Part III – *Annual Financial Report*

Inspector General's Transmittal Letter

INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY
WASHINGTON

November 15, 2004

MEMORANDUM FOR SECRETARY SNOW

FROM: Dennis S. Schindel
Acting Inspector General

SUBJECT: Audit of the Department of the Treasury's Financial Statements for Fiscal Years 2004 and 2003

SUMMARY

I am pleased to transmit the attached report presenting the results of the audit of the Department of the Treasury's (Department) financial statements as of and for the fiscal year (FY) ending September 30, 2004. This audit is required by the Chief Financial Officers Act of 1990 (CFO Act), as expanded by the Government Management Reform Act of 1994 (GMRA).

The Office of Inspector General (OIG) contracted with the independent certified public accounting firm KPMG LLP for the audit of the FY 2004 financial statements. The audit was performed in accordance with generally accepted Government auditing standards; Office of Management and Budget Bulletin 01-02 *Audit Requirements for Federal Financial Statements*; and, the *GAO/PCIE Financial Audit Manual*. Highlights of the FY 2004 audit results follow:

- KPMG issued an unqualified opinion on the Department's FY 2004 financial statements;
- KPMG identified financial management and reporting at the Internal Revenue Service (IRS) as a material weakness in internal control; KPMG also identified electronic data processing controls over financial systems at the Financial Management Service (FMS) as a reportable condition; 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 (FFMIA).

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 FY 2004 financial statements or conclusions about the effectiveness of internal control or compliance with laws and regulations. KPMG is responsible for its report dated November 12, 2004 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 accelerating its performance and accountability reporting for three consecutive years has clearly established it as a leader in federal financial reporting. Another significant achievement during the FY 2004 financial audit cycle was the progress made by certain bureaus in addressing information security weaknesses identified in prior years' audits. As a result, the only bureau that continues to have a material weakness in information security reported in connection with its annual audit is the IRS.

The progress made by the Department over the past several years in improving financial management has been noteworthy; however, it has also served to highlight the most significant remaining obstacle to achieving true financial management excellence - specifically, the longstanding financial management deficiencies at the IRS. Despite its accelerated annual reporting, 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. Moreover, planned corrective actions have generally fallen behind schedule.

As discussed in my October 26, 2004 letter to you, effective corporate management is one of the greatest challenges facing the Department. This is especially true with respect to the need for a more assertive Departmental role in resolving the continuing, pervasive financial management problems at the IRS. The IRS is the largest component entity, and the ability of the Department to meet its financial management goals and "get to green" on the President's Management Agenda is predicated upon major improvement by the IRS. The Department must exert stronger corporate leadership over the IRS to ensure that longstanding financial management deficiencies are finally addressed.

Your personal support is essential for the Department to meet the financial management and other challenges laid out in the President's Management Agenda. We are committed to working with you to build upon the Department's significant accomplishments, and to address the continuing challenges.

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

Attachment

cc: Jesus Delgado-Jenkins
Acting Assistant Secretary for Management

Barry K. Hudson
Acting Chief Financial Officer

Independent Auditors' Report on Treasury's Financial Statements

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 sheet of the U. S. Department of the Treasury (the Department) as of September 30, 2004, and the related consolidated statements of net cost, changes in net position and financing, the combined statement of budgetary resources, and the statement of custodial activity (financial statements) for the year then ended. The objective of our audit was to express an opinion on the fair presentation of the financial statements as of and for the year ended September 30, 2004. These financial statements are incorporated in the accompanying *Department of the Treasury Performance and Accountability Report Fiscal Year 2004 (Performance and 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, are 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 audit and the reports of the other auditors, we concluded that the Department's financial statements as of and for the year ended September 30, 2004, are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America. The accompanying fiscal year 2003 financial statements were audited by other auditors, whose report thereon dated November 7, 2003, expressed an unqualified opinion.

In our fiscal year 2004 audit, 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).

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- Electronic Data Processing (EDP) Controls Over Financial Systems at the Financial Management Service (FMS) 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.

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)* Sections 6159 and 6325 that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. In addition, the Department's financial management systems did not substantially comply with the requirements of the *Federal Financial Management Improvement Act of 1996* (FFMIA).

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 sheet of the Department as of September 30, 2004, and the related consolidated statements of net cost, changes in net position and financing, the combined statement of budgetary resources, and the statement of custodial activity for the year 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, 2004. We also did not audit the financial statements of the IRS, a component entity of the Department, which statements reflect custodial revenues of $2.0 trillion, total assets of $25.6 billion, and net costs of operations of $10.4 billion as of and for the year ended September 30, 2004. The gold and silver reserves of the U.S. Government and the financial statements of the IRS as of and for the year ended September 30, 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. The accompanying fiscal year 2003 financial statements were audited by other auditors, whose report thereon dated November 7, 2003, expressed an unqualified opinion.

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

The information in the *Performance and Accountability Report* listed in the accompanying table of contents as Part I – Management's Discussion and Analysis and as 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 OMB Bulletin No. 01-09, *Form and Content of Agency Financial Statements*. 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, this information was not audited and, accordingly, we express no opinion on it.

Our audit and the audits of the other auditors were conducted for the purpose of forming an opinion on the fiscal year 2004 financial statements taken as a whole. The information in the *Performance and Accountability Report* listed in the accompanying table of contents as Part II – Annual Performance Report; as the Other Accompanying Information and Management Challenges and High Risk Areas sections of Part III – Annual Financial Report; and as Part IV – Appendices, are integral parts of the *Performance and 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 audit 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 the 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.

In our fiscal year 2004 audit, 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, IRS was able to produce financial statements covering its tax custodial and administrative activities that are fairly stated in all material respects. However, many of IRS' longstanding systems and internal control weaknesses continued 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 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:

- 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 Federal government and over the issuance of tax refunds, resulting in lost revenue to the Federal 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 IRS, including performance information, may also contain misstatements resulting from these weaknesses.

Two other reportable conditions were identified related to deficiencies in controls over (1) hard-copy tax receipts and taxpayer data and (2) property and equipment.

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 Over Financial Systems at FMS Should Be Strengthened.

A reportable condition was identified related to the EDP general control environment for computer systems maintained by FMS. Deficiencies in general and application EDP controls at FMS were reported as a material weakness in the prior auditors' report dated November 7, 2003, but based upon improvements identified during the fiscal year 2004 audit, the application control weaknesses have been resolved and the remaining general control weaknesses have been reassessed as a reportable condition, as described below.

Our testing indicated that there are still existing general control weaknesses that do not effectively prevent (1) unauthorized access to and disclosure of sensitive information, or (2) unauthorized changes to systems and applications software. 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. While most of the prior access control findings have been addressed or are in process of resolution, improvement is still needed in 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. Although progress has been made in this area, improvement is still needed in the enforcement of configuration management procedures in order to reduce the risk that unauthorized, inadequately tested, or harmful changes to computer programs could be implemented.

Recommendations

Recommendations will be provided to FMS management in a separate letter to address these conditions. We recommend that the Department's Chief Information Officer provide effective oversight to ensure that corrective actions are implemented completely and timely by FMS.

Status of Other Prior Year Reportable Conditions

Reportable conditions related to (1) EDP controls at the Office of the Comptroller of the Currency and at the Alcohol and Tobacco Tax and Trade Bureau (TTB) and to (2) financial management infrastructure weaknesses at TTB and the Office of International Affairs were identified by the prior auditors in their report dated November 7, 2003. Based upon improvements made in fiscal year 2004, these matters are no longer considered reportable conditions.

* * * *

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.

Compliance and Other Matters

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 two instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02, and are described below.

- **Compliance 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 2004 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)
- **Compliance with IRC Section 6159** – Section 6159 of the IRC authorizes the IRS to enter into installment agreements with taxpayers to fully satisfy the taxpayer's tax liability. During the fiscal year 2004 audit, instances were identified in which the terms of installment agreements did not require full satisfaction of the tax liability. (Repeat Condition)

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 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 depend extensively on labor 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.
- The material weakness in information security controls at the IRS.

The instance of noncompliance with Federal accounting standards is summarized below:

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

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. Additionally, the general ledger system does not use the standard Federal accounting classification structure for custodial activities.

The Secretary of the Treasury also has determined in the Secretary's Letter of Assurance, in Part I of the accompanying *Performance and 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 Part IV.

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 the 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 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

Recommendations regarding the instances of noncompliance with the IRC have been provided to IRS management by the auditors of the IRS' financial statements. The substantial noncompliance with FFMIA relates to the material weaknesses in internal control at the IRS discussed above. We recommend that the Assistant Secretary for Management and Chief Financial Officer provide effective oversight to ensure that the IRS implements effective remediation plans.

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.

Responsibilities

Management's Responsibilities. The *Government Management Reform Act of 1994* (GMRA) requires each Chief Financial Officer (CFO) Act agency to report annually to Congress on its financial status and any other information needed to fairly present its financial position and results of operations. To meet the GMRA reporting requirements, the Department prepares annual financial statements.

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;
- Establishing and maintaining internal controls over financial reporting and preparing the Management's Discussion and Analysis (including the performance measures), Required Supplementary Information, and Required Supplementary Stewardship Information; and
- Complying with laws and regulations, including FFMIA, and contracts and grant agreements.

In fulfilling this responsibility, estimates and judgments by management are required 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 2004 financial statements of the Department based on our audit and the reports of other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, and OMB Bulletin No. 01-02. Those standards and OMB Bulletin No. 01-02 require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit 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 audit 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 2004 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 internal control, determining whether internal controls had been placed in operation, assessing control risk, and

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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. Accordingly, all internal controls relevant to operating objectives as broadly defined by the *Federal Managers' Financial Integrity Act of 1982* were not tested. The objective of our and the other auditors audits was not to provide assurance on internal control over financial reporting. Consequently, no opinion is provided thereon.

As required by OMB Bulletin No. 01-02, 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 with respect to internal control related to performance measures determined by management to be key and reported in the Management's Discussion and Analysis section, 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 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, no opinion is provided thereon.

As part of obtaining reasonable assurance about whether the Department's fiscal year 2004 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. Those tests of compliance were limited to the provisions described in the preceding sentence, and compliance with all laws, regulations, contracts, and grant agreements applicable to the Department were not tested. 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, no opinion is provided thereon.

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.

Distribution

This report is intended for the information and use of the Department's management, 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 12, 2004

Management's Response

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

November 12, 2004

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 2004 financial statements included in Treasury's FY 2004 Performance and Accountability Report.

All of our bureaus and program offices are to be congratulated for the Department's success in issuing its Performance and Accountability Report by November 15th for the third year in a row. They are likewise to be congratulated for achieving another unqualified opinion on the Department's financial statements. Without their collective dedicated efforts our accelerated reporting would not be possible.

These timely, high quality results would also not be possible without the high level of professionalism, enthusiasm, technical expertise, and commitment demonstrated by KPMG in conducting the audit. This is particularly noteworthy given that FY 2004 was KPMG's initial audit of the Department-wide financial statements. I also 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 level of commitment demonstrated by the other organizations involved in the audit process – the Office of Inspector General, the Government Accountability Office, and the various firms that conducted the audits at several individual bureaus.

As you note in your report, the Department did make progress in FY 2004 in addressing several financial management and systems deficiencies. However, we agree that we must continue to increase our efforts to address longstanding weaknesses which hamper our ability to produce timely, reliable financial information. We still have to 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 these deficiencies are corrected they will adversely affect our overall financial management capabilities and will be a burden on our employees who must deal with these deficiencies on a daily basis, particularly during the year-end reporting process. We will continue to increase our emphasis on addressing these deficiencies.

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

We were pleased to experience a professional, cooperative relationship with KPMG throughout the course of the audit, and we greatly appreciated the continuing support and involvement of the Office of Inspector General.

Sincerely,

Jesus Delgado-Jenkins

Jesus H. Delgado-Jenkins
Acting Assistant Secretary for Management

Consolidated Balance Sheets
As of September 30, 2004 and 2003
(In Millions)

	FY 2004	FY 2003
ASSETS		
Intra-governmental Assets		
Fund Balance (Note 2)	$59,946	$53,910
Loans and Interest Receivable (Note 3)	214,065	224,463
Advances to the Black Lung Trust Fund	8,741	8,243
Due From the General Fund, Net (Note 4)	7,144,056	6,511,415
Accounts Receivable and Related Interest (Note 10)	632	825
Other Intra-governmental Assets	12	27
Total Intra-governmental Assets	**7,427,452**	**6,798,883**
Cash, Foreign Currency, and Other Monetary Assets (Note 5)	53,161	73,020
Gold and Silver Reserves (Note 6)	10,933	10,933
Loans and Interest Receivable (Note 3)	977	1,190
Investments and Related Interest (Note 7)	10,870	9,254
Reserve Position in the International Monetary Fund (Note 8)	19,442	24,072
Investments in International Financial Institutions (Note 9)	5,403	5,332
Tax, Other, and Related Interest Receivables, Net (Note 10)	20,520	21,573
Inventory and Related Property, Net (Note 11)	459	439
Property, Plant, and Equipment, Net (Note 12)	2,745	2,603
Other Assets	24	45
Total Assets (Note 13)	**$7,551,986**	**$6,947,344**
LIABILITIES		
Intra-governmental Liabilities		
Federal Debt and Interest Payable (Notes 4 & 14)	$3,097,949	$2,884,015
Other Intra-governmental Liabilities	935	527
Total Intra-governmental Liabilities	**3,098,884**	**2,884,542**
Federal Debt and Interest Payable (Notes 4 & 14)	4,305,302	3,919,055
Certificates Issued to Federal Reserve Banks	2,200	2,200
Allocation of Special Drawing Rights (Note 5)	7,197	7,005
Gold Certificates Issued to Federal Reserve Banks (Note 6)	10,924	10,924
Refunds (Notes 4 & 22)	1,808	1,193
D.C. Pensions Liability (Note 16)	8,367	8,305
Other Liabilities (Note 18)	4,146	4,762
Total Liabilities (Note 18)	**7,438,828**	**6,837,986**
Commitments & Contingencies (Notes 3, 5, 8, 12, 15 & 17)		
NET POSITION		
Unexpended Appropriations	56,850	50,433
Cumulative Results of Operations	56,308	58,925
Total Net Position (Note 19)	**113,158**	**109,358**
Total Liabilities and Net Position	**$7,551,986**	**$6,947,344**

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

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

Cost of Treasury Operations:	Intra-governmental	With the Public	Total
Economic Program:			
Gross Cost	$94	$2,925	$3,019
Less Earned Revenue	(4)	(1,683)	(1,687)
Net Program Cost	**90**	**1,242**	**1,332**
Financial Program:			
Gross Cost	3,855	10,882	14,737
Less Earned Revenue	(2,419)	(2,292)	(4,711)
Net Program Cost	**1,436**	**8,590**	**10,026**
Management Program:			
Gross Cost	97	850	947
Less Earned Revenue	(520)	(5)	(525)
Net Program Cost	**(423)**	**845**	**422**
Total Program Costs, Net	4,046	14,657	18,703
Total Program Earned Revenues	(2,943)	(3,980)	(6,923)
TOTAL NET COST OF OPERATIONS (Note 20)	**1,103**	**10,677**	**11,780**
Federal Costs:			
Federal Debt Interest			322,142
Less Interest Revenue from Loans (Note 19)			(11,500)
Net Federal Debt Interest Costs (Note 20)			**310,642**
Other Federal Costs (Note 20)			12,915
NET FEDERAL COSTS			**323,557**
NET COST OF OPERATIONS, FEDERAL DEBT INTEREST, AND OTHER FEDERAL COSTS			**$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 Net Cost
For the Year Ended September 30, 2003
(In Millions)

Cost of Treasury Operations:	**Intra-governmental**	**With the Public**	**Total**
Economic Program:			
Gross Cost	$311	$2,704	$3,015
Less Earned Revenue	(4)	(4,250)	(4,254)
Net Program Cost	**307**	**(1,546)**	**(1,239)**
Financial Program:			
Gross Cost	4,797	9,099	13,896
Less Earned Revenue	(3,230)	(1,490)	(4,720)
Net Program Cost	**1,567**	**7,609**	**9,176**
Law Enforcement Program:			
Gross Cost	243	572	815
Less Earned Revenue	(2)	(1)	(3)
Net Program Cost	**241**	**571**	**812**
Total Program Gross Costs	5,351	12,375	17,726
Total Program Earned Revenues	(3,236)	(5,741)	(8,977)
Total Program Costs, Net	**2,115**	**6,634**	**8,749**
Costs Not Assigned to Programs	123	1,051	1,174
Less Earned Revenue Not Assigned to Programs	(423)	(1)	(424)
Net Cost of Continuing Operations	**1,815**	**7,684**	**9,499**
Net Cost of Transferred Operations	554	1,585	2,139
Total Net Cost of Operations (Note 20)	**2,369**	**9,269**	**11,638**
Federal Costs:			
Federal Debt Interest			314,168
Less Interest Revenue from Loans (Note 19)			(11,417)
Net Federal Debt Interest Costs (Note 20)			**302,751**
Other Federal Costs (Note 20)			12,859
Net Federal Costs			**315,610**
Net Cost of Treasury Operations, Federal Debt Interest, and Other Federal Costs			**$327,248**

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, 2004
(In Millions)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balance	**$58,925**	**$50,433**
Budgetary Financing Sources:		
Appropriations Received		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)	
Ending Balances	**$56,308**	**$56,850**

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

Consolidated Statement of Changes in Net Position
For the Year Ended September 30, 2003
(In Millions)

	Cumulative Results of Operations	Unexpended Appropriations
Beginning Balance	**$53,647**	**$49,828**
Prior Period Adjustments	28	(35)
Beginning Balance, as Adjusted	**53,675**	**49,793**
Budgetary Financing Sources:		
Appropriations Received		357,817
Appropriations Transferred In/Out		(4,149)
Other Adjustments		(183)
Appropriations Used	352,845	(352,845)
Non-exchange Revenue	2,489	
Donations and Forfeitures of Cash and Cash Equivalents	160	
Transfers In/Out Without Reimbursement	(1,657)	
Other Budgetary Financing Sources	(5)	
Other Financing Sources:		
Donations and Forfeitures of Property	(12)	
Accrued Interest & Discount on the Debt	(7,177)	
Transfers In/Out Without Reimbursement	(1,650)	
Imputed Financing Sources	729	
Transfers to the General Fund and Other (Note 19)	(13,224)	
Total Financing Sources	**332,498**	**640**
Net Cost	(327,248)	
Ending Balances	**$58,925**	**$50,433**

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

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2004 and 2003
(In Millions)

	FY 2004	FY 2003
BUDGETARY RESOURCES		
Budgetary Authority:		
Appropriations Received	$352,212	$365,544
Borrowing Authority	30	3
Net Transfers	(809)	(2,344)
Unobligated Balance:		
Beginning of the Period	73,859	65,588
Net Transfers	(39)	(1,150)
Spending Authority from Offsetting Collections:		
Earned:		
Collected	7,328	10,652
Receivable from Federal Sources	(1)	28
Change in Unfilled Customer Orders:		
Advance Received	(9)	(2)
Without Advance from Federal Sources	290	100
Subtotal	**7,608**	**10,778**
Recoveries of Prior Year Obligations	338	594
Temporarily Not Available Pursuant to Public Law	(322)	(297)
Permanently Not Available	(2,180)	(10,154)
TOTAL BUDGETARY RESOURCES	**$430,697**	**$428,562**
STATUS OF BUDGETARY RESOURCES		
Obligations Incurred:		
Direct	$357,046	$351,474
Reimbursable	3,739	3,229
Subtotal	**360,785**	**354,703**
Unobligated Balance:		
Apportioned	14,365	15,280
Exempt from Apportionment	45,368	48,217
Unobligated Balance Not Available	10,179	10,362
TOTAL STATUS OF BUDGETARY RESOURCES	**$430,697**	**$428,562**

(Continued)

Combined Statements of Budgetary Resources
For the Years Ended September 30, 2004 and 2003
(In Millions)

	FY 2004	FY 2003
Obligated Balance, Net, Beginning of the Period	$35,018	$36,845
Obligated Balance, Transferred, Net	0	(1,419)
Obligated Balance, Net, End of the Period:		
Accounts Receivable	(173)	(174)
Unfilled Customer Orders from Federal Sources	(513)	(223)
Undelivered Orders	40,430	33,593
Accounts Payable	1,702	1,822
Outlays:		
Disbursements	353,729	354,387
Collections	(7,319)	(10,648)
Subtotal	**346,410**	**343,739**
Less: Offsetting Receipts	(1,828)	(1,269)
NET OUTLAYS	**$344,582**	**$342,470**

The accompanying notes are an integral part of these financial statements.
This combined statement includes intra-agency balances that would be eliminated in a consolidated statement.

