



PART I:
MANAGEMENT'S
DISCUSSION & ANALYSIS



EXECUTIVE SUMMARY

The Department of the Treasury shoulders a great responsibility for the American people. While the Department performs a critical role in U.S. and global economies, it continually evolves to meet the ever-changing needs of the nation. The Treasury Department provides cash management for the federal government, currency and coin production, administration of the tax code, oversight of the financial sector, and plays an integral role combating the financing of terrorism, the proliferation of weapons of mass destruction, and other threats to our national security.

In fiscal year 2007, the Department of the Treasury released its Strategic Plan for Fiscal Years 2007-2012. This plan was developed collaboratively with employees and senior management, and was tested and refined against a changing global environment. Additionally, the Department went beyond linking performance to the budget, and established an Integrated Management System to address continuous improvement and add value for its stakeholders. The Strategic Framework shown on the following page illustrates the four strategic priorities in which the Department operates, and provides the foundation for this report. These four areas are:

The Financial Focus: Managing the government's finances effectively includes collecting money due to the U.S. Government by maximizing voluntary compliance with tax laws and regulations, making payments, and financing the federal government by continually improving financial management processes. The Department oversees, accounts for, and reports on government collections and expenditures, and is responsible for collecting delinquent debt owed the government. The Treasury Department forecasts receipts and payments, determines borrowing needs, and executes the borrowing strategy to meet the financial demands of the federal government at the lowest possible cost over time.

The Economic Focus: The Treasury Department performs policy and operational roles in promoting prosperous U.S. and world economies, raising living standards, and protecting domestic and international economic and financial systems. As the principal economic advisor to the President, the Secretary of the Treasury utilizes the policy expertise of the Department to address national and global economic and financial challenges.

The Security Focus: The sponsorship of terrorism and the potential acquisition of weapons of mass destruction by rogue regimes and non-state entities represent a grave threat to U.S. national security and all free and open societies. The Treasury Department implements targeted financial measures and other forms of sanctions against terrorists and their support networks, with the goal of stopping the flow of money to terrorist groups, state sponsors of terrorism, proliferators of weapons of mass destruction (WMD), drug traffickers, money launderers, and regimes that constitute a threat to the United States. The Department leads the U.S. Government's multi-faceted effort to keep the world's financial systems accessible to legitimate users, while excluding those who wish to exploit these systems for illegal purposes through law enforcement and appropriate financial regulatory initiatives.

The Management Focus: Management's primary role and responsibility in the Department is to create the conditions that allow all programs and activities to perform efficiently and effectively. The Treasury Department continues to develop integrated plans where policies and operations align to produce maximum value for the American people.

THE TREASURY DEPARTMENT'S STRATEGIC FRAMEWORK

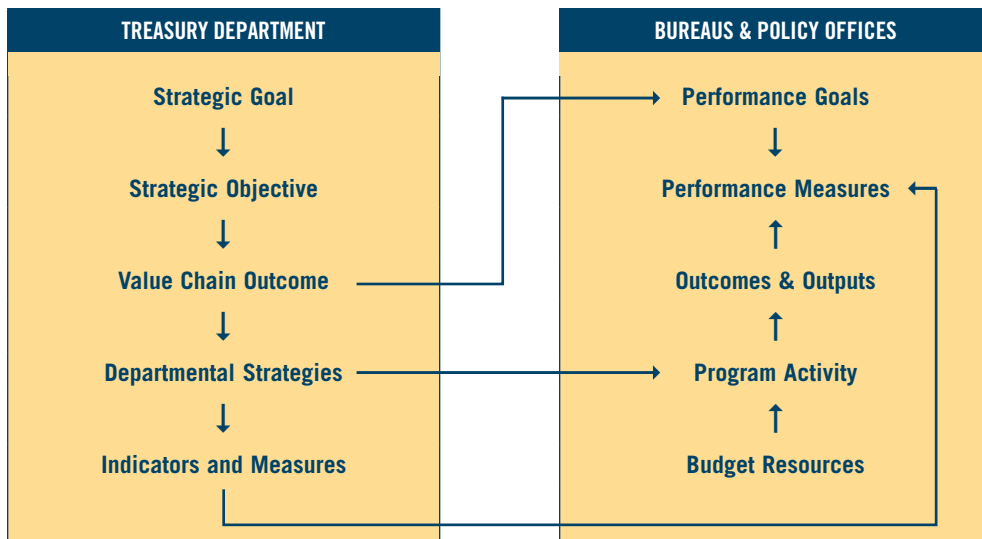
The Treasury Department's strategic framework is a summary of goals, objectives, and outcomes. This framework provides the basis for performance planning and continuous improvement.

	Strategic Goals	Strategic Objectives	Value Chains**	Strategic Outcomes
Financial	Effectively Managed U.S. Government Finances	Cash resources are available to operate the government	Collect Disburse Borrow Invest Account	<ul style="list-style-type: none"> Revenue collected when due through a fair and uniform application of the law at the lowest possible cost Timely and accurate payments at the lowest possible cost Government financing at the lowest possible cost over time Effective cash management Accurate, timely, useful, transparent and accessible financial information
Economic	U.S. and World Economies Perform at Full Economic Potential	Improved economic opportunity, mobility and security with robust, real, sustainable economic growth at home and abroad Trust and confidence in U.S. currency worldwide	Strengthen Regulate Manufacture	<ul style="list-style-type: none"> Strong U.S. economic competitiveness Free trade and investment Decreased gap in global standard of living Competitive capital markets Prevented or mitigated financial and economic crises Commerce enabled through safe, secure U.S. notes and coins
Security	Prevented Terrorism and Promoted the Nation's Security Through Strengthened International Financial Systems	Pre-empted and neutralized threats to the international financial system and enhanced U.S. national security	Secure	<ul style="list-style-type: none"> Removed or reduced threats to national security from terrorism, proliferation of weapons of mass destruction, narcotics trafficking and other criminal activity on the part of rogue regimes, individuals, and their support networks Safer and more transparent U.S. and international financial systems
Management	Management and Organizational Excellence	Enabled and effective Treasury Department	Manage	<ul style="list-style-type: none"> A citizen-centered, results-oriented and strategically aligned organization Exceptional accountability and transparency

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

THE STRATEGIC-OPERATIONAL RELATIONSHIP

The relationship between the Department’s strategic goals and its annual program performance goals are depicted in the chart below.



The Treasury Department’s **strategic goals** are stated as long-term outcomes which will assist the organization in achieving its mission. **Strategic objectives** are broad-based outcome statements for a group of value chains. **Value chains** are programs grouped by a common purpose. **Strategic or value chain outcomes** are important results for each of the Department’s major functions. Departmental **strategies** are agency-wide methods used to achieve value chain outcomes and guide program activities.

To achieve **performance goals**, program resources must be properly managed to generate desired **outcomes and output**. Departmental **indicators and measures** are used to guide the development of long-term and annual performance targets associated with performance goals, which are essential components of the annual performance budget.

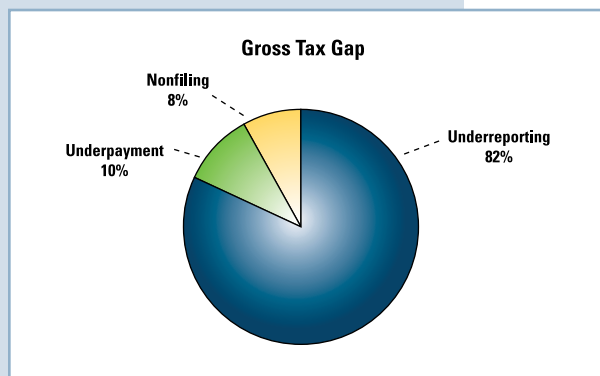
The Tax Gap

The tax gap represents the amount of noncompliance with tax laws. The most recent IRS estimate of the gross tax gap, completed in 2006, was \$345 billion for tax year 2001.

The net tax gap is currently estimated as follows:

Net Tax Gap	
Gross Tax Gap	\$345 billion
Enforced and Other Late Payments	\$55 billion
Net Tax Gap	\$290 billion

The components of the tax gap are:



In August 2007, the IRS released the report, "Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance," a follow-up to Treasury's "Comprehensive Strategy for Reducing the Tax Gap" issued in September 2006. The report presents the current tax gap activities and the steps taken to improve compliance. The report:

- Details information on steps being taken to reduce opportunities for tax evasion, leverage technology, and support legislative proposals that will improve compliance
- Presents an outreach approach to ensure all taxpayers understand their tax obligations
- Recognizes the importance of having a multi-year research program to help the IRS understand both the scope of and reasons for noncompliance

This report, combined with legislative changes and tax simplification, will guide the IRS's efforts to reduce the tax gap.

STRATEGIC GOAL EFFECTIVELY MANAGED U.S. GOVERNMENT'S FINANCES

The Treasury Department manages the nation's finances by collecting money due to the United States, making its payments, managing its borrowing, investing when appropriate, and performing central accounting functions. The ability of the Department of the Treasury to manage the nation's finances with integrity is paramount to maintaining financial stability and enabling economic growth.

Strategic Outcome

Revenue collected when due through a fair and uniform application of the law

Collecting federal taxes and other revenue is integral to the Department of the Treasury. Increasing voluntary compliance with the tax laws reduces the cost of tax administration, increases revenue, lessens the need to borrow, and ultimately lowers the cost of government. To reduce the tax gap, the Department must execute its comprehensive, integrated, multi-year strategy, while remaining sensitive to taxpayer rights and maintaining an appropriate balance between enforcement activity and the burden of compliance on taxpayers.

The IRS delivered a successful 2007 filing season, addressing new challenges associated with the implementation of the telephone excise tax refund, the split refund capability, and new legislation. The IRS processed more than 139.7 million individual returns and issued over 105.5 million refunds totaling \$244 billion. Additionally, 57.1 percent of individual returns were electronically filed, an increase of 5 percent over 2006; 19.1 percent of business returns were electronically filed, an increase of 15 percent over 2006; 22.5 million returns were filed on home computers, an increase of 11 percent over 2006; 57.2 million returns were e-filed by tax professionals, an increase of 10 percent over 2006; and over 4.1 million taxpayers used the free services offered by the Free File Alliance.

In fiscal year 2007, the IRS continued to improve its enforcement results; revenue from all enforcement sources reached \$59.2 billion, an increase of 22 percent over fiscal year 2006..

In addition, the IRS Examination and Collection Programs targeted contributors to the tax gap by increasing the number of

audits of high-income taxpayers by 29 percent, individual taxpayers by 8 percent, and small business and corporations by 17 and 3 percent respectively; and the closure of collection cases increased by 12 percent.

The TTB administers the collection of federal taxes on tobacco, alcohol, and firearms and ammunitions from more than 8,000 organizations; 200 of these account for 98 percent of all excise tax collections annually. In fiscal year 2007, the TTB collected \$14.7 billion in excise taxes, interest, and other revenues, and voluntary compliance, by industry members, was 75 percent of taxpayers filing payments on or before the scheduled due date.

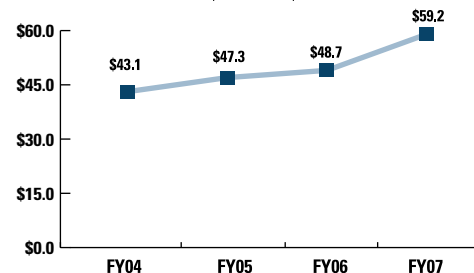
The FMS manages the collection of federal revenue for individual and corporate income tax deposits, and recovers delinquent government and child support debt by providing centralized debt collection, oversight, and operational services to Federal Program Agencies (FPA) and states. In fiscal year 2007, the FMS collected a record \$3.1 trillion through a network of more than 9,000 financial institutions with 79 percent of the dollars collected electronically; an increase of 6 percent for total revenue collected over fiscal year 2006. In addition, a record \$3.76 billion was collected in delinquent debt; consisting of \$1.7 billion in past due child support, \$1.47 billion in federal non-tax debt, \$243 million in state tax offsets, and \$343 million in tax levies.

Strategic Outcome

Timely and accurate payments at the lowest possible cost

The Treasury Department, through the FMS, plays an important role in providing critical services to millions of U.S. taxpayers as it issues government payments such as Social Security benefits, tax refunds, and veterans' benefits to the correct recipient at the proper time. As the government's financial manager, the FMS oversees a daily cash flow of nearly \$60 billion, disbursing 85 percent of the federal government's payments or nearly one billion payments to over 100 million people, valued at nearly \$1.5 trillion.

Enforcement Revenue Collected
(in Billions)



In fiscal year 2007, revenue from all enforcement sources reached \$59.2 billion, an increase of 21.5 percent enforcement revenue over fiscal year 2006. IRS Examination and Collection programs targeted contributors to the tax gap; the IRS increased their audits of high-income taxpayers by 29 percent.

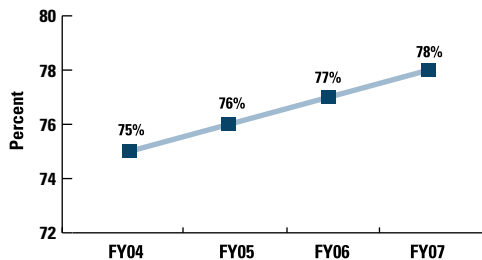
IRS Helps Taxpayers Avoid Phishing Schemes

Phishing is an attempt to criminally and fraudulently acquire sensitive information by masquerading as a trustworthy entity in an electronic communication. Taxpayers should be aware that the IRS does not send unsolicited e-mail. The IRS never asks taxpayers for PIN numbers or passwords for credit card, bank, or other financial accounts. Recipients of questionable e-mail, that appears to come from the IRS, should not open any attachments or click on any links contained in the e-mail; instead the e-mail should be forwarded to phishing@irs.gov

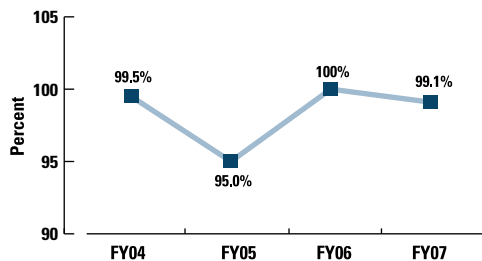
Foreclosure Tax Relief Available

The IRS unveiled a special new section on their website for people who have lost their homes due to foreclosure. The section includes a worksheet designed to help borrowers determine whether any of the foreclosure-related relief provisions apply to them. In some cases, eligible taxpayers may qualify to settle their tax debt for less than the full amount due using an offer-in-compromise. The IRS urges struggling homeowners to consider their options carefully before giving up their homes through foreclosure.

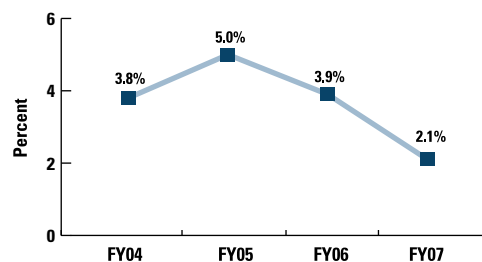
Percentage of Treasury Payments and Associated Information Made Electronically



Percentage of Auction Results Released in 2 Minutes +/- 30 Seconds



Variance Between Estimated and Actual Receipts



Strategic Outcome

Government financing at the lowest possible cost over time

The Department determines and executes the federal borrowing strategy to meet the monetary needs of the government at the lowest possible cost. The federal government finances its expenditures in excess of tax receipts through the sale of debt obligations at various maturities. The Treasury Department's activities minimize the interest paid on the national debt over time and enhance market liquidity.

The BPD conducts the debt financing operations by issuing and servicing Treasury securities. In fiscal year 2007, the BPD conducted more than 200 auctions and issued more than \$4 trillion in marketable Treasury bills, notes, bonds, and Treasury Inflation-Protected Securities, while providing retail investment services to 50 million retail customers holding \$278 billion in Treasury securities.

Expediently releasing detailed auction information minimizes the time bidders are exposed to the risk of adverse market movements, encouraging more aggressive bidding, and enabling the federal government to borrow at more favorable rates. In fiscal year 2007, the BPD consistently met its performance goal of releasing securities auction results within two minutes, plus or minus 30 seconds.

Strategic Outcome

Effective cash management

The Department of the Treasury ensures that funds are available on a daily basis to cover federal payments, maximize investment earnings, and minimize borrowing costs through accurately forecasting receipts, outlays, and debt. Forecasting accuracy continued to improve this year; the variance was 2.1 percent, as compared to 3.9 percent in fiscal year 2006.

Over the past several years, the Department explored new and innovative ways to invest excess cash. The Treasury Department invested \$6.7 trillion in overnight and short-term investments through the Term Investment Option (TIO) Program and the Repurchase (Repo) Program. By reinvesting excess cash through the TIO and the Repo, the Department earned an additional \$33 million; these programs earn market rates of interest.

Strategic Outcome

Accurate, timely, useful, transparent, and accessible financial information

The Department, through FMS’s Government-wide Accounting and Reporting Program, maintains the federal government’s books, and accounts for its monetary assets and liabilities by operating, and overseeing its accounting and reporting system. For the third consecutive year, the FMS released the *Financial Report of the United States Government*, 75 days after the close of the fiscal year. This report presents a picture of government-wide finances and is critical to a fully informed budget process.

In addition, the FMS continues to improve its policies, procedures, information systems, and internal controls used to prepare the government-wide consolidated financial statements. During a 2006 audit, the Government Accountability Office (GAO) made recommendations to the FMS regarding their internal controls; with continued effort, the FMS has implemented 74 of the 143 recommendations, and continues to resolve issues within their authority.

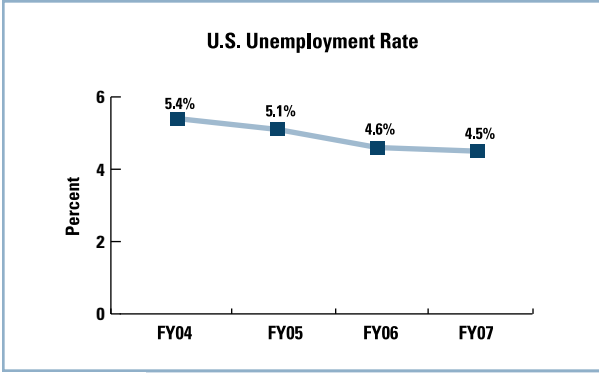
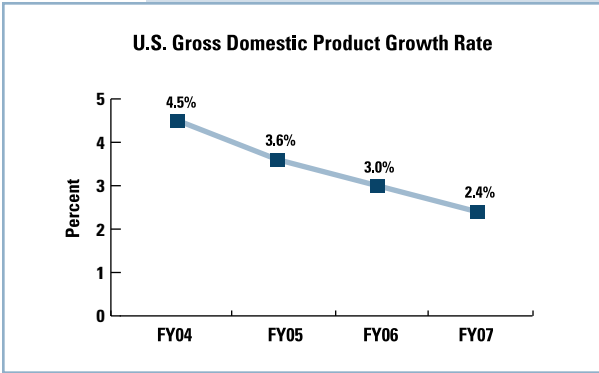
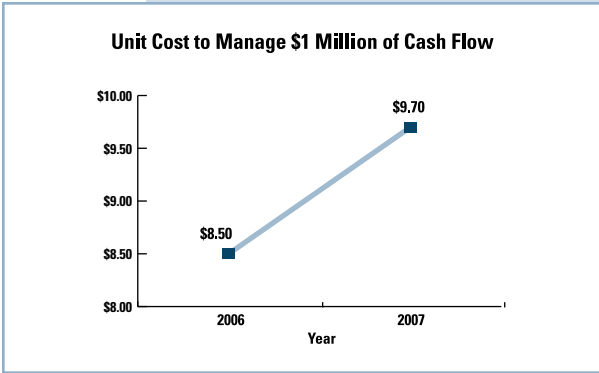
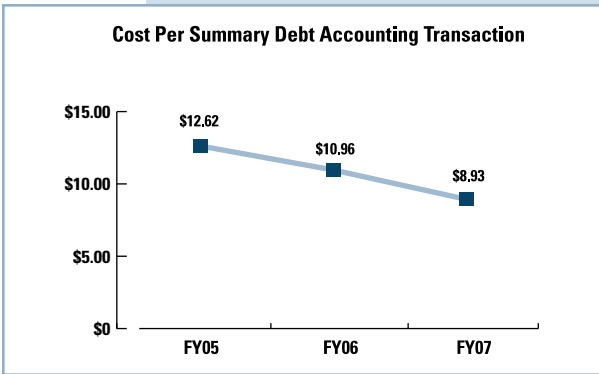
STRATEGIC GOAL
U.S. AND WORLD ECONOMIES PERFORM
AT FULL ECONOMIC POTENTIAL

To achieve conditions that enable economies to perform at full economic potential, the Treasury Department encourages economic growth through the development and implementation of policies that effectively regulate banking and financial markets, create pro-growth tax policies, and advocate free trade.

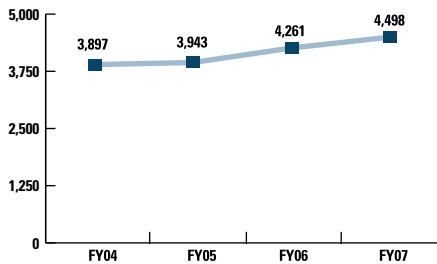
Strategic Outcome

Strong U.S. economic competitiveness

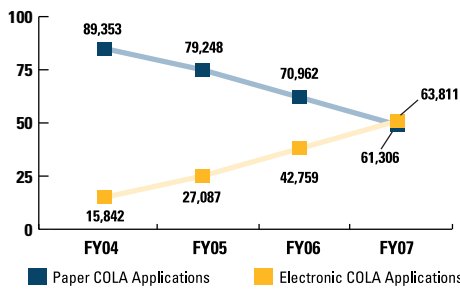
Strong economic competitiveness is critical to robust economic growth worldwide, continued investment in the United States, and job creation. The Treasury Department’s contribution to the facilitation of a prosperous financial infrastructure, a balanced macro economy, market efficiency, technological readiness, and innovation are essential for keeping a sharp competitive edge. While drawing a direct connection between the Department’s actions and economic indicators is difficult, policymakers aid in



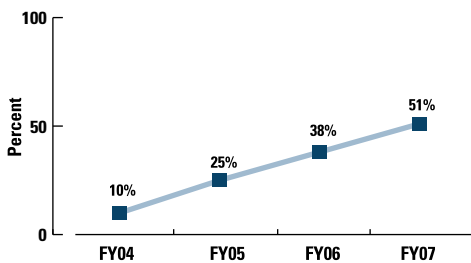
Number of Permits Issued



Certificate of Label Approvals Received



Percent of Electronically Filed COLAs



creating an environment conducive to strong economic growth and a healthy labor market.

For fiscal year 2007, real Gross Domestic Product (GDP), the broadest measure of the economy's performance, expanded by an estimated 2.4 percent. Real GDP growth fell short of the Administration's estimate of the economy's potential growth rate of 3.1 percent. Even so, the economy created 1.6 million jobs and the unemployment rate averaged a low 4.5 percent. A healthy, growing economy and strong labor market create economic opportunity.

The TTB contributes to economic growth by through its permitting and labeling processes, and international trade program. Permitting and labeling helps safeguard the consumer by protecting them from fraud and deception, and by promoting market and product integrity. The TTB accomplishes this by requiring producers to submit certificate of label approval applications, which have increased 30 percent over the last four years.

The TTB's International Trade Program helps keep the U.S. economy strong by facilitating import and export trade in alcohol and tobacco products. As an example, the program assists in ensuring tequila exports, valued at \$400 million per year, continue from Mexico to the United States without interruption.

The Community Development Financial Institutions (CDFI) Fund's Program awardees and New Markets Tax Credit allocatees create jobs, in economically distressed communities, by lending to and investing in business and real estate projects. In fiscal year 2007, the CDFI Fund reported 35,022 jobs created or maintained by awardees and allocatees.

The CDFI Fund's Native Initiatives are designed to overcome barriers preventing access to credit, capital, and financial services in Native American Communities. Through these initiatives, the CDFI Fund provides monetary awards and training aimed at increasing the number and capacity of existing or new CDFI's serving Native Communities. In fiscal year 2007, the CDFI Fund issued \$3.6 million in Native Initiative Awards to 19 CDFIs, resulting in a growth of 35 percent of native CDFI Awardees' assets; in fiscal year 2006, \$4.3 million was awarded to 23 CDFIs.

Strategic Outcome

Competitive capital markets

U.S. capital markets make a vital contribution to the nation's wealth and prosperity by directing investments toward innovation, promoting economic growth, and ensuring that the allocation of resources are directed toward the most efficient use. Capital markets give U.S. citizens the confidence to invest, earn higher returns on savings, and reduce the cost of borrowing. The challenge facing U.S. regulators today is preserving the public interest while preventing excessive regulatory burden on financial markets and institutions.

In fiscal year 2007, in an effort to encourage a responsible and measured approach, the Department launched a study of the regulatory framework for securities, banking, and insurance. In addition, a three part plan was announced to encourage competitive capital markets, and draw on recent trends, such as globalization, to leverage competitiveness and increase the benefit to the economy.

Strategic Outcome

Free trade and investment

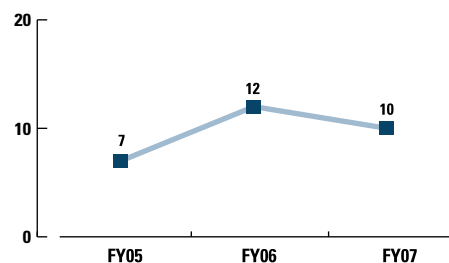
Foreign investment in the U.S. strengthens the economy, improves productivity, creates good jobs, spurs healthy competition, and is vital for a robust and sustainable economy. Foreign-owned companies directly provide jobs to over five million workers, and indirectly provide an additional five million jobs, due to foreign-owned subsidiaries procuring about 80 percent of their inputs from the U.S. markets. In fiscal year 2007, these companies produced about 6 percent of U.S. output, provided 10 percent of U.S. total capital investment, 13 percent of research and development, and 20 percent of exports.

The Treasury Department participates in the negotiation and the implementation of international agreements to remove trade and investment barriers, stimulate domestic and global growth, and allow for increased employment opportunities for Americans. The U.S. seeks strong commitments from its trading partners to ensure those markets are open to U.S. exporters and investors. Once implemented, these agreements serve as a core element for a trading partner's economic infrastructure, enhancing international economic and financial stability. In fiscal year 2007, 10 trade and

Competitive Capital Markets

The U.S. capital markets are the most efficient and transparent in the world. Leading the world in mergers and acquisitions advice, venture capital, private equity, hedge funds, derivatives, securitization skills, and exchange traded funds. With this expertise, U.S. financial institutions have contributed greatly to economic success throughout the world. The Treasury Department's efforts to enhance U.S. market competitiveness include pursuing a modernized regulatory structure, encouraging the development and adoption of industry best practices for asset managers and investors in hedge funds, Modernizing the Treasury Department's Cash Management and Debt Management, completing Basel II rulemaking, empowering all investors through financial education, and encourage international investment.

Number of FTA and BIT Negotiations Underway or Completed



CAFTA-DR

The Central America-Dominican Republic-United States Free Trade Agreement (CAFTA-DR) includes seven signatories:

1. United States (2006)
2. El Salvador (2006)
3. Guatemala (2006)
4. Honduras (2006)
5. Nicaragua (2006)
6. Dominican Republic (2007)
7. Costa Rica (2007)

The U.S. Congress approved the CAFTA-DR in July 2005 and the President signed the implementation legislation on August 2, 2005. Costa Rica was the last country to approve the agreement, resulting in a national referendum being passed on October 8, 2007. U.S. exports to the CAFTA-DR countries increased by 16 percent, based on the most recent data available.

The Paris Club

The first meeting of the Paris Club, a voluntary informal organization, was in 1956 when Argentina agreed to meet its public creditors in Paris, France. The objective of the Paris Club is to find manageable solutions for debtor nations that have payment difficulties. Club creditors agree to provide a country with debt relief under certain conditions. The Paris Club has reached 400 agreements regarding 84 debtor countries since its inception. The total amount of debt covered \$505 billion since 1983.

To qualify for the MDRI, countries must complete the HIPC initiative, or with respect to the IMF have a per capita income below US\$380 and outstanding debt to the IMF. In addition to these standards the IMF Executive Board added that eligible countries must be current on their obligations to the Fund, and demonstrate satisfactory performance in macroeconomic policies, implementation of a poverty reduction strategy, and public expenditure management. At the close of fiscal year 2007, twenty-two countries had completed the HIPC initiative and received MDRI debt relief from the MDBs and IMF. Two non-HIPC countries were eligible and benefited from the MDRI relief from the IMF.

investment negotiations were either concluded or underway; an increase of approximately 43 percent over the performance target.

In fiscal year 2007, the U.S. concluded FTA negotiations with Korea. Once approved by Congress and fully implemented, the Korea FTA will end tariffs on more than \$78 billion of trade between the United States and Korea. With Costa-Rica's approval, the CAFTA-DR has been approved by all partner countries. Once this agreement is executed, this FTA will end most tariffs on more than \$32 billion of two-way trade between the U.S. and the CAFTA-DR countries. In addition, the Panama FTA was signed in June 2007. This agreement will provide new opportunities to U.S. workers, manufacturers, and service providers, as well as expand markets for U.S. farmers and ranchers; another building block in the Department's efforts to create a Western Hemisphere free trade area.

The Department of the Treasury supports trade liberalization and budget discipline through its role in negotiating, implementing, and policing international agreements to reduce official export subsidies. By negotiating agreements, the Treasury Department drastically reduced the subsidies that other governments can provide when financing national exports. The volume of this financing activity is approximately \$70 billion annually. These agreements open markets and level the playing field for U.S. exporters, and save U.S. taxpayers about \$800 million each year.

Strategic Outcome

Prevented or mitigated financial and economic crises

It is essential to prevent financial and economic crises, and diminish its impact. By promoting sound pro-growth policies, the Department of the Treasury aids in the retention of the benefits of economic progress, reducing poverty, maintaining political stability, and avoiding expensive intervention.

In fiscal year 2007, the Department's Office of International Debt Policy (IDD) worked to implement major initiatives that are providing massive debt reduction to heavily indebted poor countries committed to economic reform and poverty reduction. Through the Heavily Indebted Poor Countries (HIPC) Initiative, the Multilateral Debt Relief Initiative (MDRI), and the 2007 agreement for additional debt relief from the Inter-American Development Bank, more than \$86 billion has been agreed to in debt relief for 22 countries.

In fiscal year 2007, the Department of the Treasury promoted sustainable economic growth, and supported the global war on terror by advancing debt reduction for Iraq and Afghanistan. The IDD spearheaded Afghanistan's entry into the HIPC Initiative, to reduce its debts by over 92 percent, more than \$11 billion. In addition, the IDD continued to provide support for Iraq's efforts

to obtain debt relief from additional creditors, implementing the 2004 Paris Club, which was designed to bring debt down to a manageable level. Debt restructuring bolsters economic development and reduces dependency on the U.S. and international community.

The Department of the Treasury, through the OCC and OTS, is the primary regulator and supervisor of national banks, savings associations, and savings and loan holding companies.

During fiscal year 2007, the Department of the Treasury, Department of Housing and Urban Development (HUD), and others in the Administration carefully focused on evaluating the challenges faced by individuals in the subprime market. The Treasury Department and HUD took several actions to provide assistance to homeowners, including the pursuit of legislation modernizing the Federal Housing Administration. Due to the threat of increased foreclosures, temporary changes were proposed to the federal tax code provision that currently considers cancelled mortgage debt on primary residences as taxable income.

The OCC and the OTS worked with other federal banking regulators to issue guidance on subprime mortgage lending and non-traditional mortgage products. This guidance articulates consumer protection standards to ensure borrowers obtain loans they can afford to repay. Additionally, the agencies worked with the Conference of State Bank Supervisors and American Association of Residential Mortgage Regulators to encourage individual states to adopt the guidelines for mortgage brokers under their supervision. The agencies also encouraged financial institutions to work with residential borrowers that are unable to meet their contractual home loan obligations.

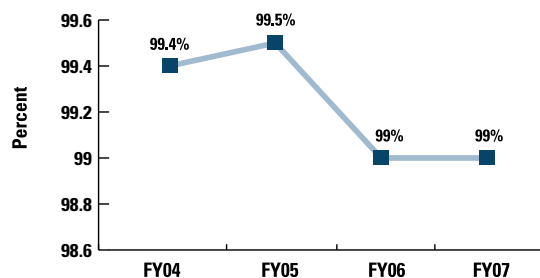
Financing the ownership of homes has been a focus of thrift institutions throughout their history. Thrifts currently hold over \$1 trillion in housing-related loans and securities. In addition, the thrift charter is used extensively by some thrifts to make small business, consumer retail, and commercial real estate loans.

Adequate capital absorbs losses, promotes public confidence, and provides protection to depositors and the FDIC insurance funds. It also provides a financial cushion that allows a thrift institution to continue operating during periods of loss or other adverse conditions. As of June 2007, the OTS supervised 836 thrift institutions with assets totaling \$1.5 trillion, and 472 hold-

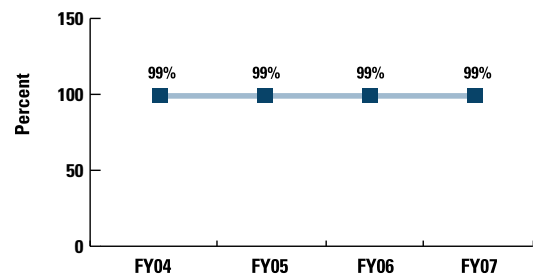
www.helpwithmybank.gov

The OCC recently launched helpwithmybank.gov, a new website dedicated to providing answers to common questions and assistance to national bank customers. The website presents information with straightforward, easy-to-use terms in a simple question-and-answer format. Topics include credit cards, interest rates, check cashing, late payments, mortgages, and many others. The site also provides guidance on how to determine if a bank is a national bank or operating subsidiary and who to contact if the bank is not. The OCC hopes to work with other financial regulators to expand this effort to support all bank customers.

Thrifts that are Well Capitalized



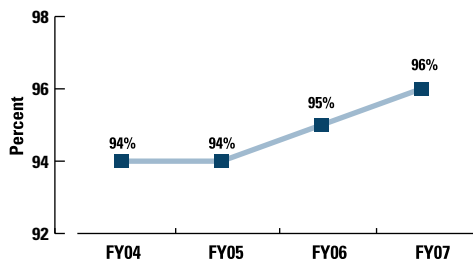
National Banks that are Well Capitalized



Capital Markets

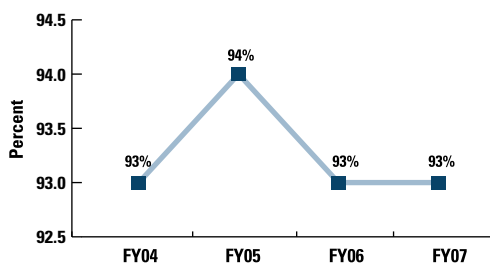
Citigroup Inc., Bank of America Corp. and JPMorgan Chase & Co. have agreed to create a rescue fund to buy distressed debt from markets affected during the fiscal year 2007 financial crises. The fund has the potential to reach \$100 billion to bail out troubled global credit markets. The joint effort is the result of more than a month of discussions with the Treasury Department with the intention of increasing confidence in the market for mortgage-backed securities while avoiding a government bailout.

Percentage of National Banks with Composite CAMELS Rating 1 or 2



CAMELS is an interagency bank and thrift-rating system used by U.S. supervisory authorities to rate financial institutions. The rating is based on six factors, which make up the acronym, Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk. Banks are assigned a rating on a scale of one to five, with one being the best. A composite rating of "1" or "2" generally is considered to be a high-quality or satisfactory institution, while banks with a rating of "3", "4", or "5" are considered to be less-than-satisfactory. This system allows supervisory authority to identify the banks that are in need of attention.

Percentage of Thrifts with Composite CAMELS Rating 1 or 2



ing company enterprises with U.S. domiciled consolidated assets of approximately \$8.5 trillion; 93 percent of the regulated thrifts achieved an overall composite CAMELS rating of 1 or 2, with 99 percent well-capitalized. The OCC supervised 1,755 institutions with national bank charters and 49 federal branches with assets totaling approximately \$7.2 trillion. Relative to their risk, 99 percent of all national banks were well-capitalized, and 96 percent of national banks earned the highest composite CAMEL rating of 1 or 2 under the standard method of evaluating a bank's operations.

Strategic Outcome

Decreased gap in global standard of living

Sustained strong economic growth creates opportunities, improves quality of life, and reduces poverty.

The Department's Office of Multilateral Development Banks (MDBs) advances the United States' development agenda of promoting economic growth, and reducing poverty through its oversight and participation in global and regional MDBs. To decrease the gap in global standards of living, the Department initiated a number of reforms to increase the effectiveness of the development assistance provided by the MDBs.

The Multilateral Debt Relief Initiative (MDRI), a landmark effort agreed to in 2005, will cancel 100 percent of debt owed to the World Bank's International Development Association, the African Development Fund, and the International Monetary Fund (IMF) by the world's poorest and most heavily indebted countries. In fiscal year 2007, through U.S. efforts, a similar landmark debt relief initiative, the Fund for Special Operations at the Inter-American Development Bank, was approved. With the support of this initiative, the MDBs have increased new resources to debt-vulnerable countries in the form of grants - not loans - which is integral to ending the lend-and-forgive cycle. For two consecutive years, nearly \$2.7 billion in grant funding has been provided to the poorest and most debt vulnerable countries by the concessional arms of the World Bank, the African Development Bank, and the Asian Development Bank. With the adoption of debt sustainability frameworks at the MDBs, assistance to the poorest and most debt distressed countries will be solely through grants.

In July 2007, the U.S. Treasury Department and the International Finance Corporation (IFC) launched the Latin America and

Caribbean (LAC) Infrastructure Development Program of the Americas to help drive private sector investment in this region. The \$17.5 million program, managed by the IFC, aids in identifying sustainable infrastructure projects suitable for private participation, makes information publicly available, provides advisory support, and organizes the public tendering process. The program also assists in improving regulatory frameworks on private sector participation in LAC countries. In its first four years, the program is estimated to mobilize as much as \$1 billion in new investments and \$400 million in fiscal savings for local governments.

Strategic Outcome

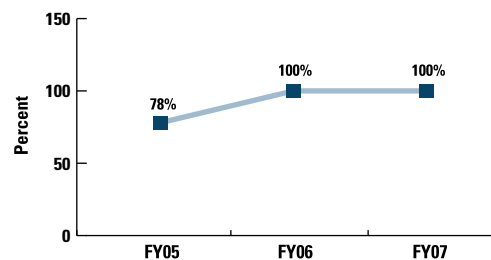
Commerce enabled through safe, secure U.S. notes and coins

Trust and confidence are vital to the continued global acceptance of U.S. currency, and to protect the global user from counterfeiting schemes, U.S. currency is redesigned and manufactured. The Department reliably provides safe, secure, cost-efficient, high quality U.S. notes, security documents, and coins that are readily accepted by all currency users and customers, which facilitates seamless and stable commerce. In addition, the Department of the Treasury secures the nation's gold and silver reserves.

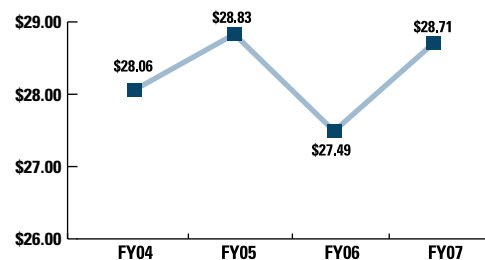
The Bureau of Engraving and Printing (BEP) designs next generation currency to guard against counterfeiting, and manufactures the nation's paper currency. In fiscal year 2007, the BEP maintained its position as a world-class securities printer providing its customers with superior products through excellence in manufacturing and technological innovation. The BEP continued to produce U.S. currency at the highest quality while incorporating state-of-the-art counterfeit-deterrent features. In fiscal year 2007, the BEP delivered 9.1 billion paper currency notes, meeting the Federal Reserve's exacting quality standards of 100 percent defect free, while under running their budget by \$32 million.

In fiscal year 2007, the BEP met its performance target for costs per 1,000 notes produced. Manufacturing costs increased from \$27.49, in 2006, to \$28.71, in 2007, due to changes in the production program and the production of higher cost denominations, but were still below target. Security costs were favorable at \$5.92 per thousand notes produced against a performance target of \$6.00 per thousand notes delivered.

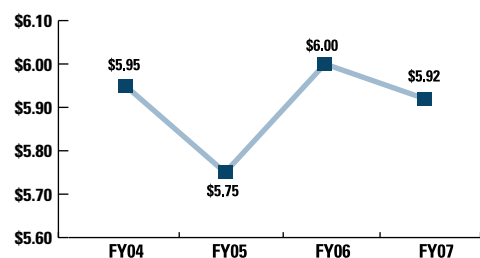
Improved IMF Effectiveness and Quality Through Periodic Review of IMF Programs

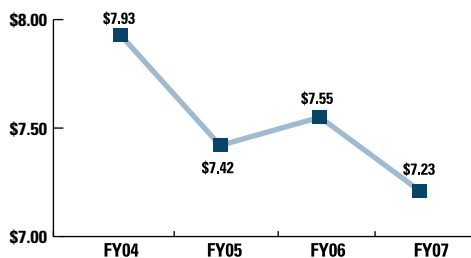


Manufacturing Costs for Currency
(Dollar Cost per Thousand Notes Produced)



Security Costs per Thousand Notes Delivered



Costs per Thousand Coin Equivalents

The United States Mint manufactures circulating coinage and popular numismatic products. In fiscal year 2007, the Mint successfully launched the first three circulating Presidential \$1 coins. The Presidential \$1 Coin Act of 2005, created this educational program to honor the presidents, in chronological order by term in office, with four different designs being released each year. In addition, the Mint issued the first three First Spouse gold coins honoring the spouses of each of the presidents.

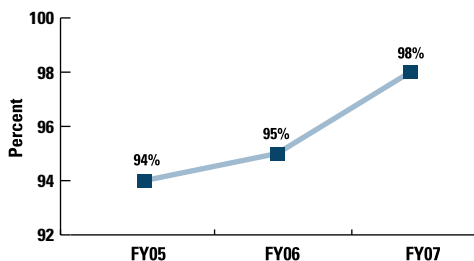
Rising metal prices continue to have an impact on production cost. For the second consecutive year, the penny and the nickel cost more to produce than their face value; the Department is exploring alternative materials in an effort to overcome production challenges.

In fiscal year 2007, the Mint had revenue and other financing sources of \$2,635 billion for circulating and numismatic coin products, an increase of 13 percent over fiscal year 2006. As a result of operations, \$825 million was returned to the Treasury General Fund, as compared to \$750 million in fiscal year 2006, an increase of 10 percent. This increase in operating results was due primarily to the introduction of the Presidential \$1 Coins.

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

While promoting financial and economic growth at home and abroad, the Treasury Department performs an important, unique, and growing role in protecting national security. The Department's sanctions, regulatory law enforcement, and intelligence authorities, provide powerful tools for the United States to apply pressure against threats to national security, and safeguard the international financial and economic systems, keeping them free and open to legitimate users.

The United States Mint H.I.P. Pocket Change web site was launched in July 1999. H.I.P. Pocket Change is a fun educational tool for students and teachers that generate interest in coins, the United States Mint, and U.S. history. Check it out at: www.usmint.gov/kids/

Order Fulfillment

Strategic Outcome

Removed or reduced threats to national security from terrorism, proliferation of weapons of mass destruction, drug trafficking, and other criminal activity on the part of rogue regimes, individuals, and their financial and other support networks

Since 2001 and the inception of an Executive Order, 483 individuals and entities were designated by the U.S. Government as terrorists, their financiers, or facilitators. In fiscal year 2007, three Libyan individuals, members of both al-Qa’ida and the Libyan Islamic Fighting Group, were designated for executing various activities from recruitment, to military training, to procurement of explosive components.

The Department in cooperation with the State Department, continued to target proliferators of WMD and their supporters, freezing their U.S. assets, and prohibiting U.S. individuals from doing business with them. The Department designated Bank Sepah, the fifth-largest Iranian state-owned financial institution, for providing extensive financial services to Iranian entities responsible for developing missiles capable of carrying WMD. Bank Sepah’s isolation has potentially made it more difficult for Iran to facilitate some of its missile proliferation-related activities.

The OFAC’s Specially Designated Narcotics Traffickers Program continued to see significant activity in fiscal year 2007, targeting additional leaders of Colombia’s North Valle cartel and their financial networks, including 30 individuals in Colombia, and 42 front companies. In fiscal year 2007, the OFAC targeted Medellin-based narcotics trafficker Fabio Enrique Ochoa Vasco for designation, along with his extensive criminal and financial network of 65 individuals and 45 companies. In addition, after targeting two leaders of Colombia’s Cali Cartel, Miguel and Gilberto Rodriguez Orejuela, their front man, Fernando Gutierrez Cancino, pled guilty to money laundering charges and agreed to forfeit his right, title, and interest in all business entities. These entities are part of the 246 front companies that were designated over the past 11 years, and under at least 12 OFAC actions targeting Colombian drug cartels.

The TFI engages in outreach and education to advance the Department’s unique security mission. The Terrorist Financing and Financial Crimes (TFFC) initiated a series of private sector Anti-Money Laundering/Combating Financing of Terrorism (AML/CFT) dialogues, linking the U.S. banking sector with those from the Middle East/North Africa and Latin American regions. These dialogues raise awareness of terrorist financing and money laundering risks, facilitate a better understanding of effective practices and programs to combat the risks, and strengthen implementation of effective AML/CFT controls.

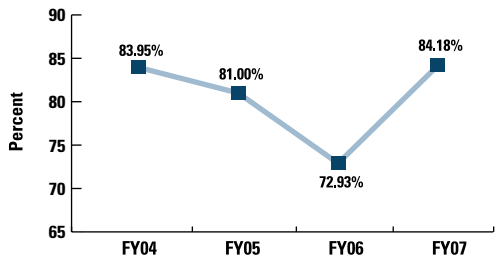
The Department of the Treasury participated in the U.S. Government interagency working group that published the 2007 National Money Laundering Strategy. This strategy built on a solid foundation of successful initiatives and programs introduced in previous strategies. As globalization opens borders to travel and trade, and global payments and clearing systems evolve, new money laundering opportunities are created and exploited, the strategy addressed these emerging money laundering trends.

TFFC spearheads a Muslim-American outreach initiative, which included planning the U.S. Treasury Department’s annual iftaar dinner, a traditional meal to break the daily fast during the Muslim holy month of Ramadan. The dinner is held to honor Muslim-Americans and to thank them for their contributions to the U.S. economy and community as a whole. Through this initiative and other outreach programs, the Department is constructively engaging Muslims in order to create a better environment for partnerships on a range of Treasury issues with the Muslim-American community.

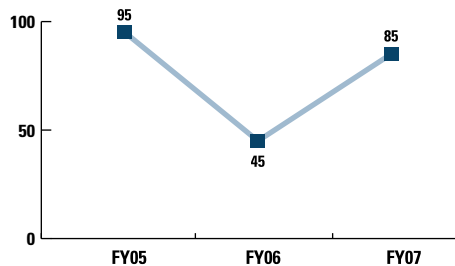
The Treasury Department Intelligence Operations Center has become a fully-functional 24 hour/ 7 days-a-week operation, providing timely, relevant, and accurate intelligence to support:

- Treasury’s participation in the NSC policymaking process
- Policymaker’s engagement with counterparts abroad, including normalizing the sharing of economic and financial intelligence
- Identification and dissemination of high-priority intelligence to senior Treasury decision-makers

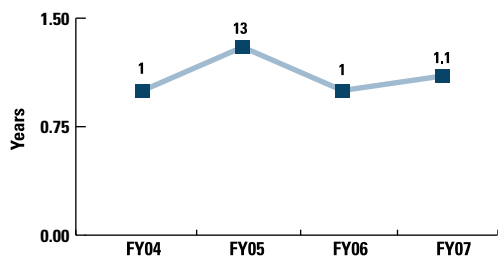
Percent of Forfeited Cash Proceeds Resulting from High-Impact Cases



Increase the Number of Outreach Engagements with the Charitable and International Financial Communities



Average Time to Process Enforcement Matters



Strategic Outcome

Safer and more transparent U.S. and international financial systems

Confidence in the integrity of the U.S. and international financial systems fosters economic growth, and improves national security. Transparency in the financial sector denies terrorists, drug traffickers, WMD proliferators, and other criminals the ability to conceal their illicit activities. The U.S. national security is enhanced when financial systems are safeguarded from criminal abuse.

To improve the consistency of the application of BSA rules regulating financial institutions, the FinCEN's regulatory policy efforts focus on efficient and effective administration of the BSA. This is achieved through briefings to increase understanding of how the BSA's regulatory requirements generate information for law enforcement. The FinCEN requires that financial institutions create policies, procedures, and systems to make the financial system transparent and protect it from becoming a conduit for financial crime. In fiscal year 2007, the FinCEN published amended BSA regulations, including special measures against Banco Delta Asia, and its subsidiaries, casino recordkeeping and reporting requirements, and guidance for certain foreign accounts under the anti-money laundering program/special due diligence rules.

In addition, the FinCEN published guidance to improve consistency in the interpretation and application of BSA regulations, and advance the understanding of regulatory expectations, including a report on the risk of money laundering related to the Shell companies and information on compliance requirements for reporting suspicious transaction reporting at mutual funds.

STRATEGIC GOAL MANAGEMENT AND ORGANIZATIONAL EXCELLENCE

The Department of the Treasury strives to maintain public trust and confidence in U.S. and international economic and financial systems, through exemplary leadership, best-in-class processes, and a culture of excellence, integrity, and teamwork. The Treasury Department realizes its strategic goals by building a strong institution that is citizen-centered, results-oriented, and efficient, while actively promoting innovation. The Department works to implement initiatives and programs that benefit the American people.

Strategic Outcome

A citizen-centered, results-oriented and strategically aligned organization

The Treasury Department ensures that taxpayers receive the most efficient and effective use of their tax dollars by building a strong institution that is dedicated to serving the public interest and focused on delivering results.

In fiscal year 2007, the Department of the Treasury released its Strategic Plan for Fiscal Years 2007-2012. This plan was developed collaboratively with employees and senior management, and was tested and refined against a changing global environment. Additionally, the Department went beyond linking performance to the budget, and established an Integrated Management System to monitor continuous improvement and make changes as necessary.

Through an established strategic framework, the Department will use performance planning and budgeting to determine funding that will achieve intended results. Performance measures with long-term and annual targets will be used and funding will be tied to the level of performance that needs to be achieved. As part of the management process, a number of options can be executed to improve value for stakeholders.

President’s Management Agenda (PMA): The Department of the Treasury is enabled through the principles of the PMA. The PMA is designed to improve management practices across the federal government and transform it into a results-oriented, efficient, and citizen-centered enterprise. Executing the PMA involves lowering the cost of doing business through competition, strengthening the Department’s workforce, improving financial performance, increasing the use of information technology and e-government capabilities, and integrating budget decisions with performance data.

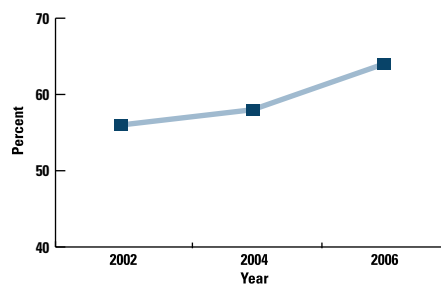
In fiscal year 2007, the Department continued to be successful in the Human Capital initiative; for the Performance Improvement, Competitive Sourcing, Financial Performance, and E-Government initiatives each had mixed results during the year; while the Improper Payments initiative remained unchanged. In its first year as a PMA initiative, the Credit Management initiative was rated with mixed results.

Protecting Citizens’ Personally Identifiable Information

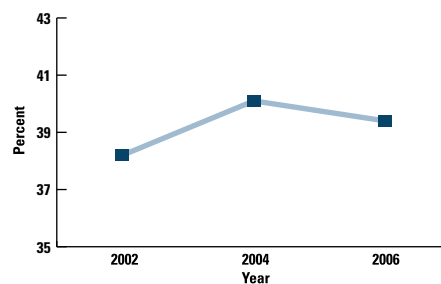
Safeguarding personally identifiable information and preventing its breach is essential to ensuring the Department retains the trust of the American public. The Treasury Department has initiated a policy to encrypt all data on mobile computers and devices. To date, the Department has encrypted 100 percent of its laptop computers. Additionally, the Department of the Treasury is actively engaged in activities to oversee its compliance with privacy protection requirements and the breach of personal information.

Selected Federal Human Capital Survey Questions

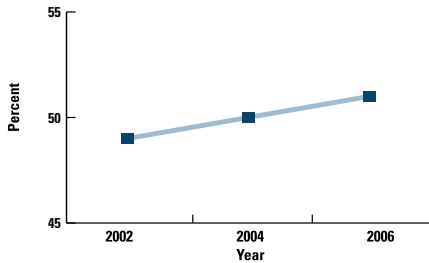
FHCS - Recommend My Organization as a Good Place to Work



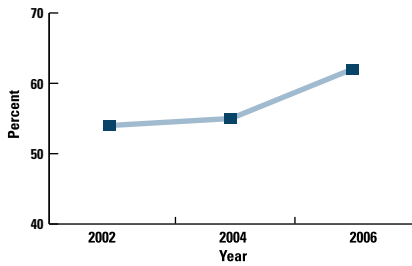
FHCS - Promotions in My Work Unit are Based on Merit



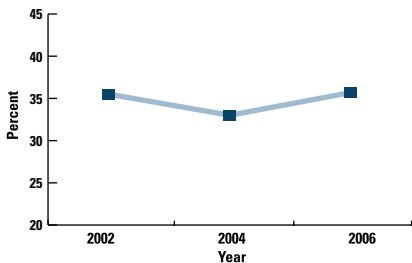
FHCS - Employees are Rewarded for Providing High Quality Products and Services to Customers



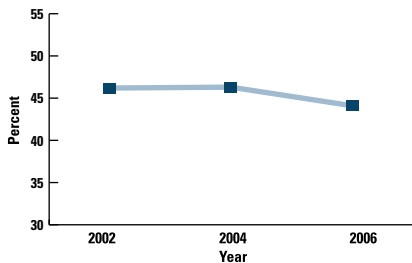
FHCS - I Feel Encouraged to Come Up with New and Better Ways of Doing Things



FHCS - In My Organization, Leaders Generate High Levels of Motivation and Commitment in the Workforce



FHCS - My Organization's Leaders Maintain High Standards of Honesty and Integrity



President's Management Agenda

Initiative	Status				FY 2007 Progress			
	FY 2004	FY 2005	FY 2006	FY 2007	Q1	Q2	Q3	Q4
Human Capital	Y	Y	G	G	G	G	G	G
Competitive Sourcing	Y	G	G	Y	Y	R	Y	Y
Financial Performance	R	R	R	Y	G	G	G	G
E-Government	R	R	Y	Y	R	G	G	Y
Performance Improvement	N/A	Y	Y	Y	G	G	G	G
Improper Payments	N/A	R	R	R	Y	Y	Y	Y
Credit Management	N/A	N/A	N/A	Y	N/A	G	G	G

● Green for Success
 ● Yellow for Mixed Results
 ● Red for Unsatisfactory

Strategic Outcome

Exceptional accountability and transparency

Good management begins with accountability and responsibility for the people, property, and money that the Department manages. Internal control is a key tool to fulfill the Treasury Department's obligations to the American people. It serves as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. The Treasury Department continues to strengthen and improve the execution of its mission through the application of sound internal controls over financial reporting.

In fiscal year 2007, testing and assessments were completed Department-wide. No new material weaknesses were found through the assessment of financial reporting under A-123, Appendix A; however, the IRS continues to address issues related to the revenue accounting system, one of its material weaknesses.

The OIG auditors conduct financial, performance, and information technology audits within the Treasury Department. These audits are intended to save taxpayer dollars, improve the Department's effectiveness and efficiency, and help prevent waste and detect fraud and abuse in Department programs and operations. During fiscal year 2007, the OIG completed 64 audit products and referred 188 cases for criminal, civil, or administrative action.

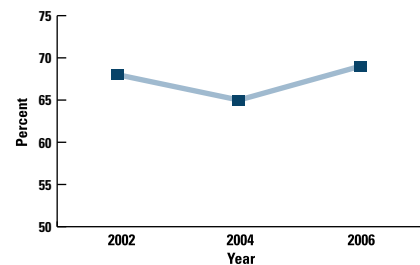
The TIGTA's audit and investigative services promote and protect the fair administration of the internal revenue laws, and their oversight is essential to the efficiency and equity of the federal tax administration system. In addition, the TIGTA's offices assist

in maintaining taxpayers’ confidence in the federal tax system by ensuring that the IRS is managed fairly and effectively, and violators of the public’s trust are detected and appropriately sanctioned.

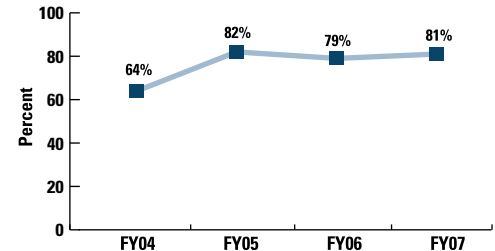
In fiscal year 2007, the TIGTA issued 180 audit reports; one specifically addressing whether the proper amounts of Social Security and Medicare taxes are being collected for tips and wages reported on Social Security and Medicare Tax on Unreported Tip Income Form. It is estimated that an additional \$108 million in Social Security and Medicare taxes each year could be assessed.

The IRS’s ability to deliver taxpayer service, enforce tax laws effectively, and collect the proper amount of taxes can be undermined by employee misconduct; over 50 percent of current investigations involve alleged employee misconduct. The TIGTA’s investigations of employee misconduct include extortion, theft, taxpayer abuse, false statements, financial fraud, and unauthorized access to confidential taxpayer records. In fiscal year 2007, approximately 81 percent of the 3,597 closed investigations generated positive results, including 1,663 cases of employee misconduct referred for action and 206 cases accepted for criminal prosecution. In addition, the TIGTA opened 521 new unauthorized access cases and closed 621 cases, 594 of which resulted in personnel action against IRS employees.

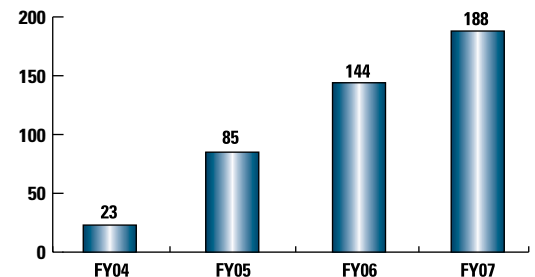
**FHCS - Considering Everything,
How Satisfied are You with Your Job?**



Percentage of Results from Investigative Activities



Number of Investigations Referred



PERFORMANCE SCORECARD

The following scorecard indicates the fiscal year 2007 results for a selection of key Treasury Department measures. For a complete list of official performance measures refer to Appendix A.

Performance Measure	FY 2007 Planned	FY 2007 Actual	Target Met?	FY 2008 Planned
Financial				
Percentage of voluntary compliance in filing tax payments timely and accurately (in terms of number of compliant industry members)	74.0%	75.0%	Y	75.0%
Percentage of voluntary compliance in filing tax payments timely and accurately (in terms of revenue)	86.0%	86.37%	Y	87.0%
Percentage of total tax receipts collected electronically	98.0%	98.0%	Y	98.0%
Percentage collected electronically of total dollar amount of Federal Government Receipts	80.0%	79.0%	N	80.0%
Unit cost to process a federal revenue collection transaction	\$1.33	Est \$1.19	Y	\$1.30
Amount of delinquent debt collected per \$1 spent	\$36.50	Est \$42.09	Y	\$36.75
Amount of delinquent debt collected through all available tools (in Billion \$)	\$3.20	\$3.76	Y	\$3.30
Percentage of delinquent debt referred to FMS for collection compared to amount eligible for referral	94.0%	100.0%	Y	95.0%
Percentage of Government-wide accounting reports issued accurately	100.0%	100.0%	Y	100.0%
Percentage of Government-wide accounting reports issued timely	100.0%	100.0%	Y	100.0%
Cost per summary debt accounting transaction	\$10.98	Est \$8.93	Y	\$10.88
Variance between estimated and actual receipts	5.0%	2.1%	Y	5.0%
Cost per debt financing operation	\$228,409	Est \$216,801	Y	\$249,679
Percent of auction results released in 2 minutes +/- 30 seconds	95.0%	99.1%	Y	95.0%
Cost per TreasuryDirect assisted transaction	\$6.16	Est \$6.03	Y	\$7.05
Cost per TreasuryDirect online transaction	\$2.96	Est \$2.79	Y	\$2.44
Percentage of retail customer service transactions completed within 12 business days	90.0%	99.43%	Y	90.0%
Percentage of Treasury Payments and associated information made electronically	78.0%	78.0%	Y	79.0%
Percentage of Paper Check and Electronic Funds Transfer Payments made accurately and on-time	100.0%	100.0%	Y	100.0%
Unit Cost for Federal Government Payments	\$0.39	Est \$0.38	Y	\$0.38
Field collection embedded quality	86.0%	84.0%	N	86.0%
Timeliness of critical other tax products to the public	79.6%	84.0%	Y	86.0%
Timeliness of critical filing season tax products to the public	85.2%	83.5%	N	86.0%
Taxpayer self assistance rate	48.6%	49.5%	Y	51.5%
Automated collection system accuracy	91.0%	92.9%	Y	92.0%
Percent individual returns processed electronically	57.0%	57.1%	Y	61.8%
Percent of business returns processed electronically	19.5%	19.1%	N	20.8%
Customer accuracy – Accounts (Phones)	93.3%	93.4%	Y	93.5%
Customer accuracy - Tax law phones	91.0%	91.2%	Y	91.0%

Table continued on next page >

Performance Measure	FY 2007 Planned	FY 2007 Actual	Target Met?	FY 2008 Planned
Customer contacts resolved per staff year	7,702	7,648	N	8,000
Customer Service Representative (CSR) Level of Service	82.0%	82.1%	Y	82.0%
Refund timeliness - Individual (paper)	99.2%	99.1%	N	99.2%
Examination coverage-Individual	1.0%	1.0%	Y	1.0%
Examination coverage-Business	8.2%	7.2%	N	6.8%
Field exam embedded quality	87.0%	85.9%	N	87.0%
Examination quality - (LMSB) Industry	88.0%	87.0%	N	90.0%
Examination quality – (LMSB) Coordinated industry	97.0%	96.0%	N	97.0%
Office exam embedded quality	89.0%	89.4%	Y	89.4%
Automated Underreporter Efficiency	1,932	1,956	Y	1,808
Automated Underreporter Coverage	2.5%	2.5%	Y	2.7%
Examination efficiency – Individual	136	137	Y	136
Collection efficiency – units	1,723	1,828	Y	1,751
Collection coverage – units	54.0%	54.0%	Y	54.0%
Economic				
Improve International Monetary Fund (IMF) effectiveness and quality through periodic reviews of IMF programs	90.0%	100%	Y	90.0%
Rehabilitated problem national banks as a percentage of the problem national banks one year ago (CAMELS 3, 4, or 5)	40.0%	52.0%	Y	40.0%
Percentage of national banks that are categorized as well-capitalized	95.0%	99.0%	Y	95.0%
Percent of thrifts with composite CAMELS ratings of 1 or 2	90.0%	93.0%	Y	90.0%
Percent of thrifts that are well-capitalized	95.0%	99.0%	Y	95.0%
Percentage of grant and loan proposals containing satisfactory frameworks for results measurement	90.0%	92.0%	Y	90.0%
Number of new Free Trade Agreement negotiations and Bilateral Investment Treaty negotiations underway or completed	7	10	Y	Discontinued
Number of full-time equivalent jobs created or maintained in underserved communities by businesses financed by CDFI Program Awardees and New Markets Tax Credit (NMTC) Allocatees	34,009	35,022	Y	28,676
Dollars of private and non-CDFI Fund investments that CDFIs are able to leverage because of their CDFI Fund Financial Assistance. (in millions)	\$861.00	\$778.00	N	\$643.00
Administrative costs per Financial Assistance application processed	\$6,920	Est \$7,180	N	\$6,920
Percent of Electronically filed Certificate of Label Applications	47.0%	51.0%	Y	48.0%
Unit Cost to process a Wine Certificate of Label Approval	Baseline	\$34.00	Y	\$34.00
Manufacturing costs for currency (dollar cost per thousand notes produced)	\$32.50	\$28.71	Y	\$33.00
Percent of currency notes delivered to the Federal Reserve that meet customer quality requirements	99.9%	100.0%	Y	99.9%
Cost per 1,000 coin equivalents	\$7.27	\$7.23	Y	\$7.15
Order fulfillment	96.0%	98.0%	Y	96.0%
Currency shipment discrepancies per million notes	0.01%	0.01%	Y	0.01%
Percentage of national banks with composite CAMELS rating 1 or 2	90.0%	96.0%	Y	90.0%
Table continued on next page >				

Performance Measure	FY 2007 Planned	FY 2007 Actual	Target Met?	FY 2008 Planned
Security				
Average time to process enforcement matters (Years)	1.0	1.1	N	1.0
Number of federal and state regulatory agencies with which FinCEN has concluded memoranda of understanding information sharing agreements	50	50	Y	52
Percentage of customers finding FinCEN's analytic reports highly valuable	Baseline	82.0%	Y	79.0%
Percentage of customers satisfied with the BSA Direct E-filing	90.0%	94.0%	Y	90.0%
Management				
Number of open material weakness (significant management problems identified by GAO, the IGs and/or the Bureaus) (President's Management Agenda) Targeted for Closure in fiscal year 2007	1	0	N	1
Complete investigations of EEO complaints within 180 days	50.0%	51.6%	Y	50.0%
Operating Expenses as a Percentage of Revenue – Consolidated/Integrated Administrative Management	12.0%	4.3%	Y	12.0%
Operating Expenses as Percent of Revenue – Financial Management Support Services	12.0%	15.1%	N	12.0%
Percent of statutory audits completed by the required date	100.0%	100.0%	Y	100.0%
Percentage of audit products delivered when promised to stakeholders	Baseline	68.0%	Y	60.0%
Percentage of recommendations made that have been implemented	Baseline	90.0%	Y	80.0%
Percentage of results from investigative activities	73.0%	81.0%	Y	76.0%
KEY: Some measures have estimates for their actual fiscal year data – due to information not available at the time of publication of this document.				

Scorecard Shortfalls

The information below explains the shortfalls for key performance measures shown above that did not achieve the target level of performance. The Appendix A shows the full suite of performance measures, data, and shortfalls.

In fiscal year 2007, the FinCEN experienced a slight increase in the average processing time of cases by 21 days; this increase in processing time resulted in just missing the target of 1.0 years average time to process cases. The additional time taken for processing was the result of joint investigations with other enforcement agencies. In the future, the FinCEN will consider the appropriate amount of time needed for joint enforcement actions when establishing their target for this performance measure.

The IRS was within one percent of meeting its performance target for the measure “Refund Timeliness-Individual.” Delays that caused this shortfall were attributed to the increase in the number of Individual Taxpayer Identification Number applications, verification of required documentation that is often submitted in foreign languages, and the Individual Taxpayer Identification Number system caused instabilities by malfunctioning during peak processing season.

For fiscal year 2007, the actual data for the performance measure “Field Examination Embedded Quality” was 85.9 percent, missing its target by 1.1 percentage points. The target predicted a 10 percent improvement factor for weak quality attributes, however this did not occur. After not meeting its target, the IRS

planned actions to improve its quality score by studying the consistency between the Embedded Quality Review and the National Quality Review Systems’ processes.

For fiscal year 2007, the FMS set its target at 80 percent for the performance measure “Percentage collected electronically of total dollar amount of federal government receipts.” Results indicated that the FMS missed the target by one percent; this due to the large number of the paper 1040 form tax remitters. Most online tax preparation sites charge fees for filing the 1040 forms electronically, discouraging e-filing. The FMS will continue to work with the appropriate entities to reduce associated costs and encourage electronic filing.

The IRS missed its fiscal year 2007 target of 8.2 by one percentage point for the performance measure “Examination Coverage – Business Corporations.” Key factors contributing to this shortfall included the implementation of currency and cycle time initiatives. An increase in time spent on the Compliance Assurance Program to address issues in a pre-filing environment resulted in fewer numbers of closed returns from a comparable current coordinated industry case examination; the Issue Management System consumed more agent time than planned.

SUMMARY OF MANAGEMENT CHALLENGES AND HIGH-RISK AREAS

The Department of the Treasury’s Inspectors General and the Government Accountability Office has identified the most significant, high-risk challenges facing the Department. While these challenges do not necessarily indicate deficiencies in performance, progress has been made in fiscal year 2007; they represent inherent risks that must be monitored continuously. The Treasury Department is committed to addressing these challenges in fiscal year 2008. Below are the management challenges identified by the IGs.

- Corporate Management
- Management of Capital Investment
- Information Security
- Linking Resources to Results
- Anti-Money laundering and Terrorist Financing/Bank Secrecy Act Enforcement
- Modernization of the Internal Revenue Service
- Tax Compliance Initiatives
 - Business and Individual
 - Tax-Exempt Entities
- Security of the Internal Revenue Service
- Providing Quality Taxpayer Service Operations
- Complexity of the Tax Law
- Human Capital
- Erroneous and Improper Payments
- Taxpayer Protection and Rights
- Processing Returns and Implementing Tax Law Changes During the Tax Filing Season
- Using Performance and Financial Information for Program and Budget Decision

Although it critical for the Department to address all of these challenges, a selected few are discussed below, noting the actions taken during fiscal year 2007. (For the comprehensive response to the full list, refer to Appendices D).

Information Security: In fiscal year 2007 the Treasury Department launched a privacy awareness training course for all employees highlighting the policies and practices necessary to safeguard and protect citizens' data. Although the Department met its goal of encrypting 100 percent of its laptops during fiscal year 2007, the Treasury Department will continue to work towards properly safeguarding all of its information assets. By fiscal year 2009, the Department plans to achieve 100 percent compliance with Security Configuration installation and the industry standard of 90 percent maintenance.

Linking Resources to Results: In July 2007, the Treasury Department issued its new strategic plan for fiscal years 2007-2012. In this plan, the Department went beyond linking performance to the budget, and established an Integrated Management System to monitor continuous improvement. Performance planning and budgeting will determine funding, which will be tied to the desired level of performance. The Integrated Management System will be implemented during fiscal year 2008.

Treasury recognizes that lacking relevant and reliable cost accounting information, federal managers may not understand and control the full cost of programs. And without a link between performance and cost, agencies are not in a position to establish cost reduction goals and maintain or improve performance results because they do not know how much it costs to deliver outcomes.

In 2008, the Chief Financial Officers Council work group will continue to refine the Departmental managerial cost accounting model, establish key cost accounting goals for all of the Department's components, and develop a plan for future Departmental oversight of cost accounting implementation and use as a management tool. Additionally, the Department will work diligently in fiscal year 2008 to more fully integrate budget and performance, linking changes in funding levels to corresponding changes in performance.

Anti-Money Laundering and Terrorist Financing/Bank Secrecy Act (BSA) Enforcement: The Department of the Treasury plays a key role in the U.S. Government's efforts to track and cut off the flow of funds to terrorist and other national security threats. The Department initiated a series of private sector Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) dialogues. These dialogues raise awareness of terrorist financing and money laundering risks, facilitate a better understanding of effective practices and programs to combat the risks, and strengthen implementation of effective AML/CFT controls.

The Treasury Department effectively administers and enforces the BSA, an important tool in combating anti-money laundering. The BSA requires that financial institutions report on suspicious activities, keep records, and establish appropriate internal controls to guard against financial crime. As the administrator of the BSA, the Department oversees and coordinates the sharing of financial intelligence and analysis with its stakeholders, and works closely with regulatory partners to take action against violating institutions.

Tax compliance Initiatives: In fiscal year 2007, the IRS continued compliance efforts that promote taxpayer confidence and support the Department's goal to reduce the tax gap. The IRS improved its ability to estimate non-compliance to pinpoint areas where taxpayers are not in compliance with federal tax laws. This year, two reporting compliance studies began; one addresses Subchapter S Corporations, the second is look-

ing at the Tax Year 2006 individual income. When completed, these studies will enable the IRS to better leverage limited enforcement resources and reduce the burden on compliant taxpayers.

Complexity of the Tax Law: In fiscal year 2007, the IRS took steps to reduce taxpayer burden, including the review of existing tax products with the goal to simplify. The IRS also incorporated taxpayer feedback, research, and focus group results to obtain taxpayer information relative to product changes. In an effort to ease the burden associated with the complexity of the tax system and recent revisions to the tax laws, the IRS continued to provide important and current information needed to file tax returns on the IRS.gov website. For individual taxpayers, the IRS designed a “1040 Central” page which contains news releases, fact sheets and tax tips, all designed to keep taxpayers informed of changes. The IRS also developed a three-point plan, that expanded Earned Income Tax Credit (EITC) outreach initiatives, identified ways to simplify and improve the forms, and outlined efforts to improve the IRS.gov website, making it more user friendly for EITC filers.

Erroneous and Improper payments: In fiscal year 2007, the IRS protected about \$2.6 billion in revenue through Earned Income Tax Credit (EITC) enforcement efforts which included the examination of almost 500,000 returns claiming EITC, approximately 390,000 document matching reviews, and 400,000 math error process corrections. In addition, the IRS met all the Improper Payment Improvement Act requirements for the EITC, providing a current estimate of erroneous payment amounts, an explanation of the methodology to calculate the amount and an action plan to reduce the number and amount of those payments.

ANALYSIS OF FINANCIAL STATEMENTS

The following are the condensed financial statements of the Department as of and for the years ended September 30, 2007 and 2006. The complete financial statements and auditors' report are in part III of this report.

Condensed Consolidated Balance Sheets

As of September 30, 2007 and 2006
(In Millions)

ASSETS	2007	2006
Intra-governmental Assets		
Due From the General Fund	\$ 9,052,624	\$ 8,540,195
Other Intra-governmental Assets	322,255	326,552
Total Intra-governmental Assets	9,374,879	8,866,747
Cash, Foreign Currency, and Other Monetary Assets	92,330	63,892
Gold and Silver Reserve	11,062	11,062
Investments and Related Interest	10,074	9,325
Tax, Other and Related Interest Receivables, Net	27,559	21,962
Other Assets	12,903	14,990
Total Assets	\$ 9,528,807	\$ 8,987,978
LIABILITIES		
Intra-governmental Liabilities		
Federal Debt and Interest Payable	\$ 3,974,788	\$ 3,673,117
Other Intra-governmental Liabilities	343,466	320,817
Total Intra-governmental Liabilities	4,318,254	3,993,934
Federal Debt and Interest Payable	5,054,250	4,844,074
Other Liabilities	