. Assessments not agreed to by taxpayers or the courts are considered compliance assessments and are not considered federal taxes receivable. Assessments with little or no future collection potential are called write-offs.

Of the $230 billion balance of unpaid assessments, $142 billion represents compliance assessments and write-offs. Write-offs principally consist of amounts owed by deceased, bankrupt or defunct taxpayers, including many failed financial institutions liquidated by the Federal Deposit Insurance Corporation (FDIC) and the former Resolution Trust Corporation (RTC). As noted above, write-offs have little or no future collection potential, but statutory provisions require that these assessments be maintained until the statute for collection expires. In addition, $44 billion of the unpaid assessment balance represents amounts that have not been agreed to by either the taxpayer or a court. Due to the lack of agreement, these compliance assessments are less likely to have future collection potential than those unpaid assessments that are considered federal taxes receivable.

Statement of Budgetary Resources Disaggregated by Sub-organization Accounts (In Millions)

	Bureau of Engraving & Printing	Bureau of the Public Debt	Departmental Offices	Fin. Crimes Enforcement Network	Financial Management Service	Internal Revenue Service	U.S. Mint	Office of the Comptroller of the Currency	Office of Thrift Supervision	Alcohol and Tobacco Tax and Trade Bureau	Combined Total	Adjustments	9/30/2005 Combined
Budgetary Resources													
Budget Authority:													
Appropriations Received	$0	$355,526	$2,846	$73	$10,628	$10,411	$0	$0	$0	$83	$379,567	$0	$379,567
Borrowing Authority	0	0	331	0	0	0	0	0	0	0	331	0	331
Net Transfers (+ or -)	0	(2)	101	0	0	0	0	0	0	0	99	0	99
Unobligated Balance:													
Beginning of Period	95	10	68,457	12	144	570	55	399	169	1	69,912	0	69,912
Net Transfers (+ or -)	0	0	(629)	0	0	0	0	0	0	0	(629)	0	(629)
Spending Authority from													
Offsetting Collections:													
Earned:													
Collected	510	10	3,577	3	178	164	1,037	596	206	2	6,283	3	6,286
Receivable from Federal Sources	2	0	36	0	2	(3)	4	(1)	0	(1)	39	(3)	36
Change in Unfilled Customer Orders:													
Advance Received	3	0	(39)	0	0	0	0	0	7	0	(29)	0	(29)
Without Advance													
From Federal Sources	0	0	(76)	(2)	(3)	0	0	0	0	0	(81)	0	(81)
Subtotal	$515	$10	$3,498	$1	$177	$161	$1,041	$595	$213	$1	$6,212	$0	$6,212
Recoveries of Prior Year Obligations	0	10	1,194	1	11	60	0	0	6	4	1,286	0	$1,286
Temporarily Not Available													
Pursuant to Public Law	0	(5)	1,962	0	0	0	0	0	0	0	1,957	0	$1,957
Permanently Not Available	0	(2,855)	(1,351)	(1)	(1,024)	(126)	(45)	0	0	(1)	(5,403)	0	($5,403)
Total Budgetary Resources	**$610**	**$352,694**	**$76,409**	**$86**	**$9,936**	**$11,076**	**$1,051**	**$994**	**$388**	**$88**	**$453,332**	**$0**	**$453,332**
Status Of Budgetary Resources													
Obligations Incurred:													
Direct	$0	$352,673	$12,050	$76	$9,539	$10,430	$0	$0	$0	$85	$384,853	$0	$384,853
Reimbursable	489	10	1,307	1	173	156	989	487	193	1	3,806	3	3,809
Subtotal	$489	$352,683	$13,357	$77	$9,712	$10,586	$989	$487	$193	$86	$388,659	$3	$388,662
Unobligated Balance:													
Apportioned	121	6	13,965	8	160	252	62	0	0	1	14,575	(3)	14,572
Exempt from Apportionment	0	3	39,329	0	50	0	0	507	195	0	40,084	0	40,084
Unobligated Balance Not Available	0	2	9,758	1	14	238	0	0	0	1	10,014	0	10,014
Total Status Of Budgetary Resources	**$610**	**$352,694**	**$76,409**	**$86**	**$9,936**	**$11,076**	**$1,051**	**$994**	**$388**	**$88**	**$453,332**	**$0**	**$453,332**
Relationship Of Obligations To Outlays													
Obligated Balance, Net,													
Beginning of Period	$74	$99	$39,268	$11	$434	$1,161	$267	$81	$27	$24	$41,446	$0	$41,446
Obligated Balance, Net, End of Period:		0											
Accounts Receivable	(47)	0	(128)	0	(3)	(17)	(15)	(5)	0	0	(215)	4	(211)
Unfilled Customer Orders													
from Federal Sources	0	(1)	(404)	0	(27)	0	0	0	0	0	(432)	0	(432)
Undelivered Orders	0	28	43,612	15	90	940	0	19	4	14	44,722	0	44,722
Accounts Payable	106	41	345	8	219	584	233	80	36	7	1,659	0	1,659
Outlays:													
Disbursements	$500	$352,703	$8,046	$65	$9,857	$10,183	$1,035	$474	$175	$86	$383,124	$4	$383,128
Collections	(513)	(10)	(3,536)	(3)	(178)	(165)	(1,037)	(596)	(214)	(2)	(6,254)	(4)	(6,258)
Subtotal	($13)	$352,693	$4,510	$62	$9,679	$10,018	($2)	($122)	($39)	$84	$376,870	$0	$376,870
Less: Offsetting Receipts	0	(13,282)	(957)	0	(1,317)	(93)	0	0	0	0	(15,649)	0	(15,649)
NET OUTLAYS	**($13)**	**$339,411**	**$3,553**	**$62**	**$8,362**	**$9,925**	**($2)**	**($122)**	**($39)**	**$84**	**$361,221**	**$0**	**$361,221**

Deferred Maintenance

In FY 2005, the Department had no deferred maintenance to report on vehicles, buildings, and structures owned by the Department.

Treasury bureaus use a specific methodology in determining deferred maintenance. This procedure includes reviewing equipment, building, and other structure logistic reports. Upon completion of this review, logistic personnel use a condition assessment survey to determine the status of referenced assets. A five level rating scale (excellent, good, fair, poor, and very poor) is used for assessment purposes. Bureau logistic personnel subsequently identify maintenance not performed as scheduled and establish future performance dates.

Intra-governmental Assets, Liabilities, Revenues & Costs, & Transfers In/Out (in millions)

Intra-governmental Assets (In Millions)

	Due from the General Fund	Loans and Interest Receivable	Advances to the Black Lung Trust Fund	Accounts Receivable and Related Interest	Other Assets
1200-Department of Agriculture		$83,515		$11	0
1300-Department of Commerce		358		1	
1400-Department of the Interior		1,221		80	$26
1500-Department of Justice		20		3	5
1600-Department of Labor			$9,186	1	
1800-United States Postal Service				1	
1900-Department of State		1		3	
2700-Federal Communications Commission		1,274			
2800-Social Security Administration				3	
3300-Smithsonian Institution		20		0	
3600-Department of Veterans Affairs		2,191		36	
4700-General Services Administration		2,240		144	
5100-Federal Deposit Insurance Corporation				1	
6000-Railroad Retirement Board		3,042			
6400-Tennessee Valley Authority		1			
6800-Environmental Protection Agency		22		21	1
6900-Department of Transportation		953		1	
7000-Department of Homeland Security		228		10	
7200-Agency for International Development		423		3	
7300-Small Business Administration		7,736		1	1
7500-Department of Health & Human Services				28	
8000-National Aeronautics & Space Admin.					
8300-Export-Import Bank of the United States		5,848			
8600-Department of Housing & Urban Development		8,922		1	
8900-Department of Energy		2,790		54	
9100-Department of Education		104,599			
9799-DOD Agencies		467		219	3
9900-General Fund (Trader Only)	7,978,081				
9500-Independent Agencies		2,620		3	4
Other				1	
TOTALS	**$7,978,081**	**$228,491**	**$9,186**	**$626**	**$40**

See Intra-governmental liabilities on next page and Financial Statements Note 4.

See the Department's Balance Sheet for "Fund Balance with Treasury."

Intra-governmental Assets, Liabilities, Revenues & Costs, & Transfers In/Out:

Intra-governmental Liabilities (In Millions)				
	Due to the General Fund	Federal Debt and Interest Payable	Other Debt and Interest Payable	Other Liabilities
1200-Department of Agriculture		$71		
1400-Department of the Interior		7,391		
1500-Department of Justice		1,039		$16
1600-Department of Labor		55,639		130
1602-Pension Benefit Guaranty Corporation		16,646		
1800-United States Postal Service		1,218		5
1900-Department of State		13,579		21
2400-Office of Personnel Management		697,887	$14,164	43
2500-National Credit Union Administration		6,537		
2700-Federal Communications Commission		3,905		
2800-Social Security Administration		1,832,893		
3600-Department of Veterans Affairs		13,286		1
4700-General Services Administration				10
5100-Federal Deposit Insurance Corporation		50,735		
6000-Railroad Retirement Board		2,102		
6800-Environmental Protection Agency		4,811		
6900-Department of Transportation		18,974		
7000-Department of Homeland Security		743		22
7200-Agency for International Development				7
7300-Small Business Administration				
7500-Department of Health & Human Services		300,663		13
7800-Farm Credit Administration		19		
7802-Farm Credit Insurance Corporation		1,993		
8000-National Aeronautics & Space Admin.		18		
8600-Department of Housing & Urban Development		30,715		1
8900-Department of Energy		23,834		
9100-Department of Education				4
9799-DOD Agencies		263,342		5
9900-General Fund	$273,551			144
9500-Independent Agencies		6,865		3
0000-Unknown				(3)
Totals	**$273,551**	**$3,354,905**	**$14,164**	**$422**

See Intra-governmental assets on previous page and Financial Statements Note 4. .

Intra-governmental Assets, Liabilities, Revenues & Costs, & Transfers In/Out:

Intra-governmental Earned Revenues from Trade Transactions (In Millions)	
	Earned Trade Revenue
1200-Department of Agriculture	$13
1300-Department of Commerce	5
1400-Department of the Interior	11
1500-Department of Justice	91
1600-Department of Labor	3
1800-United States Postal Service	18
1900-Department of State	7
2400-Office of Personnel Management	2
2800-Social Security Administration	99
3600-Department of Veterans Affairs	25
4700-General Services Administration	3
5000-Securities & Exchange Commission	4
5100-Federal Deposit Insurance Corporation	4
6000-Railroad Retirement Board	1
6800-Environmental Protection Agency	1
6900-Department of Transportation	6
7000-Department of Homeland Security	57
7200-Agency for International Development	29
7300-Small Business Administration	0
7500-Department of Health & Human Services	86
8000-National Aeronautics & Space Admin.	2
8600-Department of Housing & Urban Development	11
8900-Department of Energy	3
9100-Department of Education	1
9799-DOD Agencies	473
9500-Independent Agencies	18
Totals	**$973**

Intra-governmental Non-Exchange Revenues—Transfers In/Out (In Millions)		
	Transferred In	Transferred Out
4700-General Services Administration	$4	($4)
7000-Department of Homeland Security	0	(16)
9900-General Fund	0	(117)
TOTALS	**$4**	**($137)**

Required Supplemental Stewardship Information (Unaudited)

This section provides Required Supplemental Stewardship Information as prescribed by OMB Circular A-136, *"Financial Reporting Requirements."*

Stewardship Property, Plant, and Equipment – Heritage Assets

These heritage assets include the Treasury Department building and the Treasury Annex building.

	Heritage Assets	Land
Beginning Balance	1	1
Additions/Deletions	0	0
Ending Balance	**1**	**1**

No deferred maintenance was reported on these multi-use heritage assets.

Other Accompanying Information (Unaudited)

This section provides Other Accompanying Information as prescribed by OMB Circular A-136, *"Financial Reporting Requirements."*

Tax Gap

The tax gap is the aggregate amount of tax (i.e., excluding interest and penalties) that is imposed by the tax laws for any given tax year but is not paid voluntarily and timely. The Service currently projects, based on compliance data from the 1980s, that the annual Federal gross tax gap is somewhere between $312 billion and $353 billion. The tax gap arises from three types of noncompliance: not filing timely tax returns (the nonfiling gap), underreporting the correct amount of tax on timely-filed returns (the underreporting gap), and not paying on time the full amount reported on timely-filed returns (the underpayment gap).

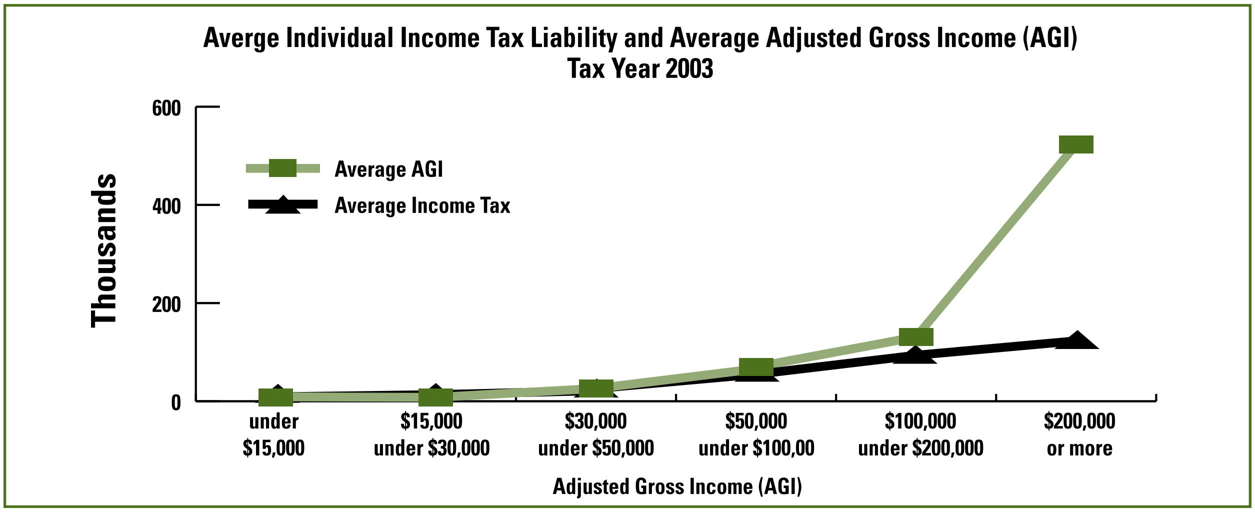
The collection gap is the cumulative amount of assessed tax, penalties, and interest that the Service expects to remain uncollectible. In essence, it represents the difference between the total balance of unpaid assessments and the net taxes receivable reported on the Service's balance sheet. The tax gap and the collection gap are related and overlapping concepts, but they have significant differences. The collection gap is a cumulative balance sheet concept for a particular point in time, while the tax gap is like an income statement item for a single year. Moreover, the tax gap estimates include all noncompliance, while the collection gap includes only amounts that have been assessed (a small portion of all noncompliance).

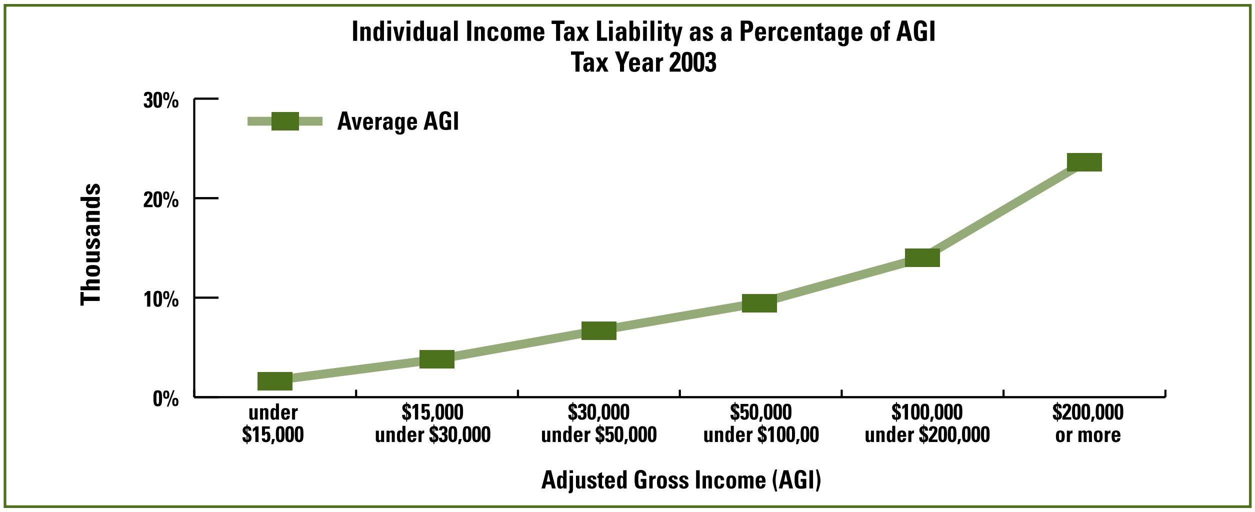
Tax Burden

(All figures are estimates and based on samples provided by the Statistics of Income (SOI) Office)

The Internal Revenue Code provides for progressive rates of tax, whereby higher incomes are generally subject to higher rates of tax. The graphs below present the latest available information on income tax and adjusted gross income (AGI) for individuals by AGI level and for corporations by size of assets. For individuals, the information illustrates, in percentage terms, the tax burden borne by varying AGI levels. For corporations, the information illustrates, in percentage terms, the tax burden borne by these entities by various sizes of their total assets. The graphs are only representative of more detailed data and analysis available from the Statistics of Income (SOI) office.

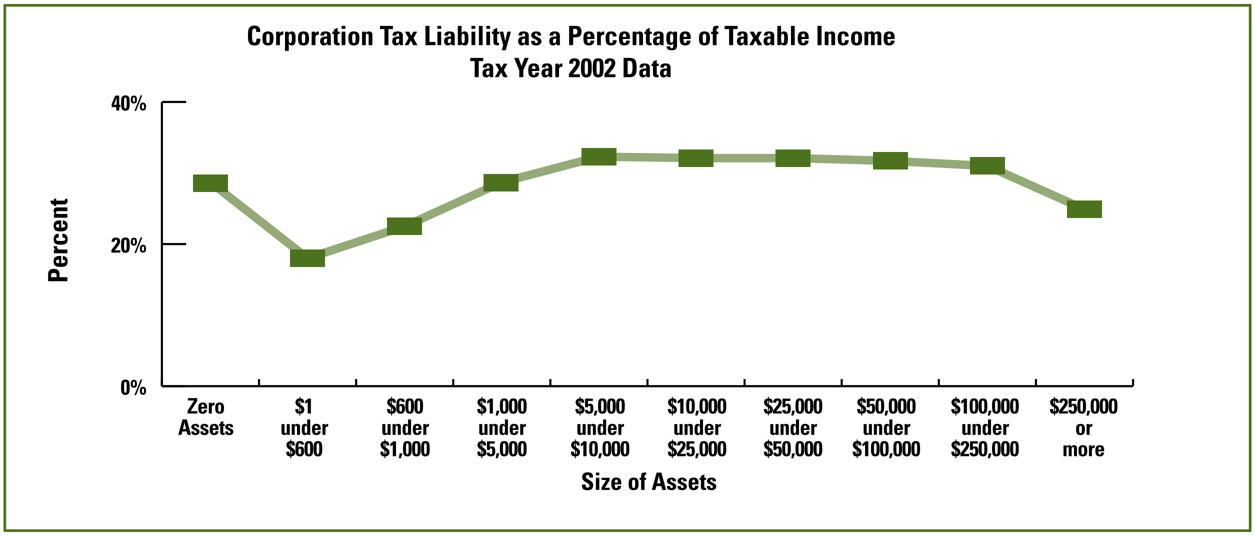
Individual Income Tax Returns (Tax Year 2003 Data)





Adjusted gross income (AGI)	Number of taxable returns (1) (in thousands)	AGI (in millions)	Total income tax (in millions)	Average AGI per return (in whole dollars)	Average income tax per return (in whole dollars)	Income tax as a percentage of AGI
Under $15,000	37,985	211,227	3,645	5,560	96	1.7%
$15,000 under $30,000	29,739	653,834	24,728	21,987	832	3.8%
$30,000 under $50,000	24,469	954,681	64,430	39,015	2,633	6.7%
$50,000 under $100,000	26,935	1,889,302	178,640	70,142	6,632	9.5%
$100,000 under $200,000	8,902	1,174,675	164,509	131,966	18,481	14.0%
$200,000 or more	2,541	1,329,254	314,073	523,154	123,610	23.6%
Total	**130,571**	**6,212,973**	**750,025**			

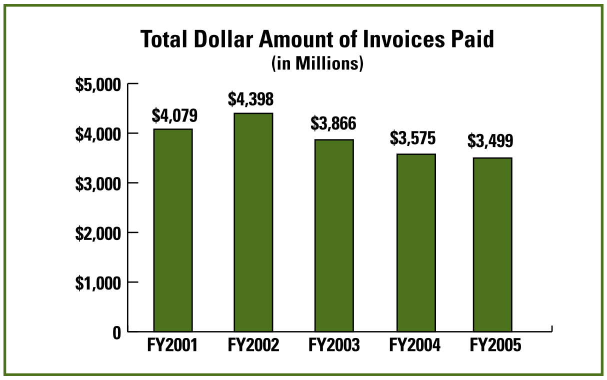
Corporation Income Tax Returns (Tax Year 2002 Data)

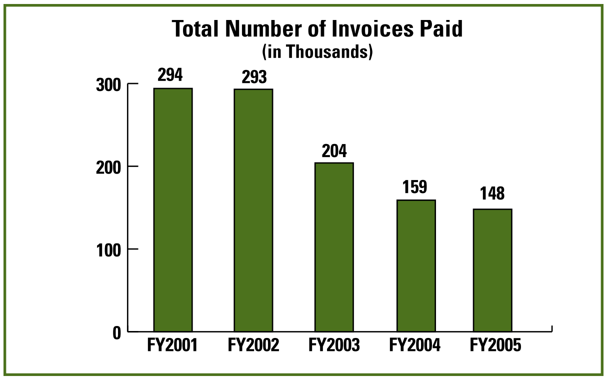


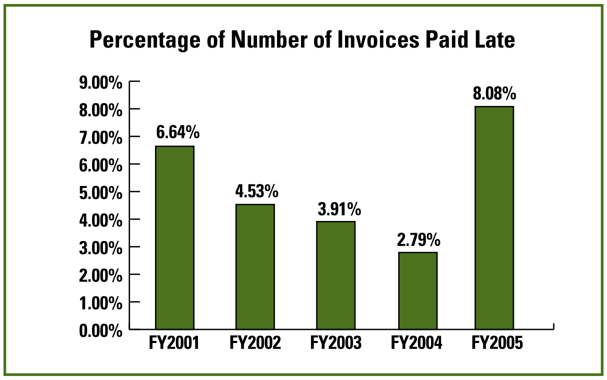
Total Assets (in thousands)	Income subject to tax (in millions)	Total income tax after credits (in millions)	Percentage of income tax after credits to taxable income
Zero Assets	8,045	2,311	28.7%
$1 under $500	8,072	1,453	18.0%
$500 under $1,000	3,745	843	22.5%
$1,000 under $5,000	11,750	3,377	28.7%
$5,000 under $10,000	6,413	2,073	32.3%
$10,000 under $25,000	9,358	3,007	32.1%
$25,000 under $50,000	8,640	2,774	32.1%
$50,000 under $100,000	10,090	3,198	31.7%
$100,000 under $250,000	21,072	6,524	31.0%
$250,000 or more	513,369	128,052	24.9%
Total	**600,554**	**153,612**	**25.6%**

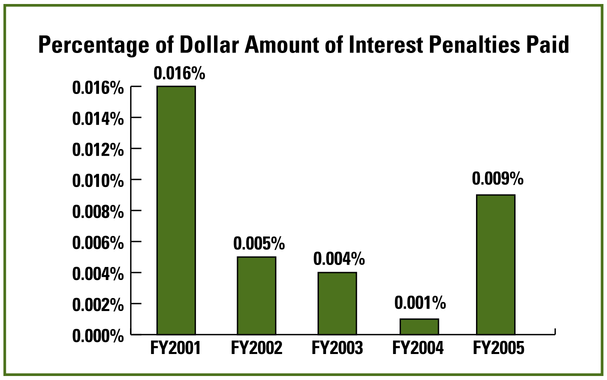
Prompt Payment

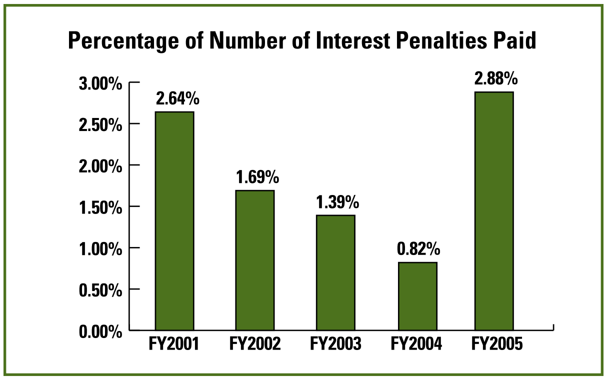
The Prompt Payment Act requires federal agencies to make timely payments to vendors for supplies and services, to pay interest penalties when payments are made after the due date, and to take cash discounts only when they are economically justified. Treasury bureaus report Prompt Payment data on a monthly basis to the Department, and periodic quality control reviews are conducted by the bureaus to identify potential problems. The number of late payments and the amount of interest penalties paid increased in FY 2005 are mostly due to the implementation of new financial system in the Internal Revenue Service.











DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

October 24, 2005

MEMORANDUM FOR SECRETARY SNOW

FROM: Harold Damelin
Inspector General

SUBJECT: Management and Performance Challenges Facing the Department of the Treasury

The Reports Consolidation Act of 2000 requires that we provide you with our perspective on the most serious management and performance challenges facing the Department of the Treasury, for inclusion in the Department's annual performance and accountability report.

Last year we identified six challenges that we believed seriously impeded the Department's ability to conduct its program responsibilities and ensure the integrity of its operations. This year, we are removing one challenge, *Management of Classified and Other Sensitive Information*, based on the Department's actions to strengthen policies, controls, and training on the proper handling of sensitive information. However, continued management attention to this area is needed. While some progress on the other five challenges has been made, we continue to believe that they represent significant risks to the Department. The five challenges are summarized as follows:

Challenge 1 – Corporate Management

The increasing emphasis on consolidated agency-wide reporting and accountability, as embodied in the management reform legislation of the past decade and the President's Management Agenda, has underscored the need for effective corporate management at Treasury. With nine bureaus and many program offices, Treasury is a highly decentralized organization. Treasury needs to provide effective corporate leadership in resolving serious deficiencies at the bureau level that adversely impact the performance of Treasury as a whole. In particular, Treasury needs to assert strong leadership and supervision over the Internal Revenue Service (IRS) to resolve longstanding material weaknesses and system deficiencies that

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continue to inhibit the timely and reliable information necessary to effectively manage IRS operations. Since the IRS is such a large component, the ability of Treasury to meet its management goals and objectives is heavily dependent on major progress at the IRS. Treasury also needs to ensure consistency, cohesiveness, and economy among all bureaus in achieving Treasury's goals and objectives. Specific challenges in this area include establishing clear lines of accountability between corporate and bureau level management, providing enterprise solutions for core business activities, ensuring consistent application of accounting principles, and providing effective oversight of information technology investments and security. There has been little progress in corporate management during the past year, due in part to the fact that several key executive positions were vacant for a significant part of the year and have just recently been filled.

Challenge 2 – Management of Capital Investments

Treasury needs to better manage large, multiyear acquisitions of systems and other capital investments. Last year, we reported that the Department has incurred significant cost escalations in its HR Connect system and Treasury and Annex Repair and Restoration project. We also reported that another major capital investment that we plan to focus on in the coming years was the Department's transition from the Treasury Communication System to the Treasury Communications Enterprise (TCE). In this regard, we have an on-going audit of the business case for this investment. However, the transition to TCE has been delayed due in part to a successful protest of the bid award, and the Department changing course on how it plans to address the bid protest decision.

Challenge 3 – Information Security

The Department faces serious challenges in bringing its systems into compliance with information technology security policies, procedures, standards, and guidelines. In our fiscal year 2005 Federal Information Security Management Act (FISMA) evaluation, we continued to report that the Department has significant deficiencies in information security that constitute substantial non-compliance with the FISMA requirements. A core issue continues to be the need to establish and maintain a system inventory. We reported last year that Treasury's system inventory was not accurate, complete, or consistently reported.

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In our fiscal year 2005 FISMA evaluation, we reported that Treasury is still in the process of gathering data to develop its system inventory. In addition to the need for a system inventory, our FY 2005 FISMA report identified deficiencies in certification and accreditation, contractor oversight, plans of action and milestones, tracking corrective actions, training, and security configuration policies. The Department has made some progress in addressing information security issues during the past year; however, major improvements are still needed in order to meet information security requirements.

Challenge 4 – Linking Resources to Results

The Department generally has not developed and incorporated managerial cost accounting into its business activities; and, therefore, financial resources cannot be adequately linked to operating results. This inhibits comprehensive program performance reporting and meaningful cost benefit analyses of the Department's programs and operations. It could also result in inaccurate or incomplete cost information in evaluating competitive sourcing activities. Managerial cost accounting is designed to provide reliable and timely information on the full cost of programs, activities and outputs, and should be a fundamental part of a financial management system. Cost information is needed by federal executives and stakeholders in making decisions about allocating resources and evaluating program performance. It is also needed by program managers to improve operating economy and efficiency. The Department has made progress during the past year by introducing more efficiency measures in its performance reporting; however, it needs to make underlying systemic changes to integrate cost accounting with financial and performance reporting.

Challenge 5 – Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement

The Financial Crimes Enforcement Network (FinCEN) is responsible for administering the Bank Secrecy Act (BSA), but largely relies on other Treasury and non-Treasury regulatory agencies to enforce the requirements of the BSA, including the enhanced terrorist financing provisions in the USA PATRIOT Act. Past audits and a series of Congressional hearings have surfaced regulatory gaps in either the detection of BSA violations or its timely enforcement. The Department continued efforts to strengthen BSA administration and taken significant enforcement

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actions against several financial institutions. As reported last year, the Department created the Office of Terrorism and Financial Intelligence (TFI). Additionally, FinCEN, which reports to TFI, created an Office of Compliance to improve BSA oversight and coordination with financial institution regulators. FinCEN also entered into a memorandum of understanding (MOU) with the five federal banking regulators to enhance communication and coordination, and now has similar agreements in place with the IRS and many states. While recent audit work by our office found that the federal banking regulators have provided information to FinCEN in a timely manner as prescribed by the MOU, it is still too soon to assess the effectiveness of these agreements to achieve improved BSA compliance by financial institutions. In response to other recent work by our office, FinCEN is taking action to improve the data quality of suspicious activity reporting, encourage greater e-filing of BSA reports, and enhance its money services business registration program. This management challenge will continue to be a major focus of our audit program, and we currently have audit work on-going at TFI, FinCEN, the Office of Foreign Assets Control, and the Office of the Comptroller of the Currency.

We would be pleased to discuss our views on these management and performance challenges in more detail.

cc: Sandra L. Pack
Assistant Secretary for Management
and Chief Financial Officer

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

November 15, 2005

MEMORANDUM FOR HAROLD DAMELIN
INSPECTOR GENERAL

FROM: John W. Snow

SUBJECT: Response to Management and Performance Challenges Facing the Department of the Treasury

I am responding to your October 24, 2005, memorandum describing the Department of the Treasury's management and performance challenges.

Thank you for acknowledging the Department's success in remediating one of last year's challenges, *Management of Classified and Other Sensitive Information.* The Department continues to strengthen controls in this area.

Our Fiscal Year (FY) 2005 Performance and Accountability Report describes actions that Treasury took during FY 2005 to address the management and performance challenges identified at the end of FY 2004. This memorandum provides information on the actions that we plan to take during FY 2006 to address each management and performance challenge identified in your memorandum.

Corporate Management

The Department is committed to exercising strong corporate leadership over all components of the Treasury Department -- through the policy offices' supervisory and oversight relationship with our bureaus, as well as through the discipline of the traditional management functions such as human resources, information technology, procurement, budget, strategic planning, and accounting. With nearly a full complement of senior officials now in office at Treasury, our ability to demonstrate the corporate management emphasis that you discuss in your memo has been greatly enhanced.

Notwithstanding the decentralization inherent in nine bureaus with different individual missions and organizational structures, we have several forums and work processes through which we identify and resolve corporate Treasury issues and through which we focus on preventing and overcoming material weaknesses and reportable conditions. These include but are not limited to the Chief Human Capital Officers' Council, the Chief Information Officers' Council, the Chief Financial Officers' Council, regular bureau heads' meetings, Departmental policy decisions reflected in the formulation and execution of annual appropriations, articulation of the Department's major goals and strategies through development of the Department's strategic plan, and the role of the Deputy Secretary as the senior performance official in evaluating and

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approving SES performance ratings, pay adjustments, and bonuses for all Treasury senior executives.

Management of Capital Investments

Treasury will continue its disciplined management of major information technology (IT) investments and ensure that cost, schedule and performance goals are met. Treasury has an established IT governance and capital planning and investment control (CPIC) program which includes quarterly reviews of the Department's IT investment portfolio. During the first quarter of FY 2006, Treasury will implement the "Evaluate" Phase of the CPIC process, the fourth and final outstanding required phase for Capital Planning. In this phase, Post-Implementation Reviews are performed on investments that recently have moved into the steady-state phase of their life-cycles to determine whether these systems meet goals and expectations. Steady-State Reviews also are performed on systems that have been in the steady-state phase for over five years to determine whether they continue to meet requirements and, if not, whether they need to be replaced.

With the completion of its deployment in May 2004 and the subsequent transition to a steady-state phase in FY 2005, HR Connect no longer is expending investment dollars. Program expenditures will be straight-lined for FY 2006 through FY 2012, consistent with an operations and maintenance phase. HR Connect will be funded going forward by bureau contributions through the Department's working capital fund. In another example of the Department's effort to contain program costs, Treasury sought and obtained designation of HR Connect as one of the five HR Line of Business (HR LoB) Shared Service Centers that provide HR-IT solutions and services to other federal agencies. Treasury will continue to pursue HR LoB cross-servicing activities which, in turn, will drive greater economies of scale by reducing operating costs for all customers.

Treasury also will continue to pursue the Treasury Communications Enterprise (TCE) contract acquisition. The vision for TCE is to implement an enterprise-wide telecommunications infrastructure for wide area network services and to provide a platform that will support current and future requirements. The sustained protest of the TCE bid award delayed the TCE project, but the acquisition and transition will be pursued under an aggressive schedule during FY 2006. Treasury continues to work with the OIG regarding the current ongoing audit of TCE.

Information Security

Treasury continues to improve its inventory and certification and accreditation (C&A) process for information systems. Treasury is initiating efforts to obtain an enterprise compliance tool to measure and report on key Federal Information Security Management Act (FISMA) reportable statistics, which we anticipate will improve Department-wide security reporting in FY 2006 and beyond. Furthermore, to address IG findings and recommendations, Treasury plans to conduct oversight security reviews to focus on C&A quality and quality of FISMA plans of action and milestones (POA&M). The Department also is working through the Cyber Security Sub-Council to develop Department-wide approaches for addressing security deficiencies.

Linking Resources to Results

Treasury appreciates the need to develop managerial cost accounting capabilities; however, there are significant challenges and costs associated with installing managerial cost accounting systems. During FY 2006, we will focus our efforts on the development of cost accounting capabilities at the bureau level and Treasury will provide additional oversight in the implementation of bureau managerial cost accounting capabilities. Treasury made significant progress in FY 2005 in better linking and integrating budget, financial, and performance data. As a result of these efforts, Treasury maintained its "Yellow" President's Management Agenda (PMA) status score and came within two criteria of receiving a green rating in the fourth quarter of FY 2005. For FY 2006, Treasury will focus on moving to green in the PMA by adding marginal cost metrics for all of its mission areas. Treasury plans to develop a more robust planning process, including using performance information to assess progress of past goals, setting measurable priorities and reporting progress in subsequent planning cycles, and leveraging existing tools that were developed in FY 2005 (dashboard, improved suite of performance measures, SES Organization assessments).

Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement

Treasury's banking regulatory agencies are working closely together to abate money laundering and terrorist financing. Treasury, through the Financial Crimes Enforcement Network (FinCEN), is taking action to complete fourteen recommendations provided in recent audit reports. Six of the recommendations already have been completed. In FY 2006, Treasury will work to seek input on critical data fields from the Bank Secrecy Act Advisory Group, to develop criteria for determining an acceptable data quality level, and to sample duplicate records to assess whether the duplicates affect statistical summaries of the data. Additionally, FinCEN's new Office of Compliance will continue to notify the appropriate federal regulator when they discover systemic or pervasive data quality issues within an institution.

We look forward to working with you in addressing these challenges in the future.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

October 27, 2005

MEMORANDUM FOR SECRETARY SNOW

FROM: J. Russell George
Inspector General

SUBJECT: Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2006

The Reports Consolidation Act of 2000[1] requires that the Treasury Inspector General for Tax Administration (TIGTA) summarize, for inclusion in the *Department of the Treasury Accountability Report for Fiscal Year 2005,* our perspective on the most serious management and performance challenges currently confronting the Internal Revenue Service (IRS).

The TIGTA's assessment of the major IRS management challenge areas for Fiscal Year (FY) 2006 has not changed substantially from the prior year. While the IRS has continued to address each challenge area, we were unable to remove any challenge area at this time. We have, however, used two subcategories, Computerized Systems and Business Structure, to further describe the challenge of modernization of the IRS. We believe these both play a crucial part in the modernization efforts. We have also rephrased one challenge, "Using Performance and Financial Information for Program and Budget Decisions," to more accurately portray our concerns. The ten current challenges, in order of priority, are:

Modernization of the Internal Revenue Service

Modernization of the IRS includes both computer systems modernization and business structure (reorganization) modernization. Although both issues have their own sets of challenges, they must both succeed to fully modernize the IRS.

Computerized Systems

Business Systems Modernization (BSM) involves integrating thousands of hardware and software components over 15 years. The program is in its seventh year and has allocated approximately $1.9 billion for contractor and integrator activities. The

[1] 31 U.S.C. § 3516(d).

IRS and its contractors have deployed projects that provide value to taxpayers and have built the infrastructure needed to support these projects. However, since the start of the modernization effort, the BSM program has experienced cost overruns and schedule delays in its project development and deployment. Over the past three fiscal years, our annual BSM program assessments have cited four primary challenges that the IRS and its contractors must meet to achieve program success: 1) implement planned improvements in key management processes and commit the necessary resources to enable success; 2) manage the increasing complexity and risks of the BSM program: 3) maintain the continuity of strategic direction with experienced leadership; and 4) ensure contractor performance and accountability are effectively managed. In the past year, we reported that weaknesses continue to exist in critical program management and system development processes.

Business Structure

The IRS Restructuring and Reform Act of 1998 (RRA 98)[2] mandated that the IRS reorganize to better meet the needs of taxpayers. On October 1, 2004, the Small Business/Self-Employed (SB/SE) Division Customer Account Services (CAS) operating unit realigned to the Wage and Investment Income (W&I) Division CAS function. As a result of this merger, the IRS' W&I Division will be the only division responsible for processing tax returns, both individual and business. While there are similarities between individual and business tax returns, there are also many differences. For example, the mix of electronic and paper returns for businesses is much different than that for individuals. Additionally, large corporations and tax exempt organizations will soon be required to file tax returns electronically, while individuals have the option to file either electronically or via paper. The IRS is also continuing with its plan to consolidate individual tax returns processing into fewer sites. Changes such as these present challenges to the IRS to ensure tax returns are processed effectively and efficiently.

Tax Compliance Initiatives

The completion of the initial phases of the National Research Project (NRP) allowed the IRS recently to release an updated estimate of the tax gap.[3] As a result of the NRP, the IRS now estimates that taxpayers with self-employment income underreport between $51 billion and $56 billion in employment tax. The IRS recently received authority and will begin testing the use of contract staff to work some collection cases. It is too early to tell if the contract resources will be able to resolve a significant number of cases or whether they will continue to go unresolved. During the last few years, the IRS has been implementing reengineering suggestions aimed at increasing effectiveness of

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[2] PUB. L. NO. 105-206, 112 STAT. 685 (CODIFIED AS AMENDED IN SCATTERED SECTIONS OF 2 U.S.C., 5 U.S.C., 5 U.S.C. APP., 16 U.S.C., 19 U.S.C., 22 U.S.C., 23 U.S.C., 26 U.S.C., 31 U.S.C., 38 U.S.C., AND 49 U.S.C.).

[3] THE IRS HAS INITIATED THE NATIONAL RESEARCH PROGRAM TO MEASURE TAXPAYERS' VOLUNTARY COMPLIANCE, TO BETTER APPROXIMATE THE TAX GAP, AND TO DEVELOP UPDATED FORMULAS TO SELECT NONCOMPLIANT RETURNS FOR EXAMINATION. THE FIRST PHASE OF THIS PROGRAM ADDRESSES REPORTING COMPLIANCE FOR INDIVIDUAL TAXPAYERS, AND DATA FROM THIS PHASE WERE USED TO PRODUCE THE RECENTLY UPDATED ESTIMATES OF THIS PORTION OF THE TAX GAP.

enforcement efforts. We have conducted several reviews of these initiatives; however, it is too early to evaluate the full impact.

Security of the Internal Revenue Service

The IRS relies upon critical computer systems to account for more than $2 trillion in revenue annually. Significant disaster recovery program weaknesses continue to be unresolved. These recurring weaknesses include: modernization systems being placed in production without a disaster recovery capability; insufficient disaster recovery capacity; roles and responsibilities not being assigned and employees not being trained; and annual tests not being conducted or not being effective. In addition, control weaknesses, such as failure to close user accounts when employees leave the IRS, inadequate documentation of user access authorizations, and insufficient documentation that employees have acknowledged their security responsibilities, continued to exist, even with the implementation of a new automated system to authorize system access. These weaknesses continue to occur because managers and system administrators have not adhered to the system procedures.

Complexity of the Tax Law

Through the years, the Federal tax system has become more complex, less transparent, and is frequently revised. The scope and complexity of the Internal Revenue Code make it virtually certain that taxpayers will face procedural, technical and bureaucratic obstacles in meeting their tax obligations. For example, in 2001, the Joint Committee on Taxation conducted a study on the complexity of the tax law and found that, at that time, the tax code consisted of nearly 1.4 million words. There were 693 sections of the code applicable to individuals, 1,501 sections applicable to businesses, and 445 sections applicable to tax exempt organizations, employee plans, and governments. At that time, a taxpayer filing an individual income tax return (Form 1040) could be faced with a 79 line return, 144 pages of instructions, 11 schedules totaling 443 lines (including instructions), 19 separate worksheets embedded in the instructions, and the possibility of having to file numerous other forms. For the 2005 tax filing season, the IRS estimates it should take, on average, over 19 hours to complete and file a Form 1040 and the associated Schedule A.

Although the IRS has consistently and commendably sought to ease the process for all taxpayers, each tax season brings new problems. The complexities of the tax law affect the ability of the IRS to administer the nation's tax system. The IRS' efforts to provide assistance to taxpayers are hampered because of these complexities.

Using Performance and Financial Information for Program and Budget Decisions

Measuring the IRS' productivity, the efficiency with which inputs are used to produce outputs, is difficult.[4] The IRS has made some progress, but using performance and

[4] GOVERNMENT ACCOUNTABILITY OFFICE, PUB. NO. 05-671, TAX ADMINISTRATION: IRS CAN IMPROVE ITS PRODUCTIVITY MEASURES BY USING ALTERNATIVE METHODS (JULY 2005).

financial information for program and budget decisions is still a major challenge. The absence of accurate and complete management information hinders the IRS' ability to make appropriate decisions when determining the locations and services it provides taxpayers seeking face-to-face assistance. The IRS' financial statements and related activities continue to be of concern to IRS stakeholders. In its audit of the IRS' FY 2004 financial statements, the Government Accountability Office (GAO) concluded that the records were fairly presented in all material respects.[5] The GAO, however, identified some continuing serious deficiencies in the IRS' financial systems. Without a financial management system that can produce timely, accurate and useful information needed for day-to-day decisions, the IRS' financial stewardship responsibilities continue to be one of the most serious challenges facing IRS management.

Providing Quality Taxpayer Service Operations

Each year, millions of taxpayers contact the IRS seeking assistance in understanding the tax law and in meeting their tax obligations by either calling the various toll-free telephone assistance lines, accessing the IRS Internet site or visiting an IRS Taxpayer Assistance Center (TAC). Walk-in assistance has proven to be particularly helpful for lower-income taxpayers and those with limited or no English language proficiency.[6] The IRS discontinued its TeleFile service, used by nearly 4 million taxpayers, in August 2005. Earlier this year, the IRS stated that it planned to close 68 TACs, to reduce costs and create efficiencies while maintaining a commitment to customer service. Currently, the IRS has suspended the closure of the 68 TACs pending further study. The TIGTA is reviewing the methodology used to select the TACs for closure. The Small Business/Self-Employed (SB/SE) Division Taxpayer Education and Communication (TEC) organization has made significant progress in reaching out to the small business taxpayer community to educate small business taxpayers on their tax and compliance responsibilities. However, the TEC organization needs to better market its products, especially for business taxpayers who are not served by the tax practitioner community.

Erroneous and Improper Payments

An improper payment is any payment that should not have been made or that was made in an incorrect amount under a statutory, contractual, administrative or other legally applicable requirement. For the IRS, improper and erroneous payments are generally associated with erroneous refunds and filing fraud issues as well as vendor or contractor overpayments. Some tax credits, such as the Earned Income Tax Credit (EITC), and the Education Credit, provide opportunities for abuse in income tax claims. In Tax Year (TY) 2003, the IRS reported that approximately 21.7 million taxpayers received EITC totaling $38.1 billion. The IRS estimated that between 27 percent and 32 percent of the $31 billion in EITC claimed on TY 1999 returns should not have been

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[5] GOVERNMENT ACCOUNTABILITY OFFICE, PUBL. NO. 05-103, FINANCIAL AUDIT: IRS'S FISCAL YEARS 2004 AND 2003 FINANCIAL STATEMENT (NOV. 10, 2004).
[6] IRS OVERSIGHT BOARD, FY2006 IRS BUDGET SPECIAL REPORT (MARCH 2005).

paid.[7] Single taxpayers with no dependents are receiving a "dual benefit" by claiming both the tuition and fees deduction, and education credits. We reported this condition during the 2004 filing season, and in the 2005 filing season, we identified 18,776 single taxpayers claiming no dependents who were allowed both an education credit, and a tuition and fees deduction because the IRS had yet to initiate action to identify and disallow "dual benefits." Our analysis showed that these taxpayers claimed education credits of more than $13 million, and tuition and fees deductions of nearly $39 million. TIGTA reviews have also identified payment issues in the contract area. For example, a recent report on a contract to support the IRS' modernization efforts identified questionable award fees of more than $2 million and questionable charges, which consisted of unsupported, unreasonable, and inaccurately recorded charges.

Taxpayer Protection and Rights

The IRS continues to dedicate significant resources and attention to implementing the taxpayer rights provisions of RRA 98. Audit reports TIGTA issued in FY 2005 found the IRS was in full compliance with the following taxpayer rights provisions:

- *Notice of Levy*
- *Restrictions on the Use of Enforcement Statistics to Evaluate Employees*
- *Fair Debt Collection Practices Act Violations*

The IRS, however, did not remove all *Illegal Tax Protester Designations* from its records, did not always address all *Collection Due Process* issues, and sometimes improperly *Denied Taxpayer Requests for Information.* In addition, the IRS did not always properly notify taxpayers in situations involving:

- *Notice of Lien*
- *Seizures*
- *Assessment Statute of Limitations*

IRS management information systems do not track specific cases so neither the TIGTA nor the IRS could evaluate the IRS' compliance with certain RRA 98 provisions. The TIGTA issued reports on two of the subject RRA 98 provisions:

- *Restrictions on Directly Contacting Taxpayers Instead of Authorized Representatives*
- *Separated or Divorced Joint Filer Requests*

Processing Returns and Implementing Tax Law Changes During the Tax Filing Season

The IRS had a successful 2005 filing season, timely processing over 117.5 million individual income tax returns (including 66.6 million processed electronically) that were received through May 27, 2005. This was the first year that more than half of all

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[7] TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, REF. NO. 2005-40-093, THE EARNED INCOME TAX CREDIT INCOME VERIFICATION TEST WAS PROPERLY CONDUCTED (2005).

taxpayers filed an electronic return. Key tax law changes for the 2005 filing season were generally correctly implemented. However, the TIGTA identified some tax law changes that were not effectively implemented during the 2005 filing season, which may cause taxpayers to lose entitlements or receive erroneous tax credits. For example, military taxpayers may not be receiving the full amount of EITC they are entitled to and not all taxpayers are benefiting from the new sales tax deduction. Also, some taxpayers are being allowed erroneous education credits, and taxpayers are receiving "dual benefit" by claiming both the tuition and fees deduction and education credits.

Human Capital

The IRS continues to be challenged with traditional workforce issues, such as training, recruitment and employee retention, along with issues specific to the IRS. These issues include reorganizations and potential restructuring from competitive sourcing results. For example, according to its FY 2006 strategic assessment, the Large and Mid-Size Business Division (LMSB) is continuing to lose highly skilled technical employees, primarily through retirement, and it is replacing fewer technical employees than those who have separated. The loss of human capital, combined with the increasing complexity of LMSB examinations, will have a negative effect on audit coverage and business results. Additionally, the IRS Tax Exempt and Government Entities Division has indicated that current staffing is still not sufficient to adequately cover the volume of calls received.[8] Although the IRS has training assessment and development procedures, these procedures are generally not followed by its operating divisions. While each operating division followed its own processes, they were generally not able to provide documentation to substantiate whether assessments were performed.

These are the ten major IRS management challenge issues for FY 2006. The TIGTA's Office of Audit's FY 2006 Annual Audit Plan categorizes the planned audits by these issues. If you have questions or wish to discuss our views on these management and performance challenges in greater detail, please contact me at (202) 622-6500.

cc: Assistant Secretary for Management and Chief Financial Officer
Commissioner of Internal Revenue

[8] TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION, REF. NO. 2005-10-149, THE INTERNAL REVENUE SERVICE DOES NOT ADEQUATELY ASSESS THE EFFECTIVENESS OF ITS TRAINING (2005).

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

November 15, 2005

MEMORANDUM FOR J. RUSSELL GEORGE
TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

FROM: John W. Snow John W. Snow

SUBJECT: Response to Management and Performance Challenges Facing the Department of the Treasury

I am responding to your October 27, 2005, memorandum describing the Department of the Treasury's management and performance challenges.

Our Fiscal Year (FY) 2005 Performance and Accountability Report describes actions that Treasury took during FY 2005 to address the management and performance challenges identified at the end of FY 2004. This memorandum provides detailed information on the actions that we plan to take during FY 2006 to address each management and performance challenge identified in your memorandum.

Modernization of the Internal Revenue Service

The IRS's FY 2006 modernization portfolio will focus on the delivery of three major tax administration projects: the Customer Account Data Engine (CADE), Modernized e-File (MeF), and Filing and Payment Compliance. Each of these tax administration projects will address a core IRS strategic priority. Program operations will continue to focus on improving program performance, improving and streamlining management process disciplines, and ensuring the delivery of projects on time, on budget, and on scope by taking a greater ownership and leadership role in managing the IRS's modernization program.

Tax Compliance Initiatives

Reducing the tax gap is the IRS's most significant challenge. In FY 2006, the IRS will focus its analysis of tax information and data from its recent compliance study to better define and quantify the tax gap and to focus its enforcement resources on corrosive activities conducted by corporations, high income taxpayers and other major contributors to the tax gap. Targeting high-risk taxpayers will improve IRS efficiency and reduce the burden on compliant taxpayers.

The IRS will direct enforcement activities to increase audits of high-income taxpayers and corporations, focusing more attention on abusive shelters and launching more criminal

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investigations. Beyond the direct revenues generated by increasing audits, collection, and criminal investigations, enforcement efforts will have a deterrent effect on those who might be tempted to skirt their tax obligations. One of the IRS's enforcement priorities is deterring and preventing abusive tax avoidance transactions or tax motivated transactions that are corrosive to the equity and the fairness of the tax laws for all taxpayers. Tax shelter promoters continue to modify schemes, making it difficult to detect patterns and identify participants on a timely basis. Because these types of transactions present unacceptable tax avoidance behavior, the IRS will continue its efforts to identify them in a timely manner and to make the public aware of the IRS's concerns.

Security of the Internal Revenue Service

The IRS plans to conduct certification and accreditation activities to meet government-wide guidelines and to complete the development of an enterprise-wide strategy for information technology systems disaster recovery. In addition, the IRS plans to enhance its Federal Information Security Management Act (FISMA) compliance by further increasing IRS business owner participation in all areas including monitoring, review, mitigation and reporting activities. To address its related material weakness, the IRS plans to test the contingency and disaster recovery plans for all of its major (high risk impact) information systems in FY 2006.

Complexity of the Tax Law

In November 2005, the Advisory Panel on Federal Tax Reform issued to Treasury a report containing revenue neutral options for reforming the Federal Internal Revenue Code. This report also included options to simplify the tax laws to reduce the costs of compliance and to make it easier for taxpayers to plan for the future and manage their affairs.

In addition, the IRS has several initiatives underway which include pursuing the feasibility of a Unified Family Credit that will combine the provisions of the Earned Income Tax Credit, Child Tax Credit, and Dependency Exemption, further reducing taxpayer compliance burdens associated with claiming these provisions. Another initiative includes proposed legislation for issuing regulations that would extend the due date for individual electronic filers to file and pay individual taxes by April 30, and expand the authority of IRS to require businesses (including corporations, partnerships and other business entities) and exempt organizations to file their returns electronically.

Using Performance and Financial Information for Program and Budget Decisions

The IRS will continue to analyze cost data obtained through its newly developed Integrated Financial System in order to develop further robust cost-based performance measures for its

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major programs. The IRS also plans to introduce a suite of enterprise-wide goals which link directly to the IRS Strategic Plan.

Providing Quality Taxpayer Service Operations

The IRS plans to continue conducting surveys and focus groups to obtain feedback from taxpayers and tax practitioners about ways to improve tax forms, instructions and publications. In addition, the IRS plans to improve the quality and clarity of computer-generated notices issued to taxpayers to reduce the number of telephone contacts and make it easier for taxpayers to understand and comply with their tax requirements. During FY 2006, the IRS will continue to seek alternative, less costly ways to address the challenge of improving taxpayer service including the following: balancing accessibility and ease of use to reduce taxpayer burden in complying with the tax laws through continued research and evaluation of taxpayer service needs, priorities, and preferences for obtaining information or services. The IRS will seek opportunities to invest in technology, process improvement, and training to achieve a consistent quality of service with reduced unit delivery costs.

Erroneous and Improper Payments

The IRS plans to develop and distribute materials educating taxpayers and practitioners on the Earned Income Tax Credit (EITC) and Education Credit eligibility rules and compliance issues. Minimizing the number of taxpayers who claim these credits erroneously, or in the case of the Education credit, claim dual benefits, is key to accurate reporting and the reduction of erroneous payments. The IRS also plans to enhance its methodology to improve the selection, assignment, and examination of returns where these credits are claimed to identify those taxpayer groups that are at higher risk of noncompliance in order to target education and outreach.

Enforcement of Tax Laws

The IRS plans to bolster the collection program. Legislation approved in FY 2005 to authorize the IRS to enter into contracts for Private Debt Collection will allow the development and deployment of a system to enter into three contracts and implement a limited program. The IRS also plans to use computer models to identify cases with a high or low propensity to pay or to be unproductive. A separate enforcement initiative to Attack Corrosive Non-Compliance Activity driving the Tax Gap provides resources to increase coverage on a growing number of high-risk compliance problems and to address the largest portion of the tax gap – the underreporting of tax. Leveraging new workload selection systems and case building approaches from continuing reengineering efforts will result in increased collections.

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Taxpayer Protection and Rights

The IRS has several initiatives planned or underway for FY 2006 including the development and implementation of the Taxpayer Rights Impact Statement to help the IRS incorporate an awareness and consideration of taxpayer rights into its program planning and implementation. In addition, the IRS continues with its systems modernization efforts to enhance its security program to avoid unauthorized access to taxpayer information.

Processing Returns and Implementing Tax Law Changes During the Tax Filing Season

The IRS has actions underway or planned for this area in FY 2006 which include piloting an automated adjustment document to make a change or correction to a taxpayer account, reducing adjustment time, and increasing the quality of adjustments. In addition, completing deployment of the Transcript Delivery System will improve efficiency and provide a "one-click" method of servicing requests from taxpayers for critical tax and financial information necessary for home purchase and educational financial assistance applications. During FY 2006, the IRS will expand CADE, increasing the number of returns processed and moving toward making CADE the single authoritative repository for account and return data, replacing the IRS's antiquated Master File. In addition, MeF will become the primary interface for all business filings, which is expected to remedy IRS's legacy electronic filing limitations. The IRS also is considering mandating e-filing for certain groups, by regulation or legislation, to ensure increased e-filing. The Administration's proposal to extend the April filing date for electronically-filed tax returns to April 30, if enacted, also may increase electronic filing. The IRS will develop additional strategies to induce more taxpayers and preparers to take the next step and file electronically.

Human Capital

The IRS has several actions planned, including completing the development of the Human Capital Strategic Plan to address its workforce issues. Other activities include the continued selective use of Voluntary Employee Retirement Authority (early-outs) and Voluntary Separation Incentive Payments (buyouts) to support organizational restructuring and workforce reshaping initiatives.

We look forward to working with you in addressing these challenges in the future.

FY 2005 Activities to Address Previously Identified Management Challenges and High-Risk Areas

This section identifies the actions taken to address the major management challenges and high-risk areas facing the Department of Treasury and its bureaus as previously identified by the Office of Inspector General (OIG), the Treasury Inspector General for Tax Administration (TIGTA), and the Government Accountability Office (GAO).

Strengthening Information Systems Security (GAO, OIG, TIGTA)

During FY 2005, Treasury demonstrated considerable progress in the remediation of Information Technology (IT) security weaknesses and conducted a Security Program review of all Treasury bureaus. In compliance with Treasury's new IT Security Policy, all bureaus submitted action plans for implementing the new policy over the next year. Treasury's FY 2005 Federal Information Security Management Act (FISMA) report to OMB stated that 95% of the Department's systems were certified and accredited (C&A). This accomplishment exceeded the Treasury President's Management Agenda (PMA) goal of certifying and accrediting 80% of its systems by the end of FY 2005. For the material weakness associated with the Office of the Chief Information Officer (OCIO), one component of the material weakness was closed and OCIO is continuing to work towards closing and/or downgrading the remaining two issues. A related Internal Revenue Service (IRS) carryover material weakness is still in the process of being corrected, although progress was achieved in FY 2005.

For FY 2006, Treasury has planned oversight security reviews to address issues of C&A quality, Plan of Action & Milestones quality/completeness, and is seeking to hire a qualified candidate to focus upon FISMA reporting/compliance and security configuration management efforts, respectively. In addition, Treasury is also working through our Cyber Security Sub-Council to develop Department-wide approaches to address security deficiencies.

Improvements are Needed in Linking Resources to Performance Results (GAO, OIG, TIGTA)

Treasury made significant progress in FY 2005 in better linking and integrating budget, financial, and performance data. As a result of these efforts, Treasury maintained its Yellow President's Management Agenda's (PMA) status score, and came within two criteria of receiving a green rating in the fourth quarter.

Treasury evaluated each of its 330+ performance measures from the FY 2004 PAR with key bureau analysts, resulting in 64% of the measures being eliminated for corporate reporting, in part because the measures did not adequately strengthen the linkage. In addition, Treasury recorded a 36% improvement over the prior year in total base of the Program Assessment Rating Tooled (PARTed) programs receiving a passing score (defined as adequate or better). In FY2005, seven Treasury programs were PARTed and all seven received a score from OMB of moderately effective or effective. The PART review results demonstrate progress toward budget, performance and financial integration. Further, for the second year, Treasury issued the Senior Executive Service (SES) organization Assessment which emphasizes the linkage of budget, performance and finance, and in part, determines the ratings of Treasury's senior executives.

For FY 2006, Treasury plans to focus efforts on developing a more robust planning process. Goals of the new process include using performance information to assess progress of past goals, to set measurable priorities and report progress in subsequent planning cycles, and to leverage existing tools developed in FY2005 (dashboard, improved suite of performance measures, SES Organization assessments). Treasury is focused on moving to green in the PMA by adding marginal cost metrics for all of its mission areas; as of September 30, 2005, approximately 80% of Treasury's program budget dollars met the PMA requirement.

Management of Capital Investments (OIG)

For FY 2005, Treasury established an information technology (IT) governance and capital planning and investment control (CPIC) program which included quarterly reviews of the Department's IT investment portfolio. Focus during the year was on developing and implementing the processes for the 'select' and 'control' phases. Treasury also applied more rigor around the sufficiency of the Exhibit 300 submissions for its 55 major investments and developed a protocol for standardizing the documentation required for our over 200 minor systems.

For FY 2006, Treasury will continue its efforts to promote a disciplined management of major IT investments by ensuring that they meet cost, schedule and performance goals.

Management of Classified and Other Sensitive Information (OIG)

For Fiscal Year 2005, Treasury has actively promoted security education and training on classification management and recognizing classified and sensitive information. Training was provided to bureau security officers to use/adapt for their own needs.

Treasury joined the newly-formed Information Security Officers' Working Group (IISOWG) of civilian agencies to represent Treasury interests. Treasury's experiences and concerns are shared as individual agencies discuss multiple solutions for problem solving and sharing information security protective techniques and abilities. The IISOWG has opened a new venue for sharing ideas among other agencies. Treasury hosted the second meeting and the IISOWG now meets on a routine basis. As a result of Treasury's efforts in this area, the OIG has removed this management challenge.

Corporate Management (OIG)

During FY 2005, the Department has been proactive in addressing the material weaknesses situations both at the IRS and the FMS. In addition to maintaining very close liaison with IRS's CFO and CIO personnel, Departmental Offices (Management) staff regularly participated in the IRS's Financial and Management Controls Executive Steering Committee meetings, where each of the outstanding material weaknesses were reviewed by senior officials.

The complexity of the IRS programs and operations causes the effort of designing and implementing comprehensive information systems to be both costly and time-consuming. Despite many successes, implementation of systems that work as a cohesive functioning process has been slow, but we real progress continues to be made.

Bring IRS Financial Management Systems into Compliance with FFMIA (GAO)

In FY 2005, IRS implemented a new core financial system, the Integrated Financial System (IFS). Implementation of the new IFS system is expected to position IRS administrative financial activities so that they are substantially compliant with the Federal Financial Management Improvement Act (FFMIA). The degree of IRS compliance will be validated once GAO has completed the 2005 financial audit under the new system. The IRS will continue to report on remediation activities related to future releases of IFS, although at present, all future releases are on hold. For FY 2006, the IRS's Financial Management Information System (FMIS) enhancements are planned to be accomplished through four releases beginning in 2006 through 2008. The full funding requirements for the FMIS enhancements have been included in the FY 2007 E-300 submission.

The IRS has also developed and submitted a business case to determine if funding can be made available for an alternative plan to remediate the custodial financial weaknesses over the next several years. The Custodial Accounting Project (CAP) was officially shut down on January 18, 2005, due to budget constraints. Upon the shut down of CAP, the IRS has begun developing an alternative Custodial Detailed Data Base (CDDB), a financial data warehouse that leverages existing legacy assets to address the critical GAO financial material weaknesses. CDDB incrementally builds to FFMIA compliance. Each CDDB release addresses one or more of the GAO material weaknesses in financial reporting. With full implementation of all CDDB releases in FY 2007, the IRS expects to be compliant with FFMIA.

Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act Enforcement (OIG)

Treasury's banking regulatory agencies are working in partnership with the credit union regulatory agency and the Financial Crimes Enforcement Network (FinCEN) to abate money laundering and terrorist financing. The approach the regulatory agencies have taken to achieve these goals is to ensure examination consistency and provide guidance to financial institutions for developing policies and programs to comply with anti-money laundering requirements.

The federal regulatory agencies and FinCEN executed an information sharing agreement in late 2004 to enhance implementation and communication regarding the Bank Secrecy Act (BSA). These agreements will provide oversight information needed to assess levels of BSA compliance in covered industries, and provide a framework for enhanced communication, collaboration and information sharing between Federal and State agencies. The agreements and resulting collaboration will result in more effective BSA administration. In addition, the OIG completed a follow-up review of Treasury' Suspicious Activity Report data quality. This review recognized the emphasis that Treasury placed on this issue and offered suggestions on how to improve this area. As a result, in FY 2006, Treasury will be working on fourteen suggested actions. These actions include seeking input on critical data fields from the Bank Secrecy Act Advisory Group and developing criteria for determining acceptable data quality level.

Prepare Reliable Financial Statement for the U.S. Government (GAO)

During FY 2005, Treasury completed the FY 2004 Financial Report (FR) three and a half months earlier than is required by the Government Management Reform Act of 1994. In FY 2004, agencies submitted their closing package data electronically for the first time through the Government-wide

Financial Report System (GFRS). The closing package process provides a direct link between the audited financial statements prepared by the agencies and the compilation of the FR. Agencies also submitted adjusted trial balance information electronically, using the Federal Agencies' Centralized Trial Balance System (FACTS I). FACTS I data was transmitted real-time to GFRS and served as the primary source of FR data for the non-material agencies and supporting detail information for the material agencies.

For FY 2006, Treasury continues its multi-year effort to rebuild the processes it uses to prepare the FR. In addition, Treasury continues to work closely with OMB in developing intra-governmental business rules.

Enforcement of Tax Laws (GAO)

Treasury improved collection processes which resulted in increases in productivity, dollars collected, enforcement activity and customer satisfaction along with decreases of time between return filing and assignment and decrease of time between assignment and case closure. Adoption of clear guiding principles including revisions to key Internal Revenue Manual sections on enforcement activity, coupled with improved electronic research and guidance tools and enhancement of managerial consultations contributed to overall improvements.

In addition, Treasury partnered with 27 states to levy individual state refunds for outstanding federal income tax liabilities through the State Income Tax Levy Program. An encryption software purchase for states will allow transmission of levy payment into the Electronic Federal Tax Payment System. Further, as part of the Treasury's initiative in FY 2005, the Treasury continued several tests to evaluate new ways of reducing erroneous Earned Income Tax Credit (EITC) payments while maintaining participation by eligible taxpayers; such as the Misreporting Income (Automated Underreporter) Test. This test focused on improved selection methodologies and immediately proved successful.

Finally, Treasury is continuing to make the EITC easier to claim by eligible taxpayers. To reduce taxpayer burden, the Treasury is improving communications to taxpayers, making the credit clearer and easier to understand and providing potential claimants and their paid preparers with resources to help them determine whether they are eligible.

IRS's Business Systems Modernization Program (GAO, TIGTA)

In FY 2005, IRS modernization efforts focused on key tax administration systems that will provide additional benefits to taxpayers. The Customer Account Data Engine (CADE) replaces the IRS's antiquated system called the Master File, which is the repository of taxpayer information. CADE allows faster refunds (CADE processes refunds on a daily basis), improved taxpayer service, faster issue detection, more timely account settlement, and a robust foundation for integrated and flexible modernized systems. More than 1.4 million returns were posted with more than $427 million in refunds generated. Next year, CADE should be able to process over twice as many returns. It will be the single authoritative repository for account and return data.

Modernized e-File (MeF) deployed Form 7004 (filing extension for corporations) as well as Form 990PF (information return for private foundations). This allowed the IRS to establish regulations requiring large corporations and tax-exempt organizations to electronically file their income tax or annual information returns.

The FY 2006 Modernization portfolio will focus on delivery of three major tax administration projects (highlighted below), along with infrastructure initiatives and continued improvement to program management operations.

- The IRS will expand CADE to increase the number of tax returns processed and taxpayers served, targeting 33 million returns to be processed during 2007.
- The Modernized e-File (MeF) continues engineering development to prepare for expanding taxpayer base served through combined Federal and State processing of tax returns. BSM also continues working on access capabilities for disabled taxpayers through e-Services upgrade of the PeopleSoft Commercial Off-the-Shelf application.
- The IRS will develop the first release of the Filing and Payment Compliance system to analyze tax collection cases to determine uncontested cases that no longer require direct IRS involvement and can be turned over to private collection agencies.

Tax Compliance Initiatives (TIGTA)

This issue involves the administering of programs to deal with tax gap issues, especially those resulting from corporate and high-income individual taxpayers as well as domestic and off-shore tax and financial criminal activity.

In FY 2005, Treasury achieved several key actions in this area which include: (1) addressing key areas of noncompliance with enhanced enforcement of tax laws such as increased examinations of the small business corporate segment by 81%; (2) corporate audits increased 15%, significant given the size (over $10 million) and complexity of these entities; (3) increased examination and collection on the high-income non-filer segment; and (4) partnered with states on abusive transactions leads.

In addition, Treasury released updated tax gap estimates for Individual Income Tax Reporting Compliance. Preliminary findings indicate that the gross tax gap was between $312 billion and $353 billion in Tax Year (TY) 2001. Underreporting noncompliance is the largest component of the tax gap and accounts for more than 80% of the total, with non-filing and underpayment at about 10% each.

Furthermore, Treasury delivered the final TY 2003 Voluntary Payment Compliance Rates (VPCR) by type of tax, tax year and operating division. The VPCR, which is the percentage of the total tax liability reported on timely-filed returns that is paid in a timely manner, provides a valid assessment of the overall level of payment compliance and facilitates the proper allocation of resources for enforcement activities.

Finally, Treasury focused criminal enforcement resources on key areas of noncompliance, including the promotion of abusive schemes such as offshore accounts to hide or improperly reduce income, the use of abusive corporate tax avoidance transactions, and high-income individuals underreporting of income and/or failure to file returns.

For FY 2006, Treasury's key plans in this area include upgrading the Bank Secrecy Act (BSA) workload database to provide a more complete record of these institutions and to better predict which entities have a greater probability of non-compliance. In addition, the Treasury plans on chartering EITC research efforts to identify ways to reduce EITC erroneous payments, as well as identify trends in the diverse EITC taxpayer population. Treasury will use the results of these studies for strategic planning of the EITC program.

Complexity of the Tax Law (TIGTA)

In FY 2005, key actions in this area included providing the Congress with legislative recommendations in the upcoming National Taxpayer Advocate Annual Report to Congress, including elimination of the Alternative Minimum Tax; simplification of provisions to encourage education; and simplification of provisions to encourage retirement savings.

During FY 2006, Treasury plans in this area include: continuing work on the revisions in the regulations under Internal Revenue Code 7216, relating to the use and disclosure of tax return information by tax returns preparers; examining the possibility of a Unified Family Credit that will combine the provisions of the EITC, Child Tax Credit, and Dependency Exemption, thereby further reducing taxpayer compliance burdens associated with claiming these provisions; and drafting a legislative proposal to issue regulations specifying returns that must be filed electronically. Also, expanding the scope of returns that are required to be filed electronically would help the IRS meet its 80% goal set by Congress.

Processing Returns and Implementing Tax Law Changes During the Tax Filing Season (TIGTA)

During FY 2005, key actions in this area included: (1) setting a record for electronic filing, reaching nearly 68 million returns, an increase of approximately 11% from 2004; (2) developing secure access for taxpayers who file electronically to enable them to review their account electronically; and (3) ensuring the corporate filing season readiness process is operational for filing seasons 2005 and 2006 and covers all aspects of the filing season, including the Annual Readiness Certification.

Treasury's key actions planned for completion in FY 2006 includes: (1) pilot an automated adjustment document to make a change or correction to a taxpayer account, reducing adjustment time and increasing the quality of required adjustments; and (2) begin development of strategies to smoothly transition and consolidate the Philadelphia Submission Processing Center; and (3) complete deployment of Transcript Delivery System by December 2005.

Improving Service to Taxpayers - Providing Quality Customer Service Operations (TIGTA)

During FY 2005, Treasury's key actions in this area included: (1) developed the electronic installment agreement initiative to enable taxpayers meeting certain criteria to request and set-up their own installment agreements over the Internet on IRS.gov; (2) enhanced research to maximize the best use of resources for the Volunteer Income Tax Assistance (VITA) site identification, partnership development and return preparation; (3) expanded Internet Refund-Fact of Filing to include Refund Trace and Change of Address capabilities for lost and/or stolen refunds; (4) improved and enhanced the availability of online services such as Internet Employer Identification Number (EIN), Centralized Authorization File, and Practitioner Priority Services; and (5) continued work wit private industry providers to expand Free File.

For FY 2006, Treasury's plan includes: (1) implementing a national rural strategy that provides outreach, free tax return preparation and/or financial literacy education to rural America; (2) continuing to educate EITC taxpayers and assess the overall EITC marketing and awareness campaigns that target the eligible EITC non-claimant population; (3) expanding of Internet Refund Fact of Filing application to reduce toll-free demand and offer customers alternative methods of service; (4) developing a TeleFile and Internet electronic withdrawal (Direct Debit) application for notice payments; (5) developing an electronic funds withdrawal (Direct Debit) application for installment agreements; and (6) continuing to improve the quality and clarity of computer-generated notices issued to taxpayers to reduce the number of telephone contacts and make it easier for taxpayers to understand and comply with their tax requirements.

Taxpayer Protection and Rights (TIGTA)

For FY 2005, key actions included: (1) reduced procedural barriers by making refinements to both third party notification and collection due process procedures; (2) administered an EITC survey as part of the EITC Qualifying Child Certification Test, consisting of questions regarding the time and cost associated with the certification and making an EITC claim; (3) reviewed IRS training to ensure that employees, particularly in compliance functions, are properly and regularly trained on the protection of taxpayer rights; (4) developed a new workload methodology that will focus on those areas of the filing population constituting the greatest increase in compliance risk with a high probability of unreported income. This strategy will promote fairness of our tax system by identifying potential noncompliance from taxpayers who would not otherwise be subject to matching document reviews; and (5) pursued abuses in the consumer credit counseling industry, targeting for audit 60 firms representing 50% of revenue in this industry.

During FY 2006, planned actions include: (1) focusing on taxpayer groups that are at higher risk of noncompliance to maintain confidence in the integrity of the tax administration program; (2) continuing to educate EITC taxpayers through partnerships with key stakeholders and a public service campaign; (3) advocating enforcement of existing penalties for paid preparers as well as the strengthening and enhancement of penalties by Congress; and (4) working with preparers to design a program that enables the majority of taxpayers to feel confident that their preparers are competent to prepare their taxes and that the IRS will take appropriate enforcement action on preparers when they perform negligently or recklessly.

Human Capital (TIGTA)

During FY 2005, the IRS's key actions included the streamlining of its operations that resulted in moving personnel from non-enforcement to enforcement positions and cost savings from centralizing case processing. These efforts will be directed to enforcement hires for FY 2006. In addition, the IRS has drafted its 2005-2009 Human Capital Strategic Plan and will begin implementation, upon IRS Oversight board approval. Once approved, the plan will be the primary guidance vehicle for strategic management of human capital in the IRS and implemented an IRS-wide human capital governance structure, including representatives from the IRS business units, support functions and specialized units, that provides a forum for all IRS entities to jointly address and propose solutions to human capital issues and challenges resulting from the implementation of large-scale human capital programs, policies and initiatives. This ensures consistent and fair treatment of employees affected by workforce change initiatives.

To support workforce restructuring initiatives and to mitigate impact on employees involved in restructuring, the IRS used all available tools, including VERA (early outs) and VSIP (buyouts) and relocation bonuses throughout the year to support workforce restructuring initiatives and to mitigate impact on employees involved in restructuring. Further, the IRS implemented a multi-year recruitment and marketing strategy that included the expansion of the Internet employment website, a complete print media advertising campaign, market research and an extensive Internet media advertising campaign.

During FY 2006, the IRS plans to complete the development of the Human Capital Strategic Implementation Plan (HCSIP) which will identify specific human capital programs and initiatives for the next two years needed to execute the strategies and achieve the goals outlined in the Human Capital Strategic Plan. The IRS will conduct a study of all leadership courses (Executive Readiness Program, Senior Manager Course/Senior Manager Readiness Program, and Frontline Manager Course) to focus on delivering content in an effective and efficient manner as well as identifying and attracting "high talent" and "high potential" for leadership development. In addition, the HCSIP will provide accountability for performance of programs and initiatives through a systematic corporate monitoring and reporting process; and integrate the budget process with human capital strategies. In addition, the IRS plans to continue the selective use of Voluntary Employee Retirement Authority (early-outs) and Voluntary Separation Incentive Payments (buyouts) to support organizational restructuring and workforce reshaping initiatives.