Consolidated Statements of Financing
For the Years Ended September 30, 2004 and 2003
(In Millions)

	FY 2004	FY 2003
Resources Used to Finance Activities:		
Budgetary Resources Obligated:		
Obligations Incurred	$360,785	$354,703
Less: Spending Authority from Offsetting Collections and Recoveries	(7,946)	(11,372)
Obligations Net of Offsetting Collections and Recoveries	352,839	343,331
Less: Offsetting Receipts	(1,828)	(1,269)
Net Obligations	**351,011**	**342,062**
Other Resources:		
Donations and Forfeitures of Property	31	(12)
Financing Sources for Accrued Interest & Discount on the Debt	3,481	(7,177)
Transfers In/Out Without Reimbursement	(38)	(1,650)
Imputed Financing from Costs Absorbed by Others	714	729
Other	(12,791)	(13,281)
Net Other Resources Used to Finance Activities	**(8,603)**	**(21,391)**
Total Resources Used to Finance Activities	**342,408**	**320,671**
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	6,713	555
Resources that Fund Expenses Recognized in Prior Periods	243	169
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	(128)	(358)
Other	(1,150)	(1,003)
Resources that Finance the Acquisition of Assets or Liquidation of Liabilities	563	685
Adjustment to Accrued Interest & Discount on the Debt	2,590	(3,534)
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations	(479)	(2,918)
Total Resources Used (Provided) to Finance Items Not Part of the Net Cost of Operations	**8,352**	**(6,404)**
Total Resources Used to Finance the Net Cost of Operations	**$334,056**	**$327,075**

(Continued)

Consolidated Statements of Financing
For the Years Ended September 30, 2004 and 2003
(In Millions)

	FY 2004	FY 2003
Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods:		
Increase/Decrease in Annual Leave Liability	$24	($3)
Upward/Downward Reestimates of Credit Subsidy Expense	328	(208)
Increase in Exchange Revenue Receivable from the Public	0	(2)
Other	90	(109)
Total Components of Net Cost of Operations That Will Require or Generate Resources in Future Periods	**442**	**(322)**
Components of Net Cost of Operations That Will Not Require or Generate Resources:		
Depreciation and Amortization	529	609
Revaluation of Assets or Liabilities	323	(150)
Other	(13)	36
Total Components of Net Cost of Operations That Will Not Require or Generate Resources	**839**	**495**
Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period, Net	**1,281**	**173**
Net Cost of Operations	**$335,337**	**$327,248**

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

Statements of Custodial Activity
For the Years Ended September 30, 2004 and 2003
(In Millions)

	FY 2004	FY 2003
Sources of Custodial Revenue & Collections (Note 22)		
Revenue Received:		
Individual and FICA Taxes	$1,695,212	$1,670,274
Corporate Income Taxes	230,377	194,264
Estate and Gift Taxes	25,580	22,827
Excise Taxes	69,552	68,264
Railroad Retirement Taxes	4,421	4,359
Duties	0	8,334
Unemployment Taxes	6,718	6,635
Deposit of Earnings, Federal Reserve System	19,652	21,878
Fines, Penalties, Interest & Other Revenue	2,456	2,187
Total Revenue Received	**2,053,968**	**1,999,022**
Less Refunds	(278,436)	(301,086)
Net Revenue Received	**1,775,532**	**1,697,936**
Accrual Adjustment	(1,938)	697
Total Source of Custodial Revenue and Collections	**1,773,594**	**1,698,633**
Disposition of Custodial Revenue and Collections:		
Amounts Provided to Fund Non-Federal Entities	612	403
Amounts Provided to Fund the Federal Government	1,774,920	1,697,533
Accrual Adjustment	(1,938)	697
Total Disposition of Custodial Revenue & Collections	**1,773,594**	**1,698,633**
Net Custodial Revenue Activity	**$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 of the General Fund of the 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 impacted 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; 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 & Trade Bureau (TTB).

The Homeland Security Act of 2002, Public Law 107-296, transferred the functions (with the exception of Customs revenue collection function), personnel, assets, and liabilities of the U.S. Customs Service (USCS), the United States Secret Service (USSS), and the Federal Law Enforcement Training Center (FLETC), including most of the related functions of the Secretary of the Treasury, to the Department of Homeland Security (DHS) on March 1, 2003. The Secretary also exercised his authority, provided in the Act, to delegate the Customs revenue collection function to the DHS.

This legislation also transferred authorities, functions, personnel and assets of the Bureau of Alcohol, Tobacco and Firearms (ATF), including the related functions of the Secretary of the Treasury, to the Department of Justice (DOJ) on January 24, 2003. ATF administrative and revenue collection functions related to alcohol and tobacco were retained within Treasury. The newly created Alcohol and Tobacco Tax & Trade Bureau, established by the Homeland Security Act, performs these revenue and administrative functions.

Treasury's FY 2003 operating statements include transferred bureau financial results from October 1, 2002 to the effective transfer dates (January 24, 2003 - ATF and March 1, 2003 - USCS, FLETC, and USSS).

Treasury's Statement of Custodial Activity for FY 2003 includes collections made by ATF from October 1, 2002 to January 23, 2003; collections made by TTB from January 24, 2003 to September 30, 2003; and collections made by the U.S. Customs Service from October 1, 2002 to February 28, 2003.

The accompanying financial statements reflect the continuing activities of Treasury, subsequent to the transfers noted above. 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.

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) Bulletin No. 01-09, "Form and Content of Agency Financial Statements." 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 2004 and FY 2003 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, intragovernmental assets, liabilities, earned revenues, and costs have been classified according to the type of entity with whom the transactions are with. Intragovernmental assets and liabilities are those from or to other federal entities. Intragovernmental earned revenues are collections or accruals of revenue from other federal entities, and intragovernmental costs are payments or accruals to other federal entities.

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. The allowance for doubtful accounts reflects an estimate of the portion deemed to be uncollectible.

D. Inventories and Related Property

Inventories and related property include inventory, operating materials and supplies, and forfeited property. Treasury values inventories at standard cost, 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, 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 accounts 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. The allowance includes mortgages and claims on forfeited property held for sale and a minimal amount of claims on forfeited property previously sold. Mortgages and claims expenses are recognized when the related asset is sold and are reflected as a reduction of sales of forfeited property. Recognition of revenue from the forfeiture of property is deferred until the property is sold or transferred to a state, local, or Federal agency, or to a foreign government.

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 Black Lung Trust Fund from the General Fund pursuant to 26 USC 9501, and are used to carry out the purposes of this trust fund. The principal and interest on these advances are to be repaid to the General Fund when the Secretary of the Treasury determines that monies are available in the Black Lung Trust Fund for such purposes. Interest is charged from the date funds are advanced to the trust fund.

G. Property, Plant, and Equipment

Treasury's property, plant, and equipment is recorded at cost and is 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 whose 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 threshold ranges 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 comprised 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 contributed 8.51 percent 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 percent of base pay and matches any employee contributions up to an additional 4 percent 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 contributed 10.7 percent 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 SDR 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 & 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). 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 collecting entity. 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. 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.

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.

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. In addition, U.S. Government entities often incur costs that are paid in total or in part for other entities. These constitute subsidized costs which are recognized by the receiving entity. An imputed financing source is also recognized by the receiving entity. Treasury recognized imputed costs and financing sources in fiscal years 2004 and 2003 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. Confiscated Iraqi Assets

On March 20, 2003, the President of the United States signed an Executive Order, "Confiscating and Vesting Certain Iraqi Property." The President vested in the Treasury all right, title, and interest in blocked funds held in the United States in certain accounts in the name of the Government of Iraq, Rafidain Bank, Rasheed Bank, or the State Organization for Marketing Oil. The Treasury's Office of Foreign Assets Control acted to implement the Executive Order. The Treasury at the direction of the Office of Management and Budget, transferred the vested funds to other agencies, such as the Department of Defense, for use in the reconstruction of Iraq. During FY 2003, Treasury transferred $1.660 billion of vested funds and disbursed another $192 million in funds received during the year. In FY 2004, an additional $18 million was received and disbursed, and the $64 million of vested funds remaining from FY 2003 was transferred. As of September 30, 2004, no Iraqi assets remained with Treasury.

R. Reclassifications

Certain 2003 balances have been reclassified to conform to the 2004 presentation.

S. Income Taxes

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

T. 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.

U. 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.

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 Balances

As of September 30, 2004 and September 30, 2003, fund balances consisted of the following (in millions):

	FY 2004	FY 2003
Appropriated Funds	$57,614	$51,176
Revolving Funds	1,641	1,981
Trust Funds	5	7
Clearing Funds	3	(32)
Deposit Funds	415	421
Special Funds	268	365
Suspense Funds	0	(8)
Total Fund Balances	**$59,946**	**$53,910**

Status of Fund Balances

As of September 30, 2004 and September 30, 2003, the status of fund balances consisted of the following (in millions):

	FY 2004	FY 2003
Unobligated Balance - Available	$35,743	$41,006
Unobligated Balance - Unavailable	10,179	10,362
Obligated Balance not yet Disbursed	41,431	35,009
Subtotal	**87,353**	**86,377**
Adjustments for Clearing, Deposit, and Suspense Funds	418	381
Adjustments for Other Non-budgetary Funds	17	20
Adjustments for Borrowing Authority	(5,672)	(5,721)
Adjustments for Investments	(2,584)	(2,937)
Adjustments for Imprest Funds	(3)	(4)
Adjustments for Cash and Certain Interest Receivable	(19,583)	(24,206)
Total Status of Fund Balances	**$59,946**	**$53,910**

The Fund Balances include $450 million in restricted unobligated balances. These amounts are included with unavailable unobligated balances appropriated in prior fiscal years that are not available to fund new obligations, but may be used to adjust obligations and disbursements that were recorded before the budgetary authority expires or to meet a bona fide need that arose in the fiscal year for which the appropriation was made. Fund Balances also include deposit funds and suspense accounts that are not apportioned.

3. Loans and Interest Receivable

Intra-governmental

As of September 30, 2004 and September 30, 2003, intra-governmental loans and interest receivable consisted of the following (in millions):

Entity:	FY 2004 Loans & Interest Receivable	FY 2003 Loans & Interest Receivable
Agency Loans Purchased	$5,150	$6,905
Direct Loans Purchased	1,800	7,274
Guaranteed Loans	22,376	21,451
Interest Receivable	250	392
Less: Discounts and Allowances	(614)	(583)
Subtotal -- Entity	**$28,962**	**$35,439**

Non-Entity:	**Loans Receivable**	**Interest Receivable**	**FY 2004 Total**	**Loans Receivable**	**Interest Receivable**	**FY 2003 Total**
Department of Agriculture	$46,821	$68	$46,889	$53,343	$94	$53,437
Department of Interior	410	888	1,298	407	948	1,355
Federal Communications Commission	3,941	0	3,941	5,066	0	5,066
Department of Veterans Affairs	2,618	0	2,618	2,854	0	2,854
Railroad Retirement Board	2,962	64	3,026	2,954	71	3,025
Small Business Administration	8,546	0	8,546	6,627	0	6,627
Department of Housing & Urban Development	8,838	82	8,920	11,434	106	11,540
Department of Energy	2,900	13	2,913	2,698	26	2,724
Department of Education	96,530	2	96,532	91,938	0	91,938
Export Import Bank of the U. S.	7,237	0	7,237	7,280	0	7,280
Other Agencies	3,170	13	3,183	3,177	1	3,178
Subtotal -- Non-Entity	**183,973**	**1,130**	**185,103**	**187,778**	**1,246**	**189,024**
Total Intra-government Loans & Interest Receivable-- Entity & Non-entity			**$214,065**			**$224,463**

Agency loans purchased are either notes or pools of loans sold by Federal agencies in the form of certificates representing shares of ownership in the loan pool. The selling agencies guarantee the principal and interest repayments on the notes or certificates. Guaranteed loans are loans made to non-federal borrowers whose obligation to repay the principal and interest is guaranteed by the U.S. Government.

Non-Federal

As of September 30, 2004 and September 30, 2003, loans and interest receivable from non-federal entities consisted of the following (in millions):

	Entity	**Non-Entity**	**FY 2004 Total**	**Entity**	**Non-Entity**	**FY 2003 Total**
Direct Loans	$57	$729	$786	$54	$871	$925
Interest Receivable	0	212	212	0	287	287
Less: Allowances and Subsidy Costs	(21)	0	(21)	(22)	0	(22)
Total Non-Federal Loans & Related Interest Receivable	**$36**	**$941**	**$977**	**$32**	**$1,158**	**$1,190**

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.

4. Due from the General Fund, Net

Treasury is responsible for managing various assets and liabilities on behalf of the U.S. Government as a whole. Due from the General Fund, Net, represents assets and liabilities managed by Treasury on behalf of the U.S. Government. Assets managed by Treasury include cash, silver reserves, loans, advances, and tax receivables. Liabilities managed by Treasury are comprised primarily of the Federal debt.

As of September 30, 2004 and September 30, 2003, Due from the General Fund, Net included the following (in millions):

	FY 2004	FY 2003
Liabilities Requiring Funding from the General Fund:		
Federal Debt and Interest Payable	$4,305,302	$3,919,055
Federal Debt and Interest Payable - Intra-governmental	3,097,949	2,884,015
Refunds Payable	1,808	1,193
Other Liabilities	0	5
Adjustment for Eliminated Liabilities	15,433	15,656
Total Due From the General Fund	**$7,420,492**	**$6,819,924**
Less Amounts to be Distributed to the General Fund:		
Fund Balance	$129	$248
Advances to the Black Lung Trust Fund	8,741	8,243
Cash, Foreign Currency and Other Monetary Assets	31,089	50,779
Silver Reserves	9	9
Loans and Interest Receivable - Intra-governmental Non-Entity	185,103	189,024
Loans and Interest Receivable	941	1,158
Accounts Receivable - Intragovernmental	543	750
Tax and Other Non-Entity Receivables	20,428	21,482
Other Assets	3	16
Adjustment for Eliminated Assets	29,450	36,800
Total Due To the General Fund	**$276,436**	**$308,509**
Due From the General Fund, Net	**$7,144,056**	**$6,511,415**

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 Treasury reporting entities that were eliminated against Loans and Interest Receivable held by the Bureau of the Public Debt.

On the Balance Sheet, Treasury reported $20,520 million in Tax, Other, and Related Interest Receivables as of September 30, 2004 ($21,573 million as of September 30, 2003). However, only $20,428 million is reported as due to the General Fund ($21,482 million as of September 30, 2003). 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, 2004 and September 30, 2003 were as follows (in millions):

	FY 2004	FY 2003
Entity:		
Cash	$4	$4
Foreign Currency:		
Japanese Yen	1,435	1,418
European Euro	7,450	8,182
Other	19	22
Other Monetary Assets:		
Special Drawing Rights (non-marketable, fair value)	12,824	12,093
Other	135	134
Subtotal - Entity	**$21,867**	**$21,853**
Non-Entity:		
Operating Cash of the Federal Government	$31,029	$50,829
Undistributed Cash/Offers in Compromise	0	3
Foreign Currency	128	32
Other	137	303
Subtotal - Non-Entity	**$31,294**	**$51,167**
Total Cash, Foreign Currency, and Other Monetary Assets	**$53,161**	**$73,020**

Entity

Entity cash, foreign currency, and other monetary assets primarily includes foreign currency denominated assets (FCDA), special drawing rights (SDR), and forfeited cash. SDRs and FCDAs are valued as of September 30, 2004 and September 30, 2003, using current exchange rates. "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.

The foreign currency holdings are normally invested in interest bearing assets 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 $5.3 billion as of September 30, 2004 ($6.1 billion as of September 30, 2003). 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, 2004, FCDAs with maturities greater than three months were valued at $3.6 billion ($3.5 billion as of September 30, 2003).

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.

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 and allocations are revalued monthly based on the SDR valuation rate calculated by the IMF.

During FY 2004, Treasury purchased, at the prevailing rates, $300 million equivalent of SDRs received from the IMF by the General Fund of the U.S. Government as remuneration (interest) on the U.S. reserve position in the IMF ($348.1 million equivalent of SDRs during FY 2003), and paid the General Fund $.4 million ($.6 million in FY 2003), in interest on dollars due the General Fund in payment of SDRs received as remuneration. As of September 30, 2004, Treasury had no remaining outstanding payable equivalent of SDRs and no interest payable to the General Fund.

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 percent 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 SDR .

Except for the payment of interest and charges on SDR allocations to the United States, the payment of Treasury's commitment related to the SDR 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, 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. (As of September 30, 2003, the amount of SDR holdings of the United States was the equivalent of $12.1 billion and the amount of SDR allocations to the United States was the equivalent of $7.0 billion.)

Non-Entity

Non-entity cash, foreign currency, and other monetary assets includes 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.

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 or collaterized by securities pledged by the depository institutions and held by the Federal Reserve Banks.

Operating Cash as of September 30, 2004 and September 30, 2003 consisted of the following (in millions):

	FY 2004	FY 2003
U.S. Operating Cash Accounts	$30,362	$27,735
Operating Cash - Federal Reserve Account	6,087	7,265
Subtotal	**36,449**	**35,000**
Time Deposits	0	22,191
Outstanding Checks and Other Miscellaneous Issues	(5,420)	(6,427)
Treasury Officer Unclassified Items	0	65
Total	**$31,029**	**$50,829**

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 under 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 any historical cost records to determine the acquisition cost of the gold and silver over several decades, the statutory rates of $42.2222 per fine troy ounce (FTO) for gold and $1.2929292 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, 2004 and September 30, 2003, the gold and silver reserves consisted of the following (in millions):

	FTOs	Statutory Rate	9/30/2004 Statutory Value	Market Rate	9/30/2004 Market Value
Gold	245,262,897	$42.2222	$10,356	$415.65	$101,944
Gold Held by FRB and in Transit	13,450,413	$42.2222	568	$415.65	5,591
Subtotal - Gold	**258,713,310**		**$10,924**		**$107,535**
Silver	**7,075,171**	$1.2929292	9	$6.67	47
Total Gold and Silver Reserves			**$10,933**		**$107,582**

	FTOs	Statutory Rate	9/30/2003 Statutory Value	Market Rate	9/30/2003 Market Value
Gold	245,262,897	$42.2222	$10,356	$388.00	$95,162
Gold Held by FRB and in Transit	13,450,413	$42.2222	568	$388.00	5,219
Subtotal - Gold	**258,713,310**		**$10,924**		**$100,381**
Silver	**7,075,171**	$1.2929292	9	$5.12	36
Total Gold and Silver Reserves			**$10,933**		**$100,417**

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, 2004 and September 30, 2003, entity investments consisted of the following (in millions):

Type of Investment	Cost	Unamortized (Premium)/ Discounts	Net Investment	Interest Receivable	9/30/2004 Investment Balance	9/30/2004 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**

Type of Investment	Cost	Unamortized (Premium)/ Discounts	Net Investment	Interest Receivable	9/30/2003 Investment Balance	9/30/2003 Market Value
Euro Bonds	$1,860	$34	$1,894	$50	$1,944	$2,008
Japanese Financing Bills	3,424	(1)	3,423	0	3,423	3,424
Japanese T Bills	3,634	0	3,634	0	3,634	3,634
Other	253	0	253	0	253	83
Total Non-Federal	**$9,171**	**$33**	**$9,204**	**$50**	**$9,254**	**$9,149**

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 Special Drawing Rights (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 one percent 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.
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 result in valuation changes in dollar terms for the U.S. reserve position in the IMF. For example, when the dollar appreciates against the SDR, a valuation loss is experienced and recorded as an increase to the Appropriations Used line item on the Statement of Changes in Net Position. Conversely, a valuation gain is experienced when the dollar depreciates against the SDR. As a result of the depreciation of the dollar against the SDR between the end of FY 2003 and the end of FY 2004, the U.S. experienced a valuation gain on the reserve position of approximately $647 million (Between the end of FY 2002 and the end of FY 2003, a valuation gain of $1,722 million was recognized). There are no transactions associated with this exchange-rate driven change in the dollar value of the reserve position, and there are no net outlays involved prospectively, although outlays are recorded retrospectively to reflect the valuation change.

As of September 30, 2004, the U.S. quota in the IMF was 37.1 billion SDRs, valued at approximately $54.6 billion. (The quota as of September 30, 2003 was 37.1 billion SDRs, valued at approximately $53.1 billion.) The quota consisted of the following (in millions):

	FY 2004	FY 2003
Letter of Credit /1.	$34,995	$28,916
U.S. Dollars Held in Cash by the IMF /1.	135	128
Reserve Position /2.	19,442	24,072
U.S Quota in the IMF	**$54,572**	**$53,116**

/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 unused domestic currency portion of the U.S. quota, denominated in SDRs, but payable in U.S. dollars, is periodically adjusted to maintain the SDR value of these holdings. These adjustments are settled after the close of the IMF financial year on April 30, although accrued maintenance of value amounts are calculated daily. Such adjustments do not involve a flow of funds. At April 30, 2004, the depreciation of the dollar against the SDR since April 30, 2003, called for an upward adjustment of the letter of credit by $1.375 billion (At April 30, 2003, the depreciation of the dollar against the SDR since April 30, 2002, called for an upward adjustment of the letter of credit by $2,580 million.) The dollar balances shown above for the letter of credit include accrued maintenance of value amounts.

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. The total reduction in the IMF remuneration received during FY 2004 and FY 2003 as a result of burden-sharing was zero and $18.6 million, respectively.

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 2004 and FY 2003. 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, 2004, and September 30, 2003, this amounted to $9.9 billion and $9.6 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, 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, 2004 and September 30, 2003, investments in international financial institutions consisted of the following (in millions):

	FY 2004	**FY 2003**
African Development Bank	$160	$155
Asian Development Bank	450	442
European Bank for Reconstruction & Development	558	522
Inter-American Development Bank	1,462	1,442
International Bank for Reconstruction & Development	1,985	1,985
International Finance Corporation	569	569
Multilateral Investment Guarantee Agency	44	43
North American Development Bank	175	174
Total	**$5,403**	**$5,332**

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, reduced by an estimate for uncollectible amounts. Also included are interest income due on monies deposited in Federal Reserve Banks. As of September 30, 2004 and September 30, 2003, tax, other, and related interest receivables, net, consisted of the following (in millions):

	FY 2004	FY 2003
Non-Entity:		
IRS Federal Tax Receivable, Gross	$89,137	$89,027
Less: Allowance on Taxes Receivable	(69,117)	(69,008)
Receivable, Deposit of Earnings, Federal Reserve	412	1,468
Other Receivables & Interest	50	10
Less: Allowance on Other & Related Interest Receivable	(40)	(7)
Total Tax, and Other Non-Entity Receivables, Net	**20,442**	**21,490**
Entity: Miscellaneous Entity Receivables & Related Interest	78	83
Total Tax, Other, and Related Interest Receivables, Net	**$20,520**	**$21,573**

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 collectibility 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 and the No Fear Act ($543 million of the $632 million and $750 million of the $825 million displayed for 2004 and 2003, 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 the 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.

Inventory

Treasury's operating materials and supplies are maintained for the production of bureau products.

Treasury's manufacturing entities, the BEP and the Mint, maintain 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. The Financial Management Service also holds inventory for check processing activities.

As of September 30, 2004 and September 30, 2003, inventory and related property consisted of the following (in millions):

	FY 2004	FY 2003
Operating materials and supplies held for use	$14	$15
Operating materials and supplies held in reserve for future use	21	22
Forfeited property	46	35
Other related property	387	381
Less: allowance for inventories and related property	(9)	(14)
Total Inventories and Related Property	**$459**	**$439**

12. Property, Plant, and Equipment, Net

As of September 30, 2004 and 2003, property, plant and equipment consisted of the following (in millions):

	Depreciation Method	Service Life	Cost	Accumulated Depreciation	FY 2004 Total
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 PP&E (ADP equipments, etc.)	S/L	2 - 30 years	1,165	(338)	827
Total			**$5,280**	**($2,535)**	**$2,745**

	Depreciation Method	Service Life	Cost	Accumulated Depreciation	FY 2003 Total
Buildings, structures and facilities	S/L	3 - 50 years	$535	($199)	$336
Furniture, fixtures and equipment	S/L	2 - 20 years	2,203	(1,260)	943
Construction in progress	N/A*	N/A*	128	0	128
Land and land improvements	N/A*	N/A*	10	0	10
ADP software	S/L	2 - 10 years	326	(91)	235
Assets under capital lease	S/L	2 - 25 years	216	(105)	111
Leasehold improvements	S/L	2 - 25 years	11	(3)	8
Other PP&E (ADP equipments, etc.)	S/L	2 - 30 years	1,253	(421)	832
Total			**$4,682**	**($2,079)**	**$2,603**

* N/A -- Not Applicable
S/L -- Straight Line

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 property, plant 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.

Generally, Treasury leases office space, vehicles and equipment under annual operating leases. These leases are cancelable or renewable on an annual basis at the option of Treasury. They do not impose binding commitments on Treasury for future rental payments on leases with terms longer than one year with the exception of the following operating leases (in millions):

Operating Leases-Future Payments Due Fiscal Years Ending September 30,	**Land & Building**
2005	$55
2006	48
2007	38
2008	36
2009	36
Thereafter	214
Total Future Payments	**$427**

13. Non-Entity Assets

As of September 30, 2004 and September 30, 2003, non-entity assets consisted of the following (in millions):

	FY 2004	**FY 2003**
Intra-governmental Assets:		
Fund Balance	$834	$1,065
Loans and Interest Receivable	185,103	189,024
Accounts Receivable and Related Interest	543	750
Advances to the Black Lung Trust Fund	8,741	8,243
Due from the General Fund	7,420,492	6,819,924
Total Non-Entity Intra-governmental Assets	**$7,615,713**	**$7,019,006**
Cash, Foreign Currency, and Other Monetary Assets	$31,294	$51,167
Gold & Silver Reserves	10,933	10,933
Loans and Interest Receivable	941	1,158
Tax, Other, and Related Interest Receivables, Net	20,442	21,490
Other Assets	3	16
Total Non-Entity Assets	**$7,679,326**	**$7,103,770**

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. 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, 2004 and September 30, 2003 was as follows (in millions):

Intra-governmental	**FY 2004**	**FY 2003**
Beginning Balance	$2,843,770	$2,645,522
New Borrowings/Repayments, Net	212,714	198,248
Subtotal -- at Par Value	**3,056,484**	**2,843,770**
Premium/Discount, Net	(739)	(448)
Interest Payable Covered by Budgetary Resources	42,204	40,693
Total	**$3,097,949**	**$2,884,015**

Owed to the Public	**FY 2004**	**FY 2003**
Beginning Balance	$3,924,090	$3,553,180
New Borrowings/Repayments, Net	383,255	370,910
Subtotal -- at Par Value	**4,307,345**	**3,924,090**
Premium/Discount, Net	(34,778)	(36,846)
Interest Payable Covered by Budgetary Resources	32,735	31,811
Total	**$4,305,302**	**$3,919,055**

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 2004 was 5.4 percent (5.5 percent in FY 2003).

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, 2004 and September 30, 2003 was as follows (in millions):

	FY 2004	FY 2003
Social Security Administration *	$1,635,398	$1,484,220
Office of Personnel Management *	670,741	637,523
Department of Defense Agencies	217,541	194,998
Department of Health and Human Services	283,851	278,255
All Other Federal Entities - Consolidated	248,953	248,774
Total Federal Debt Held by Federal Entities	**$3,056,484**	**$2,843,770**

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	FY 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

	Non-Marketable Debt Securities	Marketable Securities	FY 2003 Total
Civil Service Retirement and Disability Fund, Par Value	$601,429	$280	$601,709
Federal Disability Insurance Trust Fund, Par Value	$170,763	$30	$170,793

Federal Debt Held by the Public

As of September 30, 2004 and September 30, 2003, Federal Debt held by the Public consisted of the following:

(at par value, in millions)	Term	Average Interest Rates	FY 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**

(at par value, in millions)

			FY 2003
Marketable:			
Treasury Bills	1 Year or Less	1.0%	$918,196
Treasury Notes	Over 1 Year - 10 Years	3.8%	1,799,424
Treasury Bonds	Over 10 Years	7.8%	576,590
Treasury Inflation Protected Securities (TIPS)		3.2%	166,120
Total Marketable			**$3,460,330**
Non-Marketable	On Demand to Over 10 Years	5.3%	463,760
Total Federal Debt (Public)			**$3,924,090**

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, 2004 and 2003, 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, 2004 and 2003. Treasury notes are issued with a term of 2 - 10 years and Treasury bonds are issued with a term of more than 10 years. Treasury also issues 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. Inflation-indexed securities, TIPS, were previously included with Treasury notes and bonds. The FY 2003 amounts and average interest rates have been reclassified to conform with the presentation adopted in FY 2004.

The Federal debt is subject to a current statutory debt limit (31 U.S.C., Section 3101) of $7.384 trillion at September 30, 2004 and September 30, 2003. The debt limit includes both Treasury securities held by the public and intra-governmental debt holdings. On October 14, 2004 Treasury entered into a debt issuance suspension period in order to avoid breaching the statutory debt limit. A debt issuance suspension period is any period for which the Secretary of the Treasury has determined that obligations of the United States may not be issued without exceeding the debt limit. During a debt suspension period, legislation authorizes Treasury various methods to avoid breaching the statutory debt limit. Three of those methods have been employed through November 12, 2004, as described below.

During the debt issuance suspension period starting on October 14, 2004, Treasury has suspended investment of receipts of the Government Securities Investment Fund (G-Fund) of the Federal Employees Retirement System and sales of State and Local Government Series nonmarketable Treasury securities, and reinvestments of the Exchange Stabilization Fund to avoid exceeding the debt limit in accordance with legislation. The statute authorizing the use of these methods also ensures that once the Secretary of the Treasury can make the G-Fund whole without exceeding the public debt limit, he must do so; thus, G-Fund beneficiaries are fully protected and will suffer no adverse consequences from this action. In addition, on November 10, 2004, the Board of the Federal Financing Bank approved a plan to exchange approximately $15 billion of Treasury securities (Federal debt) for debt to the Civil Service fund in accordance with legislation.

15. Air Transportation Stabilization Program

On September 22, 2001, President Bush signed into law the Air Transportation Safety and System Stabilization Act (Public Law 107-42). Title I of Public Law 107-42 established the Air Transportation Stabilization Board (ATSB) to issue federal credit instruments (loan guarantees) 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 Act provides that the Board be composed of the Chairman of the Board of Governors of the Federal Reserve System, the Secretary of Transportation, the Secretary of Treasury, and the Comptroller General of the United States (as a non-voting member) or their designees. The board members are unpaid for their work contribution to the Board. The Board and related staff will exist only as long as necessary to service the loan guarantees.

The ATSB reviewed and made decisions on applications for Federal credit instruments, and was authorized to issue up to $10 billion in loan guarantees through September 30, 2004. The program is governed and accounted for in accordance with the provisions of the Federal Credit Reform Act of 1990, as amended. The present value of subsidy costs are recognized as a cost in the year the guaranteed loan is disbursed. Loan guarantee liabilities are reported at present value.

The subsidy rates vary from 1.43 percent to 3.35 percent. 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 ratings 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.

During FY 2004, one air carrier repaid its loan in full and ATSB guaranteed the loan of one additional air carrier. There were five guaranteed loans outstanding at September 30, 2004 and 2003. The loan guarantee liability balances, and the changes therein as of and for the years ended September 30, 2004 and 2003, are presented in the following table and include the effects of new loan guarantees for, repayments made from, and new bankruptcies filed by various air carriers during the respective fiscal years.

(In Millions)

	FY 2004	FY 2003
Face value of loans outstanding	$1,255	$1,646
Amount guaranteed by the government	$1,122	$1,473
Loans disbursed	$30	$1,218

Schedule for Reconciling Loan Guarantee Liability Balances:

	FY 2004	FY 2003
Beginning balance of the loan guarantee liability	$353	$319
Other subsidy costs	(2)	180
Total of the above subsidy expense components	**351**	**499**
Loan guarantee modifications	(39)	(5)
Fees received	68	61
Interest accumulation on the liability balance	14	15
Ending balance of the loan guarantee liability before reestimates	**394**	**570**
Interest rate reestimate	0	2
Technical/default reestimate	330	(219)
Total of the above reestimate components	**330**	**(217)**
Ending balance of loan guarantee liability	**$724**	**$353**

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. The Act established the District of Columbia Federal Pension Liability Trust Fund (the Trust Fund), to make federal benefit payments and pay necessary administrative expenses for the District of Columbia Police Officers, Firefighters, and Teachers Retirement Plans; and the District of Columbia Judicial Retirement and Survivors Annuity Fund (the Judicial Retirement Fund) to make federal benefit payments and pay necessary administrative expenses of the Judges' Retirement Plan.

Treasury assumed responsibility for all benefits earned for the judges; and benefits earned on or before June 30, 1997, for the police officers, firefighters, and teachers. The Act also established the Federal Supplemental District of Columbia Pension Fund (the Supplemental Fund) that accumulates funds to finance Federal Benefits Payments and necessary administrative expenses for the Police Officers, Firefighters, and Teachers Retirement Plans after funds in the Trust Fund have been depleted. Treasury is required to make annual amortized payments from the General Fund of the Treasury to the Judicial Retirement Fund and the Supplemental Fund. The amount paid into the Supplemental Fund from the General Fund was $270 million during FY 2004 (and $269.2 million during FY 2003). The amount paid into the Judicial Retirement Fund from the General Fund was $7.5 million during FY 2004 (and $6.7 million during FY 2003).

As of September 30, 2004, the assets of the three funds were approximately $4 billion, and liabilities were $8.4 billion, resulting in an unfunded liability of $4.4 billion. (As of September 30, 2003, the assets of the three funds were approximately $4 billion, and liabilities were $8.3 billion, resulting in an unfunded liability of $4.3 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 the Treasury. In FY 2004 and FY 2003, the assumptions for the annual rate of investment return and the annual rate of inflation and cost-of-living adjustments were 6 percent and 3 percent, respectively. In FY 2004, the assumption for the annual rate of salary increases was 6.5 percent for police officers and firefighters, 5.5 percent for teachers, and 3.5 percent for judges. In FY 2003, the assumption for the annual rate of salary increases was 4 percent for all plan members. 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 material adverse effect on the financial statements, except for litigation described below.

Treasury is a party in various administrative proceedings, legal actions, and claims brought by or against it. At September 30, 2004 and 2003, 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 tens of billions of dollars.

Tribal Trust Fund Cases: Thirteen 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 which do not name Treasury as a defendant. It is probable that tribes will file additional suits. 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.

OTHER CONTINGENCIES

***Multilateral Development Banks (MDBs)*:** Treasury has subscribed to additional 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, 2004 and September 30, 2003 U.S. callable capital in MDBs was as follows (in millions):

	FY 2004	FY 2003
African Development Bank	$1,348	$1,268
Asian Development Bank	5,911	5,911
European Bank for Reconstruction and Development	1,555	1,433
Inter-American Development Bank	28,687	28,687
International Bank for Reconstruction and Development	22,642	22,641
Multilaterial Investment Guarantee Agency	285	280
North American Development Bank	1,275	1,275
Total	**$61,703**	**$61,495**

***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 percent 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 declaration of an "act of terrorism" by the Secretary of the Treasury in concurrence with the Secretary of State and the Attorney General.

Commitment to the Republic of Turkey

The Emergency Wartime Supplemental Appropriations Act (PL 108-11), signed by the President on April 16, 2003, included an appropriation of up to $1 billion as the loan subsidy cost for the Republic of Turkey that the United States Government could convert up to $8.5 billion in loans. On September 5, 2003, the U.S. Department of State submitted a Congressional Notification (CN) on use of the $1 billion, including the possibility of an $8.5 billion loan. The fifteen day notification period ended on September 19, 2003, without Congressional objection. On September 22, 2003, the Secretary of the Treasury and the Turkish Economy Minister signed the Financial Agreement (FA) governing this loan.

Under the terms of the FA, the agreement does not become legally effective until the date that both parties complete their internal legal procedures for the ratification of this agreement and inform each other accordingly by an exchange of diplomatic notes. Under Turkish law, the Turkish Council of Ministers must ratify the FA to make it effective. (Under U.S. law, after the CN process and FA signature, there are no other legal requirements for ratifying the FA.) However, the Office of Management and Budget has held that the point of obligation of these funds was the signature of the FA because there are no legal procedures that would preclude the United States Government from exchanging diplomatic notes.

As of November 12, 2004, the Turkish Government had not yet ratified the FA.

18. Liabilities

Liabilities Not Covered by Budgetary and Other Resources

As of September 30, 2004 and September 30, 2003, liabilities not covered by budgetary and other resources consisted of the following (in millions):

	FY 2004	FY 2003
Intra-governmental Liabilities Not Covered by Budgetary & Other Resources:		
Federal Debt Principal, Premium/Discount (Note 14)	$3,055,745	$2,843,322
Other Intra-governmental Liabilities	313	95
Total Intra-gov't Liabilities Not Covered by Budgetary & Other Resources	**3,056,058**	**2,843,417**
Federal Debt Principal, Premium/Discount (Note 14)	4,272,567	3,887,244
DC Pensions Liability (Note 16)	4,420	4,335
Other Liabilities	963	1,039
Total Liabilities Not Covered by Budgetary & Other Resources	**$7,334,008**	**$6,736,035**

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 $4,146 and $4,762 million, respectively, at September 30, 2004 and September 30, 2003 consisted of the following (in millions):

	FY 2004	FY 2003
Actuarial Liability for the Federal Workers Compensation Program (FECA)	$680	$661
Liability for Deposit Funds (Funds Held by the Federal Government for Others) & Suspense Accounts	365	757
ATSB Loan Guarantee Liabilities (Note 15)	724	353
Accrued Funded Payroll and Benefits	297	233
Capital Lease Liabilities	54	106
Accounts Payable & Other Accrued Liabilities (including employee leave)	2,026	2,652
Total	**$4,146**	**$4,762**

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 “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 Treasury of $12,655 and $13,118 million, for the years ended September 30, 2004 and September 30, 2003, respectively. The interest revenue is accrued on inter-agency loans held by BPD on behalf of the General Fund. 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 “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 Treasury. The distribution is also included in “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 $586 and $537 million was recognized, respectively, for the years ended September 30, 2004 and September 30, 2003.

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 suborganizations.

Other Federal costs for the years ended September 30, 2004 and 2003 consisted of the following (in millions):

	FY 2004	**FY 2003**
Temporary State Fiscal Relief/Assistance Fund	$5,000	$5,000
Credit Reform Interest on Uninvested Funds (Intra-governmental)	3,698	3,689
Resolution Funding Corporation	2,187	1,717
Judgments Claims and Contract Disputes	746	1,007
Corporation for Public Broadcasting	437	411
Legal Services Corporation	301	337
Refunds of Moneys Erroneously Received	5	10
Presidential Election Campaign	178	0
All Other Payments	363	688
Total	**$12,915**	**$12,859**

The Temporary State Fiscal Relief /Assistance Fund was established in FY 2003 under Public Law 108-27. Upon submission of certification to the Financial Management Service, payments are made to the governments of States, the District of Columbia and U.S. Territories. Payments are made based upon population.

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.

FY 2004 Presentation Changes

The Government Performance Results Act (GPRA) requires that Federal agencies formulate Strategic Plans, identify major strategic goals, and report performance and costs related to these goals. Under GPRA, Strategic Plans are to be revised and updated every three years. Accordingly, Treasury updated the Department-wide Strategic Plan in FY 2004 and replaced the mission goals applicable in FY 2003 with revised mission goals applicable in FY 2004 and thereafter. The FY 2004 mission goals and categories within each goal are summarized as follows:

1. Economic Program
   a. Promote Prosperous U.S. and World Economies
   b. Promote Stable U.S. and World Economies

2. Financial Program
   a. Preserve the Integrity of Financial Systems
   b. Manage the U.S. Government's Finances Effectively

3. Management Program
   a. Ensure Professionalism, Excellence, Integrity, and Accountability in the Management and Conduct of the Department of the Treasury

OMB Bulletin No. 01-09 "*Form and Content of Agency Financial Statements*" requires that the presentation of the Statement of Net Cost align directly with the goals and outcomes identified in the Strategic Plan. Accordingly, Treasury has presented the earned revenues and gross costs in FY 2004 by the applicable mission goals and categories in Treasury's FY 2004 Strategic Plan and the earned revenues and gross costs for FY 2003 by the applicable mission goals and categories in Treasury's FY 2003 Strategic Plan. As a result, the FY 2004 Consolidated Statement of Net Cost is not comparable to the FY 2003 Consolidated Statement of Net Cost. The more significant changes from FY 2003 to FY 2004 include the following:

1. Removing the FY 2003 Law Enforcement mission goal.
2. Presenting the FY 2003 Costs Not Assigned to Programs as part of the FY 2004 mission goals.

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. and World Economies	Promote Stable 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	FY 2004 Total
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, Tobacco Tax & Trade Bureau	0	53	0	24	0	77
Combined Net Cost	129	1,074	392	10,805	212	12,612
Eliminations & Adjustments		129		(1,171)	210	(832)
Consolidated Net Program Cost		**$1,332**		**$10,026**	**$422**	**$11,780**

20. Consolidating Statement of Net Cost by Sub-organizations (In Millions) (Continued)

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
Program Costs:							
Economic Program:							
Intragovernmental Gross Costs	$0	$0	$68	$0	$0	$0	$0
Less: Earned Revenue	0	0	(139)	0	0	0	0
Intragovernmental Net Costs	0	0	(71)	0	0	0	0
Gross Costs with the public	0	0	2,808	0	0	0	0
Less: Earned Revenue	0	0	(1,581)	0	0	0	0
Net Costs with the public	0	0	1,227	0	0	0	0
Net Cost: Economic Program	**0**	**0**	**1,156**	**0**	**0**	**0**	**0**
Financial Program:							
Intragovernmental Gross Costs	86	77	1,433	22	167	3,374	55
Less: Earned Revenue	(23)	(6)	(2,390)	(1)	(128)	(123)	(6)
Intragovernmental Net Costs	63	71	(957)	21	39	3,251	49
Gross Costs with the public	483	247	685	36	671	7,311	956
Less: Earned Revenue	(502)	(3)	(8)	(1)	0	(163)	(1,058)
Net Costs with the public	(19)	244	677	35	671	7,148	(102)
Net Cost: Financial Program	**44**	**315**	**(280)**	**56**	**710**	**10,399**	**(53)**
Management Program:							
Intragovernmental Gross Costs	0	0	113	0	0	0	0
Less: Earned Revenue	0	0	(746)	0	0	0	0
Intragovernmental Net Costs	0	0	(633)	0	0	0	0
Gross Costs with the public	0	0	850	0	0	0	0
Less: Earned Revenue	0	0	(5)	0	0	0	0
Net Costs with the public	0	0	845	0	0	0	0
Net Cost:Management Program	**0**	**0**	**212**	**0**	**0**	**0**	**0**
Net Cost of Operations	**$44**	**$315**	**$1,088**	**$56**	**$710**	**$10,399**	**($53)**

20. Consolidating Statement of Net Cost by Sub-organizations (In Millions)

For FYE September 30, 2004	Office of the Comptroller of the Currency	Office of the Thrift Supervsion	Alcohol, Tobacco Tax and Trade Bureau	Combined Total	Eliminations and Adjustments	9/30/2004 Consolidated
Program Costs:						
Economic Program:						
Intragovernmental Gross Costs	$11	$2	$22	$103	($9)	$94
Less: Earned Revenue	(2)	(1)	0	(142)	138	(4)
Intragovernmental Net Costs	9	1	22	(39)	129	90
Gross Costs with the public	69	16	32	2,925	0	2,925
Less: Earned Revenue	(84)	(17)	(1)	(1,683)	0	(1,683)
Net Costs with the public	(15)	(1)	31	1,242	0	1,242
Net Cost: Economic Program	**(6)**	**0**	**53**	**1,203**	**129**	**1,332**
Financial Program:						
Intragovernmental Gross Costs	56	21	10	5,301	(1,446)	3,855
Less: Earned Revenue	(10)	(7)	0	(2,694)	275	(2,419)
Intragovernmental Net Costs	46	14	10	2,607	(1,171)	1,436
Gross Costs with the public	337	142	14	10,882	0	10,882
Less: Earned Revenue	(402)	(155)	0	(2,292)	0	(2,292)
Net Costs with the public	(65)	(13)	14	8,590	0	8,590
Net Cost: Financial Program	**(19)**	**1**	**24**	**11,197**	**(1,171)**	**10,026**
Management Program:						
Intragovernmental Gross Costs	0	0	0	113	(16)	97
Less: Earned Revenue	0	0	0	(746)	226	(520)
Intragovernmental Net Costs	0	0	0	(633)	210	(423)
Gross Costs with the public	0	0	0	850	0	850
Less: Earned Revenue	0	0	0	(5)	0	(5)
Net Costs with the public	0	0	0	845	0	845
Net Cost:Management Program	**0**	**0**	**0**	**212**	**210**	**422**
Net Cost of Operations	**($25)**	**$1**	**$77**	**$12,612**	**($832)**	**$11,780**

20. Consolidating Schedule of Net Costs of Treasury by Sub-Organizations (In Millions) (Continued)

For FYE September 30, 2003	Bureau of Engraving and Printing	Bureau of the Public Debt	Departmental Offices	Financial Crimes Enforcement Netwrok	Financial Management Service	Internal Revenue Service
Program Costs:						
Economic Program:						
Intra-governmental Gross Costs	$0	$2	$229	$0	$0	$0
Less: Earned Revenue	0	0	(124)	0	0	0
Intra-governmental Net Costs	0	2	105	0	0	0
Gross Costs with the Public	0	11	2,172	0	0	0
Less: Earned Revenue	0	0	(3,633)	0	0	0
Net Costs with the Public	0	11	(1,461)	0	0	0
Net Cost: Economic Program	**0**	**13**	**(1,356)**	**0**	**0**	**0**
Financial Program:						
Intra-governmental Gross Costs	75	75	3,932	0	169	2,976
Less: Earned Revenue	(38)	(6)	(3,816)	0	(146)	(26)
Intra-governmental Net Costs	37	69	116	0	23	2,950
Gross Costs with the Public	469	238	462	0	364	6,727
Less: Earned Revenue	(480)	(3)	(1)	0	0	(139)
Net Costs with the Public	(11)	235	461	0	364	6,588
Net Cost: Financial Program	**26**	**304**	**577**	**0**	**387**	**9,538**
Law Enforcement Program:						
Intra-governmental Gross Costs	0	0	191	24	0	178
Less: Earned Revenue	0	0	(2)	(2)	0	(82)
Intra-governmental Net Costs	0	0	189	22	0	96
Gross Costs with the Public	0	0	53	30	0	488
Less: Earned Revenue	0	0	0	0	0	(1)
Net Costs with the Public	0	0	53	30	0	487
Net Cost: Law Enforcement Program	**0**	**0**	**242**	**52**	**0**	**583**
Total Program Costs, Net	**26**	**317**	**(537)**	**52**	**387**	**10,121**
Costs Not Assigned to Programs:						
Intra-governmental	0	0	140	0	0	0
With the Public	0	0	1,051	0	0	0
Less: Earned Revenue Not Attributed to Program:						
Intra-governmental	0	0	(689)	0	0	0
With the Public	0	0	(1)	0	0	0
Net Cost of Continuing Operations	**$26**	**$317**	**($36)**	**$52**	**$387**	**$10,121**

20. Consolidating Schedule of Net Costs of Treasury by Sub-Organizations (In Millions)

For FYE September 30, 2003

	U.S. Mint	Office of the Comptroller of the Currency	Office of Thrift Supervision	Alcohol, Tobacco Tax & Trade Bureau	Combined Total	Eliminations & Adjustments	9/30/2003 Consolidated
Program Costs:							
Economic Program:							
Intra-governmental Gross Costs	$0	$67	$22	$0	$320	($9)	$311
Less: Earned Revenue	0	(10)	(8)	0	(142)	138	(4)
Intra-governmental Net Costs	0	57	14	0	178	129	307
Gross Costs with the Public	0	384	136	0	2,703	1	2,704
Less: Earned Revenue	0	(456)	(161)	0	(4,250)	0	(4,250)
Net Costs with the Public	0	(72)	(25)	0	(1,547)	1	(1,546)
Net Cost: Economic Program	**0**	**(15)**	**(11)**	**0**	**(1,369)**	**130**	**(1,239)**
Financial Program:							
Intra-governmental Gross Costs	61	0	0	25	7,313	(2,516)	4,797
Less: Earned Revenue	(4)	0	0	0	(4,036)	806	(3,230)
Intra-governmental Net Costs	57	0	0	25	3,277	(1,710)	1,567
Gross Costs with the Public	817	0	0	23	9,100	(1)	9,099
Less: Earned Revenue	(867)	0	0	(1)	(1,491)	1	(1,490)
Net Costs with the Public	(50)	0	0	22	7,609	0	7,609
Net Cost: Financial Program	**7**	**0**	**0**	**47**	**10,886**	**(1,710)**	**9,176**
Law Enforcement Program:							
Intra-governmental Gross Costs	0	0	0	0	393	(150)	243
Less: Earned Revenue	0	0	0	0	(86)	84	(2)
Intra-governmental Net Costs	0	0	0	0	307	(66)	241
Gross Costs with the Public	0	0	0	0	571	1	572
Less: Earned Revenue	0	0	0	0	(1)	0	(1)
Net Costs with the Public	0	0	0	0	570	1	571
Net Cost: Law Enforcement Program	**0**	**0**	**0**	**0**	**877**	**(65)**	**812**
Total Program Costs, Net	**7**	**(15)**	**(11)**	**47**	**10,394**	**(1,645)**	**8,749**
Costs Not Assigned to Programs:							
Intra-governmental	0	0	0	0	140	(17)	123
With the Public	0	0	0	0	1,051	0	1,051
Less: Earned Revenue Not Attributed to Programs:							
Intra-governmental	0	0	0	0	(689)	266	(423)
With the Public	0	0	0	0	(1)	0	(1)
Net Cost of Continuing Operations	**$7**	**($15)**	**($11)**	**$47**	**$10,895**	**($1,396)**	**$9,499**

20. Total Cost and Earned Revenue by Federal Budget Functional Classification (In Millions)

For Fiscal Year Ended September 30, 2004

Budget Functions	Gross Cost - Public	Gross Cost - Federal	Intra-Departmental Eliminations	FY 2004 Total Gross Cost
Education and Training	$444	$0	$0	$444
Income Security	539	4	(4)	539
Veterans Benefits	336	0	0	336
Commerce and Housing	2,752	90	(6)	2,836
Community and Regional Development	43	9	(4)	48
Net Interest	158,321	164,138	(317)	322,142
International Affairs	2,439	33	(2)	2,470
Administration of Justice	105	83	(30)	158
General Government	17,216	9,009	(1,438)	24,787
Total Gross Cost	**$182,195**	**$173,366**	**($1,801)**	**$353,760**

Budget Functions:	Gross Earned Revenue - Public	Gross Earned Revenue - Federal	Intra-Departmental Eliminations	FY 2004 Total Gross Earned Revenue
Income Security	$1	$180	($180)	$1
Commerce and Housing	659	20	(16)	663
Community and Regional Development	2	0	0	2
Net Interest	0	12,654	(1,154)	11,500
International Affairs	1,590	119	(116)	1,593
Administration of Justice	0	1	(1)	0
General Government	1,729	3,261	(326)	4,664
Total Gross Cost	**$3,981**	**$16,235**	**($1,793)**	**$18,423**

Budget Functions:	Total Gross Cost	Total Gross Earned Revenue	FY 2004 Total Net Cost
Education and Training	$444	$0	$444
Income Security	539	1	538
Veterans Benefits	336	0	336
Commerce and Housing	2,836	663	2,173
Community and Regional Development	48	2	46
Net Interest	322,142	11,500	310,642
International Affairs	2,470	1,593	877
Administration of Justice	158	0	158
General Government	24,787	4,664	20,123
Total Gross Cost	**$353,760**	**$18,423**	**$335,337**

20. Total Cost and Earned Revenue by Federal Budget Functional Classification (In Millions)

For Fiscal Year Ended September 30, 2003

Budget Functions:	Gross Cost - Public	Gross Cost - Federal	Intra-Departmental Eliminations	FY 2003 Total Gross Cost
Education and Training	$417	$0	$0	$417
Veterans Benefits	337	0	0	337
Commerce and Housing	2,238	89	(5)	2,322
Community and Regional Development	78	7	(4)	81
Net Interest	156,797	157,710	(339)	314,168
International Affairs	2,106	219	(2)	2,323
Administration of Justice	1,704	836	(163)	2,377
General Government	17,261	11,419	(2,563)	26,117
Total Gross Cost	**$180,938**	**$170,280**	**($3,076)**	**$348,142**

Budget Functions:	Gross Earned Revenue - Public	Gross Earned Revenue - Federal	Intra-Departmental Eliminations	FY 2003 Total Gross Earned Revenue
Commerce and Housing	$617	$18	($15)	$620
Community and Regional Development	2	0	0	2
Net Interest	0	13,131	(1,714)	11,417
International Affairs	3,631	133	(124)	3,640
Administration of Justice	26	89	(57)	58
General Government	1,512	4,802	(1,157)	5,157
Total Gross Earned Revenue	**$5,788**	**$18,173**	**($3,067)**	**$20,894**

Budget Functions:	Total Gross Cost	Total Gross Earned Revenue	FY 2003 Total Net Cost
Education and Training	$417	$0	$417
Veterans Benefits	337	0	337
Commerce and Housing	2,322	620	1,702
Community and Regional Development	81	2	79
Net Interest	314,168	11,417	302,751
International Affairs	2,323	3,640	(1,317)
Administration of Justice	2,377	58	2,319
General Government	26,117	5,157	20,960
Total Gross Cost, Revenue, and Net Cost	**$348,142**	**$20,894**	**$327,248**

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 Bulletin 01-09, Form and Content of Agency Financial Statements.) The information for the fiscal years ended September 30, 2004 and September 30, 2003 were as follows (in millions):

	FY 2004	FY 2003
Net Amount of Budgetary Resources Obligated for Undelivered Orders	$37,557	$30,931
Available Borrowing and Contract Authority at the end of the period	$5,720	$5,718
Adjustments During the Reporting Period to Budgetary Resources, Available at the Beginning of the Year	$59	$42

The *Budget of the United States* (also known as the President's Budget), with actual numbers for FY 2004, was not published at the time that these financial statements were issued. The President's Budget is expected to be published in January 2005. It will be available from the United States Government Printing Office.

The following chart displays the differences between the Combined Statement of Budgetary Resources (SBR) in the FY 2003 Performance and Accountability Report and the actual FY 2003 balances included in the FY 2005 President's Budget (PB).

Reconciliation of FY 2003 Budgetary Resources
Reconciliation to the Presidents Budget (in Millions)

	Budgetary Resources	Outlays	Offsetting Receipts
Statement of Budgetary Resources	**$428,562**	**$343,739**	**$1,269**
Included in the President's Budget (PB) but not in the Statement of Budgetary Resources (SBR):			
Divested entities included in PB for all of FY 2003 (1)	(2,568)	(2,420)	
Treasury resources shown in non-Treasury chapters of the PB (2)	(50,738)	(2,147)	
IRS non-entity tax credit payments (3)	41,719	41,719	
IRS collections for Puerto Rico	357	357	
Non-Treasury offsetting receipts included in Treasury chapter of PB (4)			12,028
Treasury offsetting receipts considered to be "General Fund" transactions for reporting purposes (5)			4,927
Subtotal	**(11,230)**	**37,509**	**16,955**
Included in the SBR but not in the PB:			
Offsetting collections net of collections shown in other chapters of PB (e.g., divested bureaus)	(6,767)		
Treasury offsetting receipts shown in other chapters of PB			(196)
Unobligated Balance Carried Forward, recoveries of prior years funds, and expired accounts	(2,118)		
Exchange Stabilization Fund resources not shown in PB	(22,134)	3,168	
Other	(191)	864	89
Subtotal	**(31,210)**	**4,032**	**(107)**
President's Budget Amounts*	**$386,122**	**$385,280**	**$18,117**

1. The President's Budget reflects bureaus divested as a result of the Homeland Security Act as though they were part of the new department from October 1, 2002 rather than the actual date of divestiture.

2. The largest of these is Treasury's International Assistance Programs ($46,724).

3. 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.

4. These are other agencies' receipt accounts that are managed by those other agencies and that Treasury believes should be reported in those agencies' financial statements.

5. These are receipt accounts that Treasury manages on behalf of other agencies and considers to be "General Fund" receipts rather than receipts of the Treasury reporting entity.

*Per President's Budget for FY 2005 - Budgetary Resources and Outlays are from the Analytical Perspective, and Offsetting Recceipts are from the Appendix.

NOTE: The reporting for the items described in notes 4 and 5 above is under review by OMB and may be subject to change in future years.

Legal Arrangements Affecting Use of Unobligated Balances

Included in FY 2004 cumulative results of operations is $83.2 million that represents the Internal Revenue Service's authority to assess and collect user fees relating to services provided for processing installment agreements. In FY 2003, IRS reported $60.9 million in the cumulative results of operations.

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, were as follows for the fiscal years ended September 30, 2004 and September 30, 2003 (in millions):

	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**

	Tax Year				
	2003	**2002**	**2001**	**Pre-2001**	**2003 Collections**
Individual Income and FICA Taxes	$1,097,960	$547,938	$13,128	$11,248	$1,670,274
Corporate Income Taxes	124,349	59,471	853	9,591	194,264
Estate and Gift Taxes	135	18,654	1,316	2,722	22,827
Excise Taxes	49,602	18,198	106	358	68,264
Railroad Retirement Taxes	3,297	1,060	0	2	4,359
Duties	8,334	0	0	0	8,334
Unemployment Taxes	4,861	1,655	33	86	6,635
Federal Reserve Earnings	15,998	5,880	0	0	21,878
Fines, Penalties, Interest & Other Revenue	1,484	700	1	2	2,187
Subtotal	**$1,306,020**	**$653,556**	**$15,437**	**$24,009**	**$1,999,022**
Less Amounts Collected for Non-Federal Entities					(403)
Total					**$1,998,619**

FY 2003 collections include duties collected by the U.S. Customs Service prior to being transferred to the Department of Homeland Security on March 1, 2003, and amounts collected by the Bureau of Alcohol, Tobacco and Firearms prior to being transferred to the Department of Justice on January 24, 2003.

Amounts reported for Corporate Income Taxes collected in FY 2004 include corporate taxes of $7 billion for tax year 2005. (Similarly, amounts reported for Corporate Income Taxes collected in fiscal year 2003 include corporate taxes of $5 billion for tax year 2003.) Individual Income and FICA Taxes, includes $63 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 2003 are $62 billion in payroll taxes collected from other federal agencies and $10 billion paid by the employers.)

Amounts Provided to Fund the Federal Government

For the fiscal years ended September 30, 2004 and September 30, 2003, collections of custodial revenue transferred to other entities were as follows (in millions):

	FY 2004	FY 2003
Department of Agriculture	$0	$32
Department of Interior	216	5
General Fund	1,774,704	1,697,496
Total	**$1,774,920**	**$1,697,533**

Amounts Transferred to Government Trust Funds

Revenue collected by the Department for Government Trust Funds (GTF) is deposited into the General Fund, then transferred to the GTF for expenditure by the responsible program agencies. The Department is responsible for managing GTFs, investing all excess trust fund collections, and liquidating securities as funds are needed. The GTFs are reported on the financial statements of the responsible program agencies. Of the amounts transferred to the General Fund, distributions to the GTFs from the General Fund were as follows for the fiscal years ended September 30, 2004 and 2003 (in millions):

Trust Fund:	FY 2004	FY 2003
Airport and Airway Trust Fund	$9,174	$8,684
Federal Disability Insurance Trust Fund	80,211	78,350
Federal Hospital Insurance Trust Fund	162,025	158,157
Federal Old Age & Survivors Trust Fund	479,450	468,354
Highway and Mass Transit Trust Fund	34,694	33,708
Unemployment Trust Fund	39,477	33,209
Other	2,315	2,003
Total Transfers to Trust Funds	**$807,346**	**$782,465**

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, 2004 and September 30, 2003 (in millions):

	Tax Year				
	2004	**2003**	**2002**	**Pre-2002**	**2004 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
Federal Reserve Earnings	0	0	0	0	0
Fines, Penalties, Interest & Other Revenue	49	0	0	0	49
Total	**$2,345**	**$219,506**	**$19,603**	**$36,982**	**$278,436**

	Tax Year				
	2003	**2002**	**2001**	**Pre-2001**	**2003 Refunds**
Individual Income and FICA Taxes	$584	$211,613	$13,074	$7,089	$232,360
Corporate Income Taxes	1,987	11,080	10,767	42,211	66,045
Estate and Gift Taxes	0	248	392	304	944
Excise Taxes	223	350	109	254	936
Railroad Retirement Taxes	0	2	1	8	11
Duties	668	0	0	0	668
Unemployment Taxes	0	70	19	33	122
Miscellaneous	0	0	0	0	0
Total	**$3,462**	**$223,363**	**$24,362**	**$49,899**	**$301,086**

Federal Tax Refunds Payable

As of September 30, 2004 and September 30, 2003, refunds payable to taxpayers consisted of the following (in millions):

	FY 2004	**FY 2003**
Alcohol, Tobacco Tax and Trade Bureau	$7	$0
Internal Revenue Service	1,801	1,193
Total	$1,808	$1,193

Required Supplemental Information (Unaudited)

Introduction

This section provides the Required Supplemental Information as prescribed by Office of Management and Budget (OMB) Bulletin No. 01-09, Form and Content of Agency Financial Statements.

Segment Information

The OMB Bulletin 01-09 requires the reporting of each franchise fund and other intragovernmental 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: Financial Management and Administrative Support; Financial Systems, Consulting and Training; and Consolidated/Integrated Administrative Management.

The following table presents the financial position of the Franchise Fund as of September 30, 2004 and September 30, 2003 (in millions):

	FY 2004	FY 2003
Fund Balance with Treasury	$65	$72
Accounts Receivable	84	66
Property, Plant and Equipment	3	3
Total Assets	**152**	**141**
Accounts Payable	16	18
Other Liabilities	91	88
Total Liabilities	**107**	**106**
Cumulative Results of Operations	**45**	**35**
Total Liabilities and Net Position	**$152**	**$141**

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

	Consolidated/Integrated Admin. Management	Financial Systems, Consulting and Training	Financial Management Admin. Support Services	FY 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)
Excess of Revenues and Financing Sources over Costs	**($9)**	**($2)**	**$2**	**($9)**

	Consolidated/Integrated Admin. Management	Financial Systems, Consulting and Training	Financial Management Admin. Support Services	FY 2003 Total
Costs	$346	$10	$54	$410
Less: Earned Revenue	(352)	(12)	(50)	(414)
Net Cost	(6)	(2)	4	(4)
Other Financing Sources	0	(1)	(2)	(3)
Excess of Revenues and Financing Sources over Costs	**($6)**	**($3)**	**$2**	**($7)**

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 and the excess of revenues and financing sources over costs of the Working Capital Fund for the years ended September 30, 2004 and September 30, 2003 (in millions):

	FY 2004	FY 2003
Fund Balance with Treasury	$181	$171
Accounts Receivable	1	1
Property, Plant and Equipment	12	17
Other Assets	1	1
Total Assets	**195**	**190**
Accounts Payable	7	8
Other Liabilities	188	182
Total Liabilities	**195**	**190**
Cumulative Results of Operations	**0**	**0**
Total Liabilities and Net Position	**$195**	**$190**
Total Costs	**$210**	**$286**
Exchange Revenue	210	286
Other Financing Sources	0	0
Excess of Revenues and Financing Sources over Costs	**$0**	**$0**

Other Claims for Refunds

The Department has estimated that $8.4 billion may be payable as other claims for tax refunds. This estimate represents amounts (principal and interest) that may be paid for claims pending judicial review by the Federal courts or internally. The total estimated payout (including principal and interest) for claims pending judicial review by the Federal courts is $1.7 billion and by Appeals is $6.7 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, 2004 were as follows (in billions):

Gross Unpaid Assessments	$237
Less: Compliance Assessments and Write-offs	(148)
Net Amount	**$89**

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 $237 billion of unpaid assessments, $115 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 $237 billion balance of unpaid assessments, $148 billion represents compliance assessments and write-offs. Write-offs principally consist of amounts owed by deceased, bankrupt or defunct taxpayer's, 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, $33 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-organizations Accounts (In Millions)

	Bureau of Engraving & Printing	Bureau of the Public Debt	Departmental Offices	Fin. Crimes Enforcement Network
Budgetary Resources				
Budget Authority:				
Appropriations Received	$0	$322,047	$4,678	$58
Borrowing Authority	0	0	30	0
Net Transfers (+ or -)	0	0	(809)	0
Unobligated Balance:				
Beginning of Period	111	23	72,439	10
Net Transfers (+ or -)	0	0	(39)	0
Spending Authority from Offsetting Collections:				
Earned:				
Collected	525	9	4,743	2
Receivable from Federal Sources	(1)	0	4	0
Change in Unfilled Customer Orders:	0	0	0	0
Advance Received	(1)	0	(11)	0
Without Advance From Federal Sources	0	0	276	2
Subtotal	**523**	**9**	**5,012**	**4**
Recoveries of Prior Year Obligations	0	8	144	1
Temporarily Not Available Pursuant to Public Law	0	0	(322)	0
Permanently Not Available	0	(177)	(330)	0
TOTAL BUDGETARY RESOURCES	**$634**	**$321,910**	**$80,803**	**$73**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred:				
Direct	$0	$321,890	$11,111	$58
Reimbursable	539	9	1,234	3
Subtotal	539	321,899	12,345	61
Unobligated Balance:				
Apportioned	95	8	13,930	11
Exempt from Apportionment	0	0	44,768	0
Unobligated Balance Not Available	0	3	9,760	1
TOTAL STATUS OF BUDGETARY RESOURCES	**$634**	**$321,910**	**$80,803**	**$73**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS				
Obligated Balance, Net, Beginning of Period	$64	$86	$32,751	$9
Accounts Receivable	(45)	0	(90)	0
Unfilled Customer Orders from Federal Sources	0	0	(480)	(2)
Undelivered Orders	0	21	39,541	12
Accounts Payable	118	78	298	1
Outlays:				
Disbursements	531	321,878	5,404	55
Collections	(524)	(9)	(4,732)	(2)
Subtotal	**7**	**321,869**	**672**	**53**
Less: Offsetting Receipts	0	(5)	(988)	0
NET OUTLAYS	**$7**	**$321,864**	**($316)**	**$53**

(Continued)

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

	Financial Management Service	Internal Revenue Service	U.S. Mint	Office of the Comptroller of the Currency
Budgetary Resources				
Budget Authority:				
Appropriations Received	$15,021	$10,328	$0	$0
Borrowing Authority	0	0	0	0
Net Transfers (+ or -)	0	0	0	0
Unobligated Balance:				
Beginning of Period	265	473	38	340
Net Transfers (+ or -)	0	0	0	0
Spending Authority from Offsetting Collections:				
Earned:				
Collected	198	173	988	507
Receivable from Federal Sources	(6)	0	1	1
Change in Unfilled Customer Orders:	0	0	0	0
Advance Received	0	0	0	0
Without Advance From Federal Sources	12	0	0	0
Subtotal	**204**	**173**	**989**	**508**
Recoveries of Prior Year Obligations	27	154	0	0
Temporarily Not Available Pursuant to Public Law	0	0	0	0
Permanently Not Available	(1,532)	(137)	(4)	0
TOTAL BUDGETARY RESOURCES	**$13,985**	**$10,991**	**$1,023**	**$848**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred:				
Direct	$13,655	$10,250	$0	$0
Reimbursable	187	171	968	450
Subtotal	13,842	10,421	968	450
Unobligated Balance:				
Apportioned	87	179	55	0
Exempt from Apportionment	33	0	0	398
Unobligated Balance Not Available	23	391	0	0
TOTAL STATUS OF BUDGETARY RESOURCES	**$13,985**	**$10,991**	**$1,023**	**$848**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS				
Obligated Balance, Net, Beginning of Period	$469	$1,265	$255	$83
Accounts Receivable	(1)	(19)	(11)	(6)
Unfilled Customer Orders from Federal Sources	(30)	(1)	0	0
Undelivered Orders	101	719	0	16
Accounts Payable	365	462	279	69
Outlays:				
Disbursements	13,843	10,371	955	451
Collections	(198)	(173)	(988)	(507)
Subtotal	**13,645**	**10,198**	**(33)**	**(56)**
Less: Offsetting Receipts	(747)	(88)	0	0
NET OUTLAYS	**$12,898**	**$10,110**	**($33)**	**($56)**

(Continued)

	Office of Thrift Supervsion	Alcohol, Tobacco Tax and Trade Bureau	9/30/2004 Combined Total
Budgetary Resources			
Budget Authority:			
Appropriations Received	$0	$80	$352,212
Borrowing Authority	0	0	30
Net Transfers (+ or -)	0	0	(809)
Unobligated Balance:			
Beginning of Period	159	1	73,859
Net Transfers (+ or -)	0	0	(39)
Spending Authority from Offsetting Collections:			
Earned:			
Collected	182	1	7,328
Receivable from Federal Sources	(1)	1	(1)
Change in Unfilled Customer Orders:			
Advance Received	3	0	(9)
Without Advance From Federal Sources	0	0	290
Subtotal	184	2	7,608
Recoveries of Prior Year Obligations	2	2	338
Temporarily Not Available Pursuant to Public Law	0	0	(322)
Permanently Not Available	0	0	(2,180)
TOTAL BUDGETARY RESOURCES	**$345**	**$85**	**$430,697**
STATUS OF BUDGETARY RESOURCES			
Obligations Incurred:			
Direct	$0	$82	$357,046
Reimbursable	176	2	3,739
Subtotal	176	84	360,785
Unobligated Balance:			
Apportioned	0	0	14,365
Exempt from Apportionment	169	0	45,368
Unobligated Balance Not Available	0	1	10,179
TOTAL STATUS OF BUDGETARY RESOURCES	**$345**	**$85**	**$430,697**
RELATIONSHIP OF OBLIGATIONS TO OUTLAYS			
Obligated Balance, Net, Beginning of Period	$23	$13	$35,018
Accounts Receivable	0	(1)	(173)
Unfilled Customer Orders from Federal Sources	0	0	(513)
Undelivered Orders	4	16	40,430
Accounts Payable	24	8	1,702
Outlays:			
Disbursements	171	70	353,729
Collections	(185)	(1)	(7,319)
Subtotal	**(14)**	**69**	**346,410**
Less: Offsetting Receipts	0	0	(1,828)
NET OUTLAYS	**($14)**	**$69**	**$344,582**

Deferred Maintenance

In FY 2004, the Department has 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, and Transfers In/Out

Intra-governmental Assets
(In Millions)

Partner Agency	Due from the General Fund	Loans and Interest Receivable	Advances to the Black Lung Trust Fund	Accounts Receivable and Related Interest	Other
Department of Agriculture 12		$68,436		$8	
Department of Commerce 13		274			
Department of Interior 14		1,305		105	$1
Department of Justice 15		20		5	5
Department of Labor 1601			$8,741	1	
U.S. Postal Service 18		1,800		2	2
Fed. Communications Commission 27		3,941			
Smithsonian Institution 33		20			
General Services Administration 47		2,249		132	1
Securities and Exchange Commission 50				1	
Railroad Retirement Board 60		3,027			
Environmental Protection Agency 68		24		20	
Department of Transportation 69		1,114		2	
Department of Homeland Security 70		8		6	
Agency for International Development 72		121		3	
Small Business Administration 73		8,604			
Department of Health and Human Services 75				23	
Export/Import Bank of the US 83		7,237			
Department of Housing & Urban Develop. 86		10,103			
Department of Energy 89		2,914		94	
Department of Education 91		96,652			
Department of Defense (DE00)		1,556		187	1
All Other 9500		4,660		43	2
General Fund 99	$7,420,492				
Totals	**$7,420,492**	**$214,065**	**$8,741**	**$632**	**$12**

On the Department's Balance Sheet, "Due to the General Fund" is netted against "Due from the General Fund." See intra-governmental liabilities on the next page and Financial Statements Note 4.

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

Intra-governmental Liabilities
(In Millions)

Partner Agency	Due to the General Fund	Federal Debt & Interest Payable	Other
Unknown 00		$32	$3
Department of Agriculture 12		58	1
Department of Commerce 13			(2)
Department of Interior 14		6,165	
Department of Justice 15		932	(2)
Department of Labor 1601		46,025	132
Pension Benefit Guarantee Corp 1602		15,708	
U.S. Postal Service 18		1,283	
Department of State 19			22
Office of Personnel Management 24		679,904	41
National Credit Union Administration		6,272	
Fed. Communications Commission 27		30	
Social Security Administration 28		1,657,712	
Department of Veterans Affairs 36			14
General Services Administration 47			9
Federal Deposit Insurance Corporation 51		48,935	
Railroad Retirement Board 60		1,304	
Environmental Protection Agency 68		4,535	
Department of Transportation 69		20,567	
Department of Homeland Security 70		1,629	36
Agency for International Development 72			8
Department of Health and Human Services 75		287,887	12
Farm Credit Administration 7801		18	
Farm Credit Insurance Corporation 7802		2,096	
National Aeronautics Space Administration 80		17	
Department of Housing & Urban Development 86		31,029	2
Department of Energy 89		21,678	
Department of Education 91			5
Department of Defense (DE00)		228,307	5
All Other 9500		35,826	15
General Fund 99	$276,436		634
Totals	**$276,436**	**$3,097,949**	**$935**

On the Department's Balance Sheet, "Due to the General Fund" is netted against "Due from the General Fund." See Intra-governmental assets on previous page and Financial Statements Note 4.

Intra-governmental Earned Revenues from Trade Transactions
(In Millions)

Partner Agency	Exchange Revenue from "Trade Transactions"
Department of Agriculture 12	$12
Department of Commerce 13	5
Department of Interior 14	10
Department of Justice 15	104
Department of Labor 1601	3
U.S. Postal Service 18	20
Office of Personnel Management 24	1
Social Security Admininistration 28	83
Department of Veterans Affairs 36	24
General Services Administration 47	6
Securities and Exchange Commission 50	1
Federal Deposit Insurance Corporation 51	2
Railroad Retirement Board 60	1
Environmental Protection Agency 68	1
Department of Transportation 69	7
Department of Homeland Security 70	43
Agency for International Development 72	20
Department of Health and Human Services 75	41
National Aeronautics Space Administration 80	1
Department of Housing & Urban Development 86	8
Department of Energy 89	2
Department of Education 91	1
Department of Defense (DE00)	337
All Other 9500	21
Totals	**$754**

Note: Total intra-governmental revenue from trade transactions is a component of intra-governmental earned revenue displayed on the Consolidated Statement of Net Cost. Accordingly, intra-governmental earned revenue displayed in this table will not equal total earned revenue displayed on the Consolidated Statement of Net Cost.

Intra-governmental Non-Exchange Revenues -- Transfers In/Out
(In Millions)

Partner Agency	Transfers In	Transfers Out
Department of Justice 15	$23	$2
Department of Labor 1601	17	17
Department of Transportation 69	4	
Department of Homeland Security 70		22
General Fund 99		83
Totals	**$44**	**$124**

The above does not include distributions of income to the General Fund of the Treasury included on the Department's Statement of Changes in Net Position as "Other" (recorded in SGL 7500).

Cost to Generate Intra-Governmental Earned Revenues from Trade Transactions by Budget Functional Classification
(In Millions)

Budget Functional Classification	Gross Cost to Generate Earned Trade Revenue
Commerce and Housing	$4
International Affairs	2
General Government	748
Total Gross Cost to Generate Trade Revenue	**$754**

Required Supplemental Stewardship Information (Unaudited)

This section provides Required Supplemental Stewardship Information as prescribed by OMB Bulletin No. 01-09, Form and Content of Agency Financial Statements.

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	0	0
Deletions	0	0
Ending Balance	**1**	**1**

No deferred maintenance was reported on these assets.

Other Accompanying Information (Unaudited)

This section provides Other Accompanying Information as prescribed by OMB Bulletin No. 01-09, Form and Content of Agency Financial Statements.

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 1980's, that the annual Federal gross tax gap is somewhere between $300 billion and $350 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).

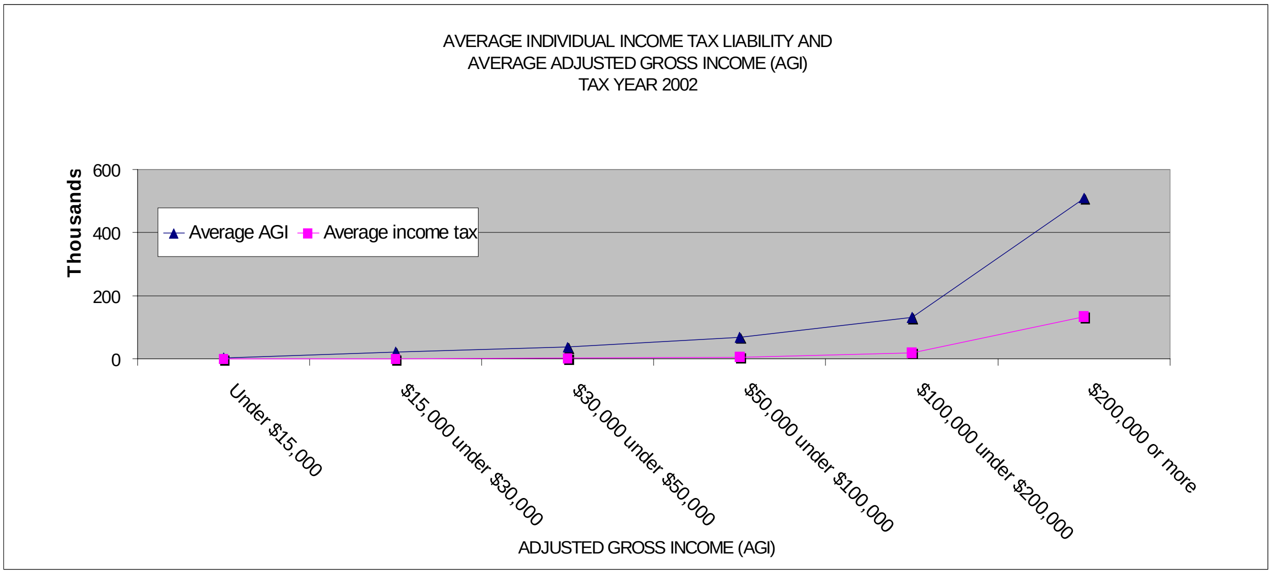
The collection gap is the cumulative amount of assessed tax, penalties, and interest that the Service expects to remain uncollectible. In essence, it represents the difference between the total balance of unpaid assessments and the net taxes receivable reported on the Service's balance sheet. The tax 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).

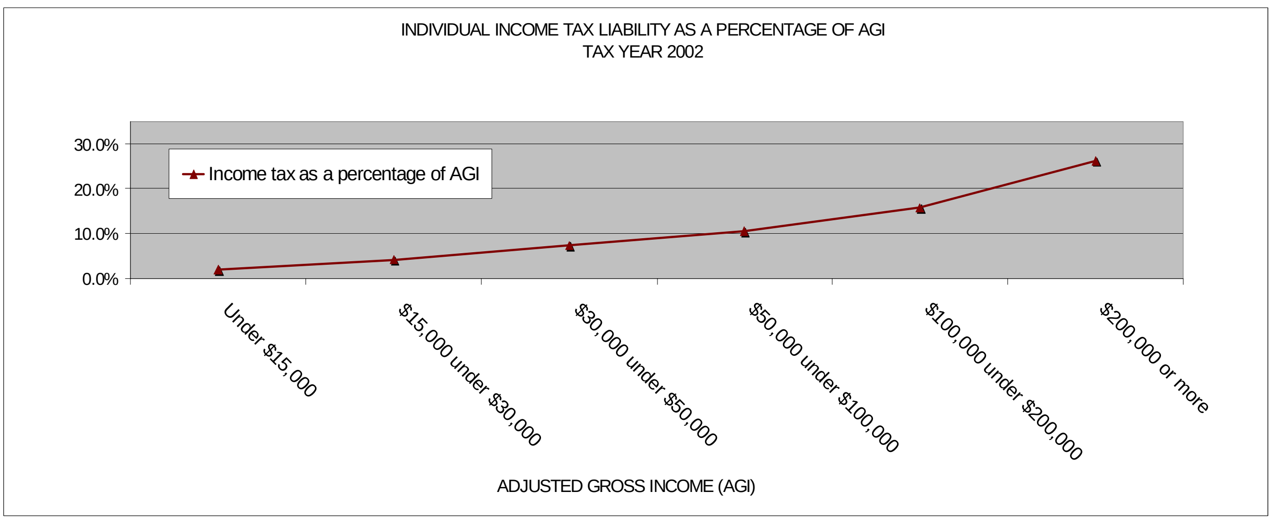
Tax Burden

(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.

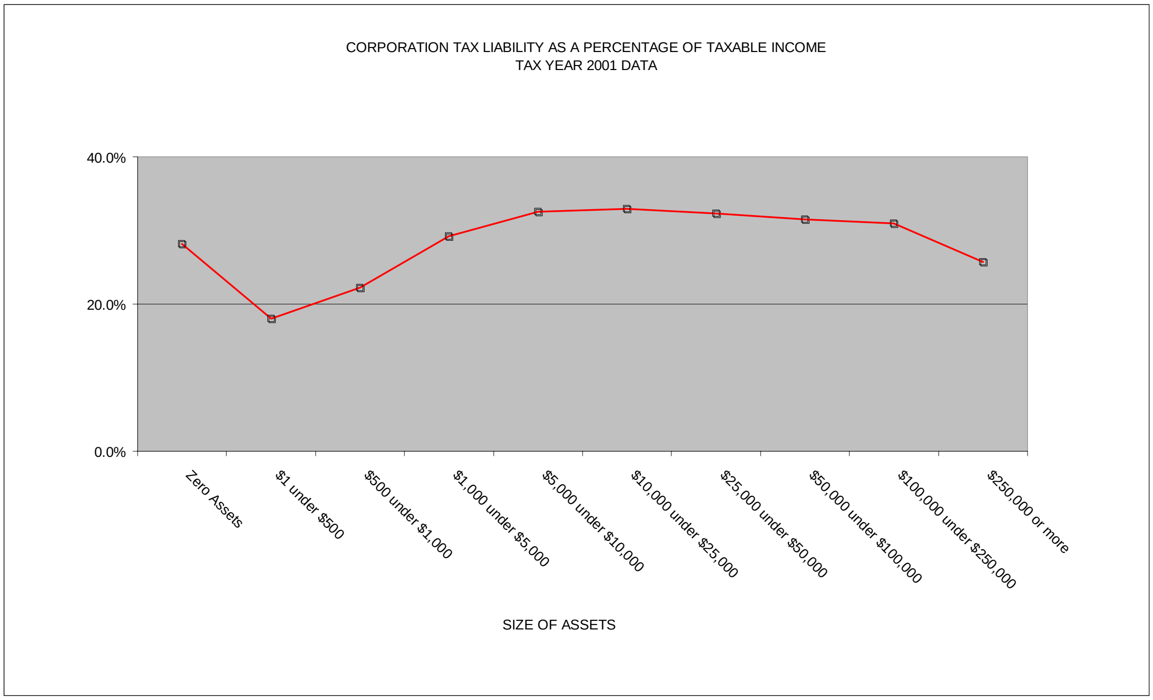
Individual Income Tax Returns (Tax Year 2002 Data)





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............................	38,133	211,417	3,942	5,544	103	1.9%
$15,000 under $30,000................	29,964	657,946	27,621	21,958	922	4.2%
$30,000 under $50,000................	24,556	959,677	70,761	39,081	2,882	7.4%
$50,000 under $100,000..............	26,687	1,864,379	196,005	69,862	7,345	10.5%
$100,000 under $200,000............	8,442	1,112,924	175,904	131,834	20,837	15.8%
$200,000 or more.........................	2,419	1,233,062	323,558	509,695	133,745	26.2%
Total..	130,201	6,039,405	797,791	-	-	-

Corporation Income Tax Returns (Tax Year 2001 Data)

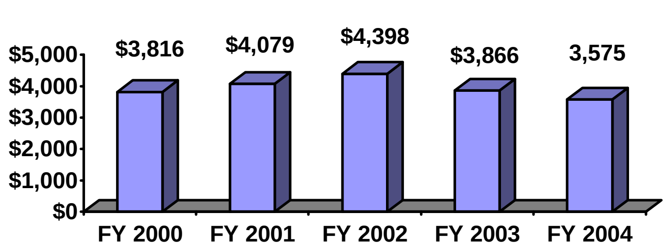


Total Assets (in thousands)	Income subject to tax (in millions)	Total income tax after credits (in millions)	Percentage of income tax after credits to taxable income
Zero Assets............................	12,101	3,410	28.2%
$1 under $500........................	9,232	1,662	18.0%
$500 under $1,000.................	4,624	1,027	22.2%
$1,000 under $5,000..............	13,786	4,031	29.2%
$5,000 under $10,000............	7,091	2,310	32.6%
$10,000 under $25,000..........	10,330	3,399	32.9%
$25,000 under $50,000..........	8,945	2,892	32.3%
$50,000 under $100,000........	10,711	3,379	31.5%
$100,000 under $250,000......	20,613	6,378	30.9%
$250,000 or more...................	537,824	138,224	25.7%
Total......................................	635,257	166,712	26.2%

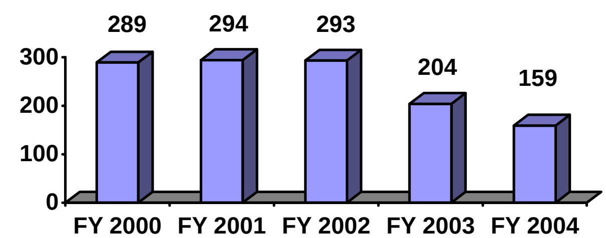
Prompt Payment

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 percentage of the dollar amount of interest penalties paid has remained below 0.01 percent since FY 2002.

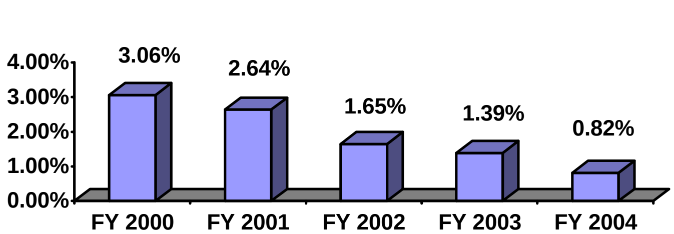
Total Invoices Paid Dollar Amount (in Millions)



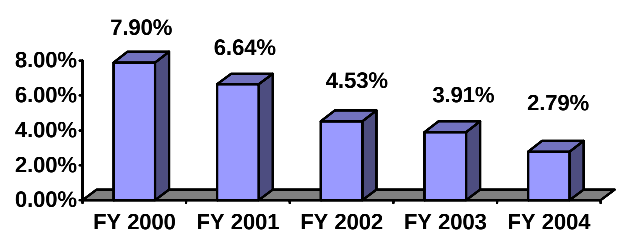
Total Invoices Paid Number (in Thousands)



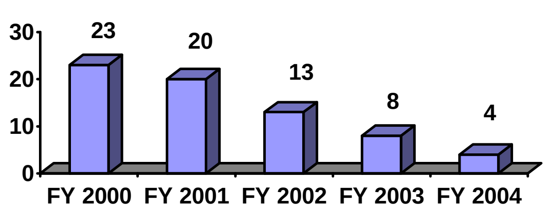
Percentage of Number of Interest Penalties Paid



Percentage of Invoices Paid Late



Total Invoices Paid Late Number (in Thousands)



Biennial Review Of Treasury "User Fees/Charges"

The Chief Financial Officer (CFO) Act of 1990 and the Office of Management and Budget (OMB) Circular A-25 require agencies to biennially review their user fees/charges to include: (1) assurance that existing charges are adjusted to reflect unanticipated changes in cost or market values; and (2) a review of all agency programs to determine whether fees should be assessed for Governmental goods or services.

During FY 2004, Treasury performed reviews of user fees/charges (approximately 43 separate fees/charges) and of the reviews scheduled and conducted in FY 2004, no significant changes in costs were identified which affect fees or agency activities for which new or increased fees would need to be assessed.

Biennial reviews are intended to identify whether fees assessed by the bureau cover the program and administrative cost associated with the assessed fee/charge. Bureaus are responsible for conducting their reviews, and where the reviews indicate adjustments in the charges are needed, they are to make those changes in the amounts charged in order to cover the costs. In instances where legislative /statutory changes are needed in order to revise the user fee/charge, the bureau is to take action to submit legislative changes proposing increases or decreases in the statutory fee/charge. Each bureau performs reviews that identify the following:

- Type and purpose of user fee/charge;
- Authority of the charge (i.e., Economy Act for reimbursable charges, statutory legislation for user fees, etc.);
- Amount of fee/charge;
- Account where fee is collected; and
- Date of last review.

Management Challenges and High Risk Areas

DEPARTMENT OF THE TREASURY
WASHINGTON

INSPECTOR GENERAL

October 26, 2004

MEMORANDUM FOR SECRETARY SNOW

FROM: Dennis S. Schindel
Acting 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 believe seriously impeded the Department's ability to conduct its program responsibilities and ensure the integrity of its operations. We have dropped one challenge from last year, *Vacant Senior Leadership Positions.* While certain key positions remained or became vacant during the past year and are still a concern, many critical positions were filled. For example, a Deputy Secretary, an Under Secretary for Enforcement, and an Assistant Secretary for Terrorist Financing have been appointed. Additionally, under the leadership of the Deputy Secretary, progress has been made in addressing longstanding problems with the Department's daily business operations, most notably with improvements in information security by its non-Internal Revenue Service (IRS) bureaus. We have recast two of last year's challenges - *Prompt Correction of Material Weaknesses* and *Duplicated, Wasteful Practices.* *Prompt Correction of Material Weaknesses* has been broadened to more appropriately reflect the need for more robust *Corporate Management*, while *Duplicated, Wasteful Practices* has been broadened into *Management of Capital Investments* to better reflect the Department's challenge in managing large, multiyear capital projects. We have also identified a new challenge, *Management of Classified and Other Sensitive Information,* as a result of work our office completed this year. Accordingly, the six current challenges are summarized as follows:

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Challenge 1 - Corporate Management

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 IRS to resolve longstanding material weaknesses and system deficiencies that 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. 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. The mandated consolidated reports on financial statements, internal control, program performance, information systems, and other areas are prime sources used to evaluate Treasury's overall performance in managing its operations.

Challenge 2 - Management of Capital Investments

Treasury needs to better manage large, multiyear acquisitions of systems and other capital investments. The Department has incurred significant cost escalations in its HR Connect system and Treasury and Annex Repair and Restoration (TBARR) projects. A recent audit of TBARR found that the project was not adequately planned at its inception and numerous changes in scope and inefficiencies during renovation have delayed and increased the cost of this project. Another major capital investment that we plan to focus on in the coming years is the Department's transition from the Treasury Communication System to the Treasury Communications Enterprise.

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Challenge 3 - Information Security

The Department continues to face serious challenges in bringing its systems into compliance with information technology security policies, procedures, standards, and guidelines. As reported in our fiscal year 2004 Federal Information Security Act (FISMA) independent evaluation, Treasury's system inventory was not accurate, complete, or consistently reported. There have been major variances in the number of systems reported year-to-year, without adequate reconciliation. The number of systems reported by Treasury decreased from 708 in fiscal year 2003 to 237 in fiscal year 2004. This was primarily due to changes in the methodology for reporting systems at certain bureaus, notably the IRS. Although Treasury reported significant increases in the percentage of systems certified and accredited, from 24 percent to 85 percent, the major swings in inventory and inconsistent methodologies used by bureaus raise doubts as to the extent of real improvement. Effective management of Treasury's information security program also requires clear lines of authority and reporting requirements between the Treasury bureaus and offices and Treasury's Chief Information Officer (CIO). Treasury has taken a positive step in strengthening the role of the CIO by having him report directly to the Deputy Secretary.

Challenge 4 - Linking Resources to Results

The Department has not developed and incorporated managerial cost accounting into its business activities. Thus, financial resources cannot be linked to operating results. This undermines the accuracy, reliability, and usefulness of program performance reporting. Financial management systems need to be integrated with performance measurement and budgetary reporting systems to enable meaningful cost benefit analyses of the Department's programs and operations. Very little progress has been made in this area since the Government Performance and Results Act was passed in 1993.

Challenge 5 - Management of Classified and Other Sensitive Information

Work by our office during the past year disclosed several weaknesses in Treasury's handling and safeguarding of national security and other sensitive information. Taken together, these

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weaknesses constitute a serious deficiency in the operations of the Department that have resulted in unauthorized disclosure of classified information. The Department has developed a plan to address these weaknesses. Among other things, it has completed a risk-based review of certain questioned documents; revised a Treasury Order requiring that designated officials undergo annual mandatory training on processing, marking, and safeguarding classified information; and is in the process of updating another Treasury Order dealing with requests by former and departing employees for documents. Continued attention is needed to address the fragmented authority and accountability for management of such information, including updating security policies, training employees, and re-instituting security compliance programs.

Challenge 6 - 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. Recognizing this, the Department has recently taken several measures to strengthen BSA administration, as well as confront terrorist financing. For example, the Department created the Office of Terrorism and Financial Intelligence (TFI). Additionally, FinCEN, which now 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 with the five federal banking regulators to enhance communication and coordination. Given that these measures are just being implemented, it is too soon to assess their effectiveness. Accordingly, this will be a major focus of our audit program during fiscal years 2005 and 2006, which will include follow-up audits of previously identified BSA

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supervisory weaknesses at the Office of the Comptroller of the Currency and the Office of Thrift Supervision, and FinCEN's administration of various BSA reporting requirements.

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

Attachment

cc: Jesus Delgado-Jenkins
Acting Assistant Secretary for Management

Barry K. Hudson
Acting Chief Financial Officer

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

October 14, 2004

MEMORANDUM FOR SECRETARY SNOW

FROM: Pamela J. Gardiner
Acting Inspector General

SUBJECT: Management and Performance Challenges Facing the Internal Revenue Service for Fiscal Year 2005

The Reports Consolidation Act of 2000[1] requires that we summarize, for inclusion in the *Department of the Treasury Accountability Report for Fiscal Year 2004,* our perspective on the most serious management and performance challenges currently facing the Internal Revenue Service (IRS).

Our assessment of the major IRS management challenge areas for Fiscal Year (FY) 2005 has not changed substantially from the prior year. While the IRS has acted to address each challenge area, we were unable to remove any challenge area from our list at this time. We have, however, removed the subtitles previously included for two areas – Security of the Internal Revenue Service and Integrating Performance and Financial Management. The narrative for each primary category describes the issue as a whole; therefore the subtitles are no longer needed. The ten current challenges are:

Systems Modernization of the Internal Revenue Service

The latest effort to modernize IRS' computer systems, mandated by the IRS Restructuring and Reform Act of 1998 (RRA 98)[2] and started in FY 1999, is expected to take 10 to 15 years at a cost of $7 to $10 billion. The IRS has developed an enterprise architecture to guide the Business Systems Modernization (BSM) program. In addition, the IRS and the PRIME[3] contractor have deployed projects that provide value to taxpayers and have built the infrastructure needed to support these projects. Even so, the IRS and its contractors have drawn increased criticism due to continuing schedule delays and cost increases. To address the results of recent studies, the IRS and the PRIME contractor have developed and are implementing a 48-point action plan that should help improve the BSM program.

[1] Pub. L. No. 106-531.
[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 Prime Systems Integration Services Contractor (PRIME) is the Computer Sciences Corporation, which is responsible for designing new systems to meet IRS business needs, developing these systems, integrating them into the IRS, and ultimately transferring operation of these systems to the IRS.

Tax Compliance Initiatives

The IRS continues to face challenges in administering programs that deal with tax gap issues, especially those resulting from corporate and high-income individual taxpayer corrosive activities as well as domestic and off-shore tax and financial criminal activity. The IRS is revising its compliance program by reengineering the collection and examination practices, and we have noted some improvements. However, without the proposed FY 2005 budget relief for additional Collection function staffing and legislation to allow some cases to be worked by contract staff, a significant number of cases will remain unworked. The Examination function staffing decreased during FY 2003; however, the percent of tax returns examined increased. Still, the number of corporate tax return examinations continued the decline that started in FY 1997, decreasing a total of 67 percent since that time. We also noted that the Tax Exempt and Government Entities (TE/GE) Division must develop better research tools, improve training to trace funds through complex transactions, and enhance and leverage available electronic data to address heightened concerns that charities are being used to fund terrorists and other illegal activities. The President's FY 2005 budget includes funding to address some of these issues.

Security of the Internal Revenue Service

For the last 3 years, TIGTA assessments have concluded that the security infrastructure and the applications that guard sensitive data are weak because of inadequate accountability and security awareness as well as insufficient training for key security employees. The end result is that the IRS still does not have an organizational culture that places strong emphasis on the security and privacy of taxpayer data. For example, additional work remains in certifying its many computer systems; sensitive technology information was posted on the Internet; some equipment, when synchronized to a network computer, provided a backdoor into the network and could bypass existing security detection controls; and centralizing security issues under the Mission Assurance organization could encourage complacency in other IRS offices. In addition, some disaster recovery plans require additional development, testing, or personnel training to assure that the IRS can quickly recover in the event of a disaster.

Integrating Performance and Financial Management

The IRS recently issued its 5-year strategic plan for FYs 2005-2009, building on its first plan issued in January 2001. In addition, during the FY 2005 budget formulation process, the IRS took the important step of aligning performance and resources requested, and modified its budget and performance plans to include more customer-focused and "end results" measures. Still, the IRS has had mixed success in establishing its long-term goals. We believe the IRS must continue to integrate performance into its decision-making and resource allocation processes to completely achieve an integrated performance budget. The IRS' financial statements and related activities also continue to be of concern to IRS stakeholders. In its audit of the financial statements, the Government Accountability Office identified some continuing serious deficiencies in the IRS financial systems, including control weaknesses and system deficiencies affecting financial reporting, unpaid tax assessments, tax revenue and refunds, and computer security.

Complexity of the Tax Law

Tax administration comprises approximately 80 percent of the overall paperwork burden imposed by the Federal Government. Simplifying the tax process could include a range of actions from developing legislative recommendations to clarifying tax instructions or forms. Computer modernization, too, has a role in simplifying the tax process. For example, the current *e-file* system can be modernized to provide a single standard for filing electronic tax returns with the IRS, allowing transmittal of multiple return types in the same transmission. Complexity has also given rise to the latest generation of abusive tax avoidance transactions, with taxpayers attempting to take advantage of the tax code's length and complexity by combining a myriad of technical rules to claim tax benefits not intended by the Congress.

Providing Quality Customer Service Operations

Every year, the IRS helps millions of taxpayers understand their tax obligations by answering questions over toll-free telephone lines or in person at local offices, making information available on its Web site, and responding to correspondence. The IRS' success rate in implementing these efforts has been mixed. For example, during the 2004 Filing Season, the IRS provided taxpayers with effective and improved access to its toll-free telephone system, providing over 872,000 more toll-free telephone services to taxpayers than in the prior year. While Customer Service Representatives exceeded goals in professionalism and timeliness, they provided taxpayers with accurate answers in only 62 percent of the calls monitored. In addition, the success of IRS' Kiosk Program, an effort initiated in 1998 to broaden taxpayer use of a convenient electronic channel for obtaining information, cannot be measured since there are no guidelines or processes in place to efficiently and effectively monitor the Program. If some of the traditional prefiling work of assisting taxpayers at the Taxpayer Assistance Centers (TAC) could largely be accomplished through an effective Kiosk Program, IRS could refocus TAC resources to providing face-to-face assistance to taxpayers with compliance issues.

Erroneous and Improper Payments

For the IRS, improper and erroneous payments are generally associated with refund and filing fraud issues as well as vendor or contractor overpayments. The availability of certain tax credits, such as the Earned Income Tax Credit (EITC), the Disabled Access Credit, and the Education Credit, increases the possibility for abuse. Improper use of the EITC, a refundable credit available to taxpayers with certain limited earned income and a qualifying child, has resulted in a significant loss of tax revenue. An IRS compliance study of TY 1999 returns estimated between $8.5 and $9.9 billion (27 to 32 percent) of the $31 billion in EITC claimed for TY 1999 should not have been paid. Recent audits revealed that not all data available to the IRS is used to validate EITC claims. We identified instances in which IRS processed returns with taxpayers claiming as dependent children persons who were older than the primary taxpayer and returns improperly using a deceased individual's social security number. In addition to tax refund issues, recent TIGTA audits revealed instances where contract expenditures, representing a significant outlay of IRS funds, were unreasonable or unallowable. In our opinion, the IRS needs to strengthen its invoice review process by routinely requesting and reviewing a sample of supporting documents.

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

Overall, the 2004 Filing Season was successful and most of the 123.1 million individual income tax returns received through May 2004 (including over 60 million received electronically, an increase of nearly 16 percent over 2003) were timely and accurately processed. However, we are continuing to identify tax law changes from prior years that have not been correctly implemented and could result in loss of taxpayer entitlements and erroneous tax reductions.

Taxpayer Protection and Rights

The IRS has dedicated significant attention and resources toward implementing the 12 provisions of the RRA 98 that increase or further protect taxpayers' rights. The IRS was in full compliance with the following taxpayer rights provisions:

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

The IRS did not remove all *Illegal Tax Protestor 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 Levy.*
- *Notice of Lien.*
- *Notice of Seizure.*
- *Assessment Statute of Limitations.*

Neither the TIGTA nor the IRS could evaluate the IRS' compliance with three RRA 98 provisions since IRS management information systems do not track the specific cases:

- *Restrictions on directly contacting taxpayers instead of authorized representatives.*
- *Taxpayer complaints.*
- *Separated or divorced joint filer requests.*

Human Capital

The IRS' ability to meet program requirements and the expectations of both external and internal customers is in jeopardy because of substantial loss of experience in some occupations. For example, the Small Business/Self-Employed and the Large and Mid-Size Business Divisions reported in the FY 2006 strategic assessments that the human capital crisis continues to intensify as employees in key occupational series increasingly become retirement eligible, are lost through attrition, or migrate to other areas. Stagnant funding allocations have impacted the ability to attract new hires and retain existing employees. The TE/GE Division is already understaffed for its current volume of customer calls, and without additional staffing or system enhancements, the level of service will deteriorate. In contrast, the Wage and Investment Division and the Criminal Investigation function have reported significant progress in the human capital area.

The Office of Audit's FY 2005 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) 622-6510.

cc: Assistant Secretary for Management (Acting)

Treasury FY 2004 Activities to Address Management Challenges and High Risk Areas

This section identifies the major management challenges and high-risk areas facing the Department of Treasury and its bureaus as identified by various audit organizations and their respective reports listed below:

- General Accounting Office (GAO), "Major Management Challenges and Program Risks – Department of the Treasury," dated January 2003.
- Office of the Inspector General (OIG), "Management and Performance Challenges Facing the Department of the Treasury," dated November 12, 2003.
- Treasury Inspector General for Tax Administration (TIGTA), "Management and Performance Challenges Facing the Internal Revenue Service," dated October 15, 2003.

Included in the tables below are actions taken by the corresponding bureaus during FY 2004 to address the particular challenges. Also included in each section are the actions the bureaus expect to accomplish in the next fiscal year along with a completion date (when appropriate).

1. Management Challenge/High-Risk Area:	**A. Strengthen Information Security (GAO, OIG)** **B. Security of the IRS: Information Systems (TIGTA)**
Issue:	**Strengthening information systems security**
Bureau:	**Departmental Offices (CIO), FMS, IRS**

Actions Taken

During FY 2004, 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 timely submitted its Federal Information Security Management Act (FISMA) report to OMB on October 6th. The report indicates that Treasury's cyber security program improved significantly in FY 2004 by increasing the percentage of information systems certified and accredited from 24% to 86%. This accomplishment exceeded the Treasury PMA goal of certifying and accrediting 70% of its systems by the end of FY 2004. Furthermore, the systems security material weakness at Financial Management Service (FMS) was downgraded at the end of the fiscal year. The material weakness associated with the office of the Chief Information Officer (OCIO) is also expected to be evaluated for a possible downgrade before the calendar year closes. A related Internal Revenue Service (IRS) carryover material weakness is still in the process of being corrected.

FMS has implemented an effective Entity-wide Information Technology (IT) Security Program by taking the following actions:

- Reviewed and updated all system security plans to ensure compliance with NIST guidance.
- Developed and implemented a strategy for Memorandums of Understanding and Interconnection Security Agreements in accordance with NIST standards. All major connections have completed agreements.
- Developed and implemented improved recertification guidelines to include documentation of the application process and identification of least privileges users, high-risk profiles, and multiple IDs and quarterly recertification of powerful users. Annual and quarterly recertifications are completed.
- Approved stricter standards for account removal.
- Developed baseline configurations for all platforms. Implementation is monitored at senior management level.
- Completed the certification and accreditation activities for all major applications and general support systems.
- Conducted on-going disaster recovery tests, including our Enterprise infrastructure and major applications running on the infrastructure.
- Implemented a process to push out patches more efficiently.

As a result of these actions, FMS management has downgraded its computer security material weakness.

The IRS has made steady progress in improving systems security on all fronts during the year. In particular, IRS has expanded its entity-wide security program to encompass greater participation by user offices, thus improving the overall security environment. IRS has taken the following actions:

- Realigned IRS security organizations into a single entity, Mission Assurance, to leverage resources and integrate security activities for more effective delivery of security functions.
- Defined four critical security program areas: Physical, InfoSec, Personnel and Emergency Preparedness/Critical Infrastructure Protection to more effectively focus IRS security activities.
- Aligned IRS systems and networks to OMB A-130, Appendix III and NIST Major Application and General Support System definitions.
- Formed executive-level Emergency Preparedness Working Group, led by Chief, Mission Assurance, to ensure effective engagement of business, IT and security organizations in business resumption, disaster recovery, and safety issues.
- Expanded training, testing and exercise activities for business continuity, including participation in Forward Challenge.
- Continued progress in certification of sensitive systems.
- Improved business engagement in Federal Information Security Management Act of 2002 (FISMA) review process.

Actions Planned or Underway

The Office of Inspector General (OIG) and the Treasury Inspector General for Tax Administration (TIGTA) evaluated Treasury's FISMA compliance and determined that its FISMA system inventory lacks configuration management discipline and contains excessive discrepancies. To that end, Treasury is in the process of establishing a department-wide program which will govern the integrity of the FISMA system inventory and all certification and accreditation policies and procedures. In addition, the OCIO has stepped-up its efforts in evaluating and implementing an automated FISMA solution. This solution will greatly improve department-wide security reporting in FY 2005 and beyond.

Although Treasury achieved significant improvements in its cyber security programs, two other weaknesses related to training were cited for needed improvement. Key managers and employees are not held accountable for carrying out security responsibilities (i.e. Certifying Officials and Designated Accrediting Authorities); and, employees with key security responsibilities have not been adequately trained. Treasury, working closely with the OIG and the TIGTA, will build upon its success with the cyber security symposium and make it an annual event.

Project Matrix, as part of Treasury's Critical Infrastructure Protection (CIP) program, is being conducted in accordance with OMB/DHS guidance and reporting instructions. Project Matrix Step One refresh and Step Two interdependency analyses will be the major focus for our CIP program area in FY 2005.

2. Management Challenge/High-Risk Area:	A. Establish Measures Comparable Over Time and Collect Sufficient Performance Data (GAO) B. Linking Resources to Results/Develop Reliable Cost-Based Performance Information (OIG) (TIGTA)
Issue:	Improvements are needed in linking resources to performance results
Bureau:	Departmental Offices (DCFO DAS/MB), IRS

Actions Taken

Treasury made significant progress in FY 2004 in better linking and integrating budget, financial, and performance data. As a result of these efforts, Treasury was recognized with a Yellow PMA status score. The improvement was a culmination of a year's worth of activities where Treasury built on its new strategic plan. In FY 2004, Treasury worked with bureaus to introduce a new budget submission process, including a new format for its Departmental and OMB budget submissions that provided stronger links between budget and performance information. The new budget submission format also met OMB's requirement for Treasury to show the full cost of its programs; specifically, Treasury focused on a realignment of the Internal Revenue Service budget in order to report full cost information. Treasury also worked with bureaus to dramatically increase the numbers of efficiency measures in its programs to improve operational performance.

Stronger links between employee and bureau performance were also forged with the launch of the Senior Executive Service (SES) performance evaluation system. Plans have also been made to cascade the SES system to senior Treasury managers and beyond. Finally, in late FY 2004, Treasury began implementing a new performance framework which provides performance and financial information along eight specific, cross-cutting "value chains" that encompass all bureaus and programs. Looking ahead, this new framework allows Treasury to leverage existing data to create a broader snapshot of the value that the Department provides the American public as whole rather than consider bureau activities in a vacuum. Treasury will continue implementation of the framework in FY 2005 and beyond.

Progress also continued at the IRS where the following actions were undertaken:

- IRS published its strategic plan for FY 2005 – FY 2009. The plan links the strategic goals and objectives to the performance goals in the Annual Performance Plan and to the budget. Performance data is collected, collated and reported through the Data Mart and Business Performance Management System (BPMS) for most of the IRS's critical measures.
- IRS is continuing to expand use of OMB's PART. A five year-PART plan has been developed with new programs being added each year to reach the goal of 100 % of IRS programs being reviewed in five years.

Actions Planned or Underway

Treasury's new comprehensive performance framework launched in FY 2004 will guide Treasury's efforts to better link budget, financial, and performance data. This includes expanding Treasury managers' access to performance information to shape decisions in all areas of the agency's operations and implement regular, quarterly performance meetings as the framework is rolled out to shape agency and bureau activities. Additional efforts will be undertaken by Treasury to meet with budget and performance stakeholders such as OMB and Congressional representatives and determine an optimal performance budgeting format for the future. Treasury will also work with the OMB to develop appropriate marginal cost reporting and reduce the number of Treasury programs receiving a score of Results Not Demonstrated on their Program Assessment Rating Tool evaluations.

3. Management Challenge/High-Risk Area:	A. Duplicated, Wasteful Practices (OIG)
Issue:	Adapt enterprise solutions to core business activities
Bureau:	Departmental Offices (HR, CIO, DCFO)

Actions Taken

During FY 2004 Treasury made significant progress in implementing and expanding enterprise solutions to core business activities including:

- **HR Connect**. HR Connect, Treasury's state-of-the-art HR system has been deployed in every Treasury bureau except for OTS. A memorandum was issued from the Assistant Secretary for Management/CFO in February 2004 requiring all bureaus to create a plan for self-service functionality to be fully deployed by the end of FY 2004. In early FY 2004, the CareerConnector component of HR Connect was prototyped by IRS. Since then, other bureaus have begun adopting the new recruitment system that centralizes the rating, ranking, and certificate process. As of September 1, 2004, three Treasury bureaus are using the system to conduct automated receipt of applications and on-line rating and ranking. By the Spring of 2005, over 60% of the bureaus are expected to be using Career Connector.
- **Financial Systems**. Enhancements were made to several existing enterprise systems, including three major components of the Financial Analysis and Reporting System (FARS): (1) the Treasury Inventory Executive Repository (TIER), which supports centralized financial reporting and the preparation of consolidated financial statements; (2) the Joint Audit Management Enterprise System (JAMES), which supports the entity-wide tracking of audit issues and material weaknesses; and (3) the Performance Reporting System (PRS), which supports all Treasury reporting tied to GPRA. As part of Treasury's ongoing streamlining effort, 10 Treasury bureaus and reporting entities are being cross-serviced by the Treasury Franchise Fund. Cross-servicing enables smaller bureaus and reporting entities to have access to core financial systems without having to maintain the necessary technical and systems architectures.
- **E-Travel.** Treasury has been in the forefront of General Services Administration's eTravel initiative by awarding the first eTravel service contract in June 2004. Treasury selected GovTrip which was successfully implemented as a pilot at TTB and FinCEN on schedule in September 2004.
- **Treasury Communications Enterprise (TCE) Contract –** Treasury made significant progress in awarding the TCE contract that will be the preferred source of supply for meeting bureau communications requirements. Bureaus will be required to use a waiver process if they do not use the TCE contract.
- **Other Enterprise Solutions –** Treasury has enterprise solutions in place for E-authentication through a Department-wide contract for public key infrastructure (PKI) services and for capital planning and investment control activities by having a Department-wide licensing agreement for ProSight.

Actions Planned or Underway

- **HR Connect.** With the planned deployment of HR Connect at OTS in FY 2005, all Treasury bureaus will have deployed HR connect for personnel processing. HR Connect also migrates onto a single system, several separate HR applications currently managed by Treasury bureaus. These systems will be replaced and retired thus realizing a savings to the Department of about $11.9 million. Treasury plans more aggressive monitoring of bureau legacy systems and sharing the information. Treasury is partnering with OPM in the HR Line of Business initiative with the intent of providing *HR Connect* as a common solution, available for cross-servicing.
- **Financial Systems.** The Treasury Franchise Fund will begin cross-servicing an additional two entities in FY 2005. This will support the Department's plan to reduce the number of core financial systems from 14 to 10.
- **E-Travel.** Treasury will continue with its migration schedule by implementing GovTrip at an additional five Bureaus plus Departmental Offices during the first three quarters of fiscal year 2005, with complete rollout of GovTrip to all Treasury Bureaus by the end of fiscal year 2006.
- **Treasury Communications Enterprise (TCE) Contract –** Treasury will soon award the TCE contract and will work to ensure that bureaus utilize the contract for their communications requirements.
- **Other Enterprise Solutions –** Treasury will work to identify new areas for enterprise solutions and work to ensure that existing enterprise solutions are adopted by the bureaus.

4. Management Challenge/High-Risk Area:	A. Vacant Senior Leadership Positions (OIG)
Issue:	Key, senior leadership positions vacant and leadership turnover
Bureau:	Departmental Offices
Actions Taken	
Treasury filled several key senior leadership positions in FY 2004, including the Deputy Secretary, General Counsel, and Under Secretary for Enforcement. Individuals were nominated for the Assistant Secretary for Management and the Treasury Inspector General for Tax Administration. This challenge has been removed from the OIG's 2004 management challenges letter.	

5. Management Challenge/High-Risk Area:	A. Prompt Correction of Material Weaknesses (OIG)
Issue:	Take actions to address longstanding material weaknesses and other serious deficiencies in programs and operations
Bureau:	Departmental Offices
Actions Taken	
During FY 2004, 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, the Director of Accounting and Internal Control regularly participated in the Financial and Management Controls Executive Steering Committee meetings, where each of the outstanding material weaknesses were reviewed by senior officials, all key milestone dates are closely examined, and any impediments were addressed and its solutions were sought, overall successes assessed for their currency. 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 believe the goal is in sight. During FY 2004, the FMS has closed one of two of its material weaknesses. This is a net reduction of one out of the nine weaknesses for the Department.	

6. Management Challenge/High-Risk Area:	A. Bring Treasury's Financial Management Systems Into Compliance with Federal Financial Management Improvement Act (FFMIA) (GAO) B. Strengthen FMS' Computer Controls (GAO)
Issue:	Bring Treasury's Financial Management Systems into Compliance with FFMIA
Bureau:	FMS, IRS

Actions Taken

Treasury continued to make progress in correcting non-compliance with the FFMIA. The material weakness in general computer controls prevented FMS from being in substantial compliance with FFMIA in FY 2003. During FY 2004, FMS implemented its FFMIA remediation plan and management has determined that FMS is now in substantial compliance with the Act. Further details are provided in Management Challenge #1.

IRS continued to make progress with key financial systems efforts:

- Continued implementation of the Custodial Accounting Project (CAP). The development and testing work has been completed for Releases 1.0 and 1.1.
- Systems Acceptance Testing (SAT) is continuing on Release 1.2.
- Certification and accreditation of Integrated Financial System (IFS) and CAP completed.

Actions Planned or Underway

Key actions for IRS in FY 2005 and beyond include:

- CAP will be updated for mid-year tax law changes and begin to load fiscal year 2005 data.
- CAP will be used beginning in June 2005 to perform a parallel audit for the FY 2005 statements.
- The second release of CAP is currently on hold pending successful completion of the Release 1 activities. CAP Release 2 will expand the warehouse to include Business Master File (BMF) data and Non-Master File (NMF) data.
- IFS is on schedule to begin initial operating capability - November 2004.
- IFS is on schedule to begin full operating capability - February 2005.

7. Management Challenge/High-Risk Area:	**A. Anti-Money Laundering/Bank Secrecy Act Enforcement (OIG)**
Issue:	**The OIG believes the Bank Secrecy Act enforcement efforts need to ensure that banks, thrifts, and other financial institutions improve the accuracy and timeliness of their reports. The OIG also believes that the supervisory agencies need to devote additional examination attention to this critical law enforcement effort.**
Bureau:	**Financial Crimes Enforcement Network, OCC, OTS**

Actions Taken

To respond to audit findings, FinCEN developed an action plan to improve the data quality of Suspicious Activity Reports (SARs).

The Treasury OIG conducted an audit that was issued in September 2003 with the focus on reviewing OTS's use of enforcement actions against thrift institutions with "substantive" violations of the Bank Secrecy Act (BSA). The OIG made several recommendations in this area, and OTS implemented and addressed all recommendations and closed all actions in early 2004.

There are no open audit recommendations regarding the OCC's supervision of national banks as it relates to compliance with the Bank Secrecy Act.

Actions Planned or Underway

FinCEN will identify financial institutions with apparent systemic suspicious activity report quality problems through the quarterly review of electronic reports identifying blank fields and possible duplicate reports. In addition, FinCEN will enhance its outreach and education to financial institutions to improve the accuracy of the reported information. FinCEN will also expand outreach to industry focused on decreasing the number of paper and magnetic media filings (which are most vulnerable to filing error) and substantially increasing electronic filings via the Patriot Act Communication System.

To combat fraud, money laundering, and protect the integrity of financial systems, OTS will continue to examine thrifts for compliance with the requirements of the Bank Secrecy Act, the USA PATRIOT Act, and other anti-money laundering laws. Through examinations, guidance, and training, OTS will also continue to assess the financial condition and risk profile of thrift institutions and identify violations of law and regulation and potential financial and economic problems.

OTS and the federal banking agencies work closely on Patriot Act-related working groups and regulatory projects. OTS will work closely with FinCEN and the other federal banking agencies to implement the Memorandum of Understanding executed in 2004. Cooperation between the federal banking agencies on Bank Secrecy Act (BSA) /Anti-money Laundering matters is consistent and long-standing; the addition of the Memorandum of Understanding will further enhance timely sharing of information and coordinated supervisory action when violations are detected. OTS will also issue new examination procedures developed in coordination with the other banking agencies as well as other guidance to ensure consistent application of the provisions of the Bank Secrecy Act and the USA PATRIOT Act.

The OCC will carry out the regulatory and supervisory recommendations from its FY 2004 review of Bank Secrecy Act/Anti-Money Laundering (BSA/AML) supervision. The OCC also will issue a revised "Bank Secrecy Act" booklet to the Comptroller's Handbook and develop two information systems projects to enhance its BSA/AML work. The Quantity of Money Laundering Risk Identification project allows the OCC to gather money laundering risk information for each mid-size and community bank. This information will be used to develop unique supervisory strategies, allocate examiner resources, and quantify money laundering risks across these national banks. The Suspicious Activity Reporting Data Base will increase the OCC's ability to detect existing and emerging operational risks associated with suspicious activity reported by the banking industry and develop appropriate supervisory responses to those risks. The OCC will continue to coordinate with other federal financial regulators and criminal law enforcement agencies to combat money laundering and terrorist financing activities.

<table>
<tr><td align="right">8. Management Challenge/High-Risk Area:</td><td>A. Prepare Reliable Financial Statements for the Government (GAO)</td></tr>
<tr><td align="right">Issue:</td><td>Federal agencies have been cited as having problems related to fundamental record keeping, incomplete documentation, and weak internal controls which prevent the Government from accurately reporting a large portion of assets, liabilities, and cost. GAO reaffirmed these deficiencies in their audit of the consolidated FY 2002 Financial Report of the United States Government.</td></tr>
<tr><td align="right">Bureau:</td><td>Financial Management Service</td></tr>
<tr><td colspan="2" align="center">Actions Taken</td></tr>
<tr><td colspan="2">During FY 2004, FMS implemented a new process and system to prepare the Financial Report of the U.S. Government. The new process will be used in preparing the FY 2004 financial statements, scheduled for publication in December 2004. This process will compile, with a few exceptions, the Financial Report directly from agencies' financial statements. When implemented, the new process and business rules will mitigate the material weakness in the current process.</td></tr>
<tr><td colspan="2" align="center">Actions Planned or Underway</td></tr>
<tr><td colspan="2">FMS continues its multi-year effort to rebuild the processes it uses to prepare the Financial Report of the U.S. Government. FMS also worked closely with OMB in developing intra-governmental business rules.</td></tr>
</table>

9. Management Challenge/High-Risk Area:	A. Collection of Unpaid Taxes (GAO)
Issue:	**Collecting taxes due the government has always been a challenge for the IRS. Congress and others are concerned that the decline in the IRS's compliance and collections programs are eroding taxpayers' confidence in the fairness of our tax system. The IRS's new effort to review compliance, the National Research Program, provides IRS payment and filing compliance data on a regular basis and with the first up-to-date information on reporting compliance rates and sources of noncompliance since tax year 1988.**
Bureau:	**Internal Revenue Service**

Actions Taken

- The IRS developed a comprehensive strategy and approach to modernize technology and improve collection processes.
- Completed implementation of a decision tool for the automated collection system that assists in managing calls and improve quality.
- Completed the data gathering phase of the National Research Program. The results phase is expected to provide the first up-to-date information on compliance rates and sources of noncompliance since it was last measured using 1988 tax returns.
- Implemented contact recording capability at one call site, a tool which allows managers to review call content with employees to focus on quality and efficiency of taxpayer contacts. Capability is being provided to other sites.
- Commenced a desktop integration pilot that enables collection employees to provide better service and expedite case dispositions.
- Implemented Automated Queue announcements which provided management flexibility in creating unique messages for taxpayers, providing for additional payment options while on hold.
- Initiated the use of Predictive Models to better select inventory for assignment to personnel. Those with a "full pay" indicator have the highest priority.
- Working with Treasury, IRS developed a legislative proposal for the use of Private Collection Agencies (PCA) to support its collection efforts. On October 10, 2004, Congress passed the legislation. Next steps include building a system and processes to allow PCAs to work cases best suited for resolution based on their authority and skills.
- Procedures were implemented that enable collection employees to work individual balance due cases exceeding $100,000, resulting in significant and timely attention being paid to collecting high dollar/high risk accounts.
- Increased closures of delinquent balance due cases 37% from FY 2002 to FY 2004, up 41% in phone collection and 31% for in-person collection.
- Increased identified and secured delinquent returns from non-filers 49% from FY 2002 to FY 2004, up 55% in phone collection and 40% for in-person collection.

Actions Planned or Underway

- Improve efficiency, effectiveness, quality and case resolution in the Automated Collection System. (09/2005)
- Develop and implement an Installment Agreement Risk and Treatment Approach to improve case processing. (09/2005)
- Implement Collection Tax Delinquent Account Reengineering to better identify cases with a high or low propensity to pay or to be unproductive, thus allowing for a better use of scarce resources. (09/2005)

10. Management Challenge/High-Risk Area:	**A. Systems Modernization of the IRS (TIGTA)** **B. Manage Business Systems Modernization Program (GAO)**
Issue:	**Recognizing the long-term commitment needed to solve the problem of modernizing antiquated information systems, Congress created a special Business Systems Modernization (BSM) program to bring the IRS's business systems to a level equivalent with best practices in the private and public sectors.**
Bureau:	**Internal Revenue Service**

Actions Taken

In FY 2004, IRS implemented three major recommendations resulting from external independent studies conducted in late FY 2003:

- Scale back the modernization portfolio to better align with IRS and contractors' capacities
- Engage IRS business units to drive the projects with a business focus
- Improve contractor performance on cost, scheduling, and functionality

The studies also raised a number of other key improvement opportunities, including:

- Adding outside expertise to manage the program and to complement IRS skills
- Ensuring projects are staffed appropriately
- Adhering to methodologies in areas such as configuration management, cost and schedule estimating, and contract management
- Simplifying the budget process
- Initiating the testing of the Consumer Account Data Engine (CADE) Business Rules

IRS used the results from the four comprehensive studies to create a BSM Challenges Action Plan comprised of more than forty action items. Since then the IRS closed several key action items, including: clarifying the roles of committees as advisory, accountability resides with individuals and not committees; identifying "blockers" on contracting issues; appointing business leaders to each project and defining their roles; establishing a risk-adjusted schedule and new baseline for CADE Releases 1.0 and 1.1; and, increasing the frequency of CADE reviews with the business leader to twice monthly. Many of the action items are still works-in-progress, some of which will take time to fully complete. Others will span the life of the BSM program.

Actions Planned or Underway

Key actions planned for completion in FY 2005 include:

- Custodial Accounting Project (CAP) will deploy an integrated link between tax administration revenue financial information and internal management administrative financial information. Custodial Accounting Project Release 1.2 is scheduled to deliver mid-year 2004 changes and the CADE data solution. (11/2004)
- CADE Release 1.2 will include tax law changes for filing season 2005. IRS estimates that CADE will process more than two million of the most basic 1040 EZ tax returns during the 2005 filing season. (01/2005)
- Modernized e-File, MeF Release 3.0, includes additional corporate and tax-exempt organization forms, an interface with state retrieval systems, a redesign of the signature matching process, and tax law changes for filing season 2005.
- Develop and publish e-Strategy for Growth: Expanding e-Government for Taxpayers and Representatives. (09/2005)
- Complete Modernized e-File re-sequencing plan to support Disaster Recovery requirements. (09/2005)

11. Management Challenge/High-Risk Area:	A. Tax Compliance Initiatives (TIGTA)
Issue:	**The IRS management challenge is to establish a tax compliance program that identifies those citizens who do not meet their tax obligations, either by not paying the correct amount of tax or not filing proper tax returns, and ensure that they meet their tax obligations.**
Bureau:	**Internal Revenue Service**

Actions Taken

- Established the Exempt Organization Compliance Unit to address non-compliance by tax-exempt organizations through correspondence and telephone contacts, reaching a greater number of organizations than possible through traditional audits.
- The IRS aggressively investigated allegations of fraud among consumer credit counseling organizations. Criminal Investigation is coordinating with TE/GE to determine the extent of the fraud; Criminal Investigation is creating liaisons to ensure that any referrals are directed to them.
- Issued six notices and announcements related to corporate tax shelters to increase examination compliance on tax shelter promoter activity through increased investigations.
- The IRS is promoting and supporting the Joint International Tax Shelter Identification Center (JITSIC) with the United States, Canada, United Kingdom, and Australia, to coordinate knowledge and actions to detect and deter Abusive Tax Avoidance Transactions (ATAT). JITSIC will focus primarily on promoters and investors.
- The IRS Office of Tax Shelter Administration, Chief Counsel, and Treasury began regular meetings to discuss trends identified through disclosures, registrations and other sources regarding ATAT. These meetings promote identification of issues and earlier action to detect and deter ATATs through guidance or legislation.
- Publicized a settlement initiative for taxpayers who invested in an abusive tax shelter commonly known as "Son of Boss," which evolved from a bond and option sales strategy shelter. More than 1,500 taxpayers filed Notices of Election by June 21, 2004 to accept an IRS settlement offer to resolve their tax issues.

Actions Planned or Underway

Key actions planned for completion in FY 2005 include:

- The IRS' Individual Reporting Compliance Study for Tax Year 2001 is in its final stages. Data from this study will be available by December 31, 2004.
- Establish the Exempt Organization Fraud and Financial Transactions Unit to provide specialized exempt organization expertise to law enforcement in identifying and working fraud cases. (4/2005)
- Streamline Joint Committee and claims processes. (09/2005)
- Implement the Curb Egregious Noncompliance initiative to balance compliance efforts, support tax law enforcement, and provide the necessary increase in resources across all major compliance programs, while leveraging new workload selection systems and case-building approaches developed through re-engineering. (09/2005)
- Continue to identify flow-through entities and other strategies used to disguise questionable structured transactions by high-income taxpayers. Detect those engaging in abusive tax practices through enforcement, full implementation of K-1 matching, education and research. (09/2005)

<table>
<tr><td>12. Management Challenge/High-Risk Area:</td><td>A. Security of the Internal Revenue Service: The Employees and the Facilities (TIGTA)</td></tr>
<tr><td>Issue:</td><td>Recent terrorist attacks demonstrated very graphically that the physical security of IRS employees, equipment, and structures should be of utmost concern to IRS management. The IRS must remain vigilant to all opportunities to enhance the safety of employees.</td></tr>
<tr><td>Bureau:</td><td>Internal Revenue Service</td></tr>
<tr><td colspan="2">Actions Taken</td></tr>
<tr><td colspan="2">• Continued work with the General Services Administration (GSA) and local law enforcement to safeguard personnel and assets.
• Monitored and changed as appropriate procedures for inspection of incoming mail and packages.
• Completed implementation of Level V security enhancements.
• Developed, and began implementation of a Federal Emergency Management Agency-based incident command structure, using Senior Commissioner Representatives as command managers.
• IRS is implementing a Shelter-in-Place program safety procedure, which is an alternative to building evacuation (during an emergency, employees remain in their building until it is safe to leave).</td></tr>
<tr><td colspan="2">Actions Planned or Underway</td></tr>
<tr><td colspan="2">• Complete build out of incident command structure. (9/2005)
• Continue and expand IRS ability to respond to emergencies through more frequent exercise of Continuity of Operations Plan (COOP) and other emergency response actions. (9/2005)
• Update and complete business resumption plans in response to changes in threat conditions. (9/2005)
• Fully support government-wide and Departmental emergency response initiatives. (9/2005)</td></tr>
</table>

13. Management Challenge/High-Risk Area:	A. Complexity of the Tax Law (TIGTA)
Issue:	**Recent Annual Reports by the Taxpayer Advocate to the Congress cite tax law complexity as a serious problem for individual and business taxpayers. The effect of tax law complexity is compounded as the IRS modernizes. Since complexity can be a major factor in the cost of operations, IRS must devote resources to simplifying tax administration within current law while at the same time modernizing its systems and processes.**
Bureau:	**Internal Revenue Service**

Actions Taken

The National Taxpayer Advocate's (NTA) 2003 Annual report to Congress focuses on three themes: several "extremely serious" problems facing taxpayers, the need to balance enforcement and customer service, and how Congress and the IRS should handle "perceived" problems in tax administration. The report urges Congress to address the alternative minimum tax before it bogs down tax administration and increases taxpayers' cynicism to such a level that overall compliance declines. The NTA also proposes that Congress direct Treasury to create a joint task force to compile information about the extent of 'problematic paid-preparer behavior.'

Actions Planned or Underway

The National Taxpayer Advocate's Fiscal Year 2005 Objectives Report to Congress provides a number of examples of TAS activities that will address the issues cited above, including but not limited to:

- Providing Congress with legislative recommendations in the upcoming Annual Report to Congress (December 2004), including a revised non-wage withholding recommendation.
- Finalizing the Taxpayer Rights Impact Settlement.
- Continuing to work with the IRS Office of Chief Counsel and the Treasury Department on revisions to the regulations under Internal Revenue Code 7216, relating to the use and disclosure of tax return information by tax returns preparers.
- Exploring IRS' training program relative to how employees are familiarized with TAS and with issues pertaining to protection of taxpayer rights.
- Examining the possibility of a Unified Family Credit that will combine the provisions of the Earned Income Tax Credit, Child Tax Credit, and Dependency Exemption, thereby further reducing taxpayer compliance burdens associated with claiming these provisions.
- Encouraging IRS to develop a system to protect victims of identity theft from unwarranted, intrusive, and repetitive audits and collection activity attributable to the misreported income.
- Participating in research initiatives such as "Abusive Tax Schemes: The 'Tipping Point' Study; The Impact of Representation on the Outcome of Earned Income Tax Credit (EITC) Audits, Federal Case Registry Study; EITC Certification Test; EITC Pre-certification Test; EITC Recertification; Downstream Effects of Compliance Initiatives.
- Advocating that taxpayers be provided the opportunity for an independent appeal of their case with an IRS Appeals Officer.

14. Management Challenge/High-Risk Area:	A. Processing Returns and Implementing Tax Law Changes During the Tax Filing Season (TIGTA)
Issue:	The filing season impacts every American taxpayer and is always a highly critical program. Many programs, activities and resources have to be planned and managed effectively for the filing season to be successful.
Bureau:	Internal Revenue Service

Actions Taken

The 2004 filing season was very successful as electronic filing set a record and reached over 61 million returns, an increase of approximately 16 % from last year.

- Home computer usage by individuals to prepare and e-file tax returns soared to over 14 million returns. Tax professional use of e-file jumped over 15 %, with 42.8 million filing electronically.
- In its second year, 3.5 million taxpayers used Free File, the on-line filing service, representing a 26% increase from 2003.
- More taxpayers used the IRS web site, including the "Where's My Refund?" feature, which allows taxpayers to inquire if the IRS received their return and whether their refund was processed and sent to them. There were almost 24 million inquiries to the on-line service to check on refunds.
- With more account and tax law inquiries moving to the Internet for resolution, the toll-free level of service for taxpayers who do not get a busy signal and get into the system is at 87%.
- IRS processed over 131 million individual returns and issued approximately 100 million refunds totaling $207.9 billion.
- Nearly 49 million taxpayers chose direct deposit of refunds this year, an increase of just under 11% increase from the 2003 record.

Actions Planned or Underway

Key actions planned for completion in FY 2005 include:

- Continue to enhance the functionality of the web site by providing new features such as enhanced search capabilities and presentation of results, tax applications and/or calculators of various types, and enhanced globalization to present web content in various languages. (09/2005)
- Develop secure access for taxpayers who file electronically to enable them to review their account electronically. (09/2005)
- Complete the ramp down of the Memphis Submission Processing Center (MSPC). (09/2005)

15. Management Challenge/High-Risk Area:	**A. Improving Service to Taxpayers - Providing Quality Customer Service Operations (TIGTA)**
Issue:	**Providing top quality service to every taxpayer in every transaction is an integral part of IRS's strategic and modernization plans.**
Bureau:	**Internal Revenue Service**

Actions Taken

- IRS has intensified efforts to assist taxpayers in filing correct, complete and compliant returns through pre-filing agreements and Industry Issue Resolutions.
- IRS has emphasized increased use of Published Guidance to clarify the law and resolve uncertainty regarding its application.
- With record numbers of Americans e-filing their tax returns and recently announced e-filing options for corporations and tax exempt organizations, this year the Internal Revenue Service launched a new online form that gives tax professionals a faster, easier method of applying to become an authorized e-filer.
- Tax professionals now have an online application form that cuts processing time and reduces errors associated with using the paper Form 8633, Application to Participate in IRS e-file. Once the application is approved by the IRS, tax professionals can e-file returns for their clients.
- The online application is the latest segment of a suite of Internet-based business tools called "e-services" that give tax professionals and financial institutions new choices for working electronically with the IRS and easier access to client information.

The Internal Revenue Service also released three new electronic e-services tools for tax professionals. Disclosure Authorization, Electronic Account Resolution and the Transcript Delivery System give tax professionals online options for working with the IRS. The Disclosure Authorization tool gives eligible tax practitioners an online option for submitting Power of Attorney or Taxpayer Information Authorization forms. Electronic Account Resolution allows tax practitioners to electronically correspond with the IRS. Using the Transcript Delivery System, tax practitioners can request transcripts of their client's tax records and receive them within minutes instead of days or weeks. The Internal Revenue Service also launched a new service through the IRS GuideWire list server to make technical guidance available via e-mail to tax professionals when the documents are issued.

Actions Planned or Underway

Quality customer service remains a foundation in the Strategic Plan implemented and is being monitored and measured in key IRS programs. Key activities to be completed include:

- Begin the rollout of Contact Recording, which will enable synchronized voice/data recordings to monitor face-to-face interactions, assessing quality as well as trends. (06/2005)
- Improve and enhance the availability of online services such as Internet EIN (Employer Identification Number), CAF (Centralized Authorization File) and PPS (Practitioner Priority Services). (09/2005)
- Continue redesigning and simplifying notices, forms and publications. (09/2005)
- Continue to work with private industry to expand low-cost Internet filing options. (09/2005)
- Expand the Internet Refund Fact of Filing (IRFOF) application to reduce toll-free demand and offer customers alternative methods of service. (09/2006)
- Complete the rollout of Q-Matic (Queuing Management) to facilitate customer traffic and workload planning. (09/2006)

16. Management Challenge/High-Risk Area:	A. Erroneous Payments; Refund Fraud; Earned Income Credit Noncompliance (TIGTA) B. Earned Income Credit Noncompliance (GAO)
Issue:	Both the President and the Congress have expressed concerns with the large amount of erroneous payments made by Federal agencies each year. The risk of improper payments increases in programs with complex criteria for computing payments, a significant volume of transactions or emphasis on expediting payments. Although many IRS programs are susceptible to erroneous payments, the Earned Income Tax Credit (EITC) Program is particularly vulnerable. Despite extensive education and outreach, the EITC has continued to experience high error rates due to its complicated calculation, taxpayer awareness of eligibility, and even fraud. IRS processing systems currently lack the capacity to detect some of the errors before the EITC claim is paid and IRS business processes are not designed to adequately administer the credit.
Bureau:	Internal Revenue Service

Actions Taken

The IRS administers a balanced EITC Program – one that reduces erroneous payments while increasing participation by eligible taxpayers. These efforts included customer service and public outreach campaigns, enforcement activities and enhanced research efforts. The IRS continued to educate taxpayers through partnerships with key stakeholders and a public service campaign. It has worked with over 180 partners at the national level and 165 community-based partners to educate taxpayers on EITC requirements and to encourage eligible taxpayers to apply. Since the majority of EITC claims are completed by paid Tax Preparers, the IRS made Tax Preparer education a priority and modified the return preparer strategy to include more emphasis on non-compliance with "due diligence requirements."

Since 1996, EITC has been identified as having an unacceptable rate of improper payments. One of the difficulties in developing strategies for reducing the high error rate was, and still is to a degree, measuring the actual error rate. A full compliance study was conducted on 1999 tax returns claiming EITC, resulting in error rate estimates ranging from 27% to 32% of an approximately $30 billion program.

Through various IRS initiatives such as the National Performance Review (NRP), updated error rate estimates will be available to determine whether EITC program actions during the past few years have been effective in reducing the error rate estimate and associated dollars. These results are expected in mid-FY 2005. Also expected in FY 2005 are the results of a study on the effect of the 2002 tax law changes that were implemented for the 2003 tax filing season. Finally, through complex program guidance developed by the government wide Chief Financial Officers Council, EITC will produce annual error rate estimates based on a statistically valid sample of a component of the program, using data from the Qualifying Child Residency Certification Study.

Actions Planned or Underway

- Support the implementation of technology solutions, including Risk Based Scoring and Selection – RBSS (01/2005); Selection/Assignment and Decision Support Tool – DST (01/2006); Corporate Inventory Management – CIM/Routing; and Contact Management/Outreach (01/2006).
- Develop an integrated strategy to enhance EITC compliance through return preparers. (03/2005)
- Execute a strategy that leverages partnership opportunities with states that offer tax credits comparable to the EITC. (09/2005)
- Evaluate the effectiveness of a procedure that will allow IRS to obtain the National Directory of New Hires (NDNH) from Health and Human Services to provide quarterly employee wage information by employer, and also information on newly hired employees. This information will allow for the identification of fraudulent W-2s or the substantiation of valid W-2s (Dependent upon authorizing legislation). (12/2005)
- Charter EITC research efforts to identify ways to reduce EITC erroneous payments, as well as identify trends in the diverse EITC taxpayer population. Use the results of these studies for strategic planning of the EITC program. (Ongoing)

17. Management Challenge/High-Risk Area:	A. Taxpayer Protection and Rights (TIGTA)
Issue:	**IRS has made significant progress in complying with RRA 98 and most provisions have been implemented. Significant management attention is still required to ensure that taxpayers' rights are not restricted by any IRS enforcement actions.**
Bureau:	**Internal Revenue Service**

Actions Taken

- Conducted an independent review to determine IRS' compliance with RRA 98 Section 1204, which prohibits the use of enforcement statistics to evaluate IRS employees or to impose or suggest production quotas or goals. All appropriate supervisors certified each quarter that they had not improperly used enforcement statistics in evaluating employees.
- TIGTA conducted an Independent Audit of the Section 1204 Program and found that: the IRS is in compliance with RRA 98 §1204 (a) and (b); no potential violations of the use of Records of Tax Enforcement Results were found; and employees were evaluated on the fair and equitable treatment of taxpayers.
- Implemented the K-1 matching program, reconciled partnership income reporting documents to the beneficiaries of this income on federal income tax returns, which promotes fairness of the tax system.
- Implemented information-sharing programs to promote income document matching and fairness of the tax system.
- Partnered with state taxing agencies to implement programs that compare state tax information with federal income and/or employment tax return information. More than 28,000 audit leads and other information were shared with the states.

Actions Planned or Underway

- Focus on taxpayer groups that are at higher risk of noncompliance to maintain confidence in the integrity of the tax administration program. (Ongoing)
- Rollout the Taxpayer Assistance Center (TAC) model, as it is critical to maintaining taxpayers' privacy and confidentiality, particularly as the IRS becomes more involved in compliance activities. (09/2005)
- Implement a solution for encrypting electronic return data during the transmission process from electronic return transmitters. (01/2005)
- Review IRS training to ensure that employees, particularly in compliance functions, are properly and regularly trained on the protection of taxpayer rights. (09/2005)
- Develop 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. (09/2005)
- Work 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 IRS will punish preparers when they perform negligently or recklessly. (Ongoing)

18. Management Challenge/High-Risk Area:	**A. Human Capital (TIGTA)**
Issue:	**IRS continues to face a range of serious personnel management issues, ranging from recruiting, training, and retaining employees to problems associated with IRS' recent reorganization and modernization efforts**
Bureau:	**Internal Revenue Service**

Actions Taken

- IRS developed a phased retirement program for potential use as incentives for employees in critical job series to extend their association with the IRS. IRS also received the authority for waivers to annuity offsets in order to benefit from the vast experience of annuitants.
- A robust succession-planning model was implemented and executive search assistance was used in filling critical executive positions.
- A new, competency-based, transformational leadership development program was introduced to equip current and future leaders for increased service to both IRS employees and taxpayers. Training has been decentralized to give the operating divisions responsibility for technical training so it can be tailored to meet the needs of their specific taxpayers. Leadership development is a corporate asset, centrally managed by the Human Capital Office.
- Successfully partnered with the OPM *Go Learn* e-training initiative to acquire e-training products and services to leverage government-wide economies of scale.
- Reengineered training for newly hired revenue agents from sixty weeks to twenty-two weeks.
- Re-employed annuitants have been recruited for On-the-Job Instructor and Classroom Instructor positions, allowing highly skilled, senior professionals to remain on the frontlines.

Actions Planned or Underway

- The IRS will implement a comprehensive Human Capital Strategic plan, addressing the six human capital standards for success: strategic alignment, workforce planning and deployment, leadership and knowledge management, performance culture, talent, and accountability. IRS will establish baseline performance under the new Human Capital Metrics and identify areas for improvement activity in FY 2005.
- The IRS will also implement a multi-year recruitment/marketing strategy that includes the expansion of the internet employment website, a complete print media advertising campaign, market research, and an extensive internet media advertising campaign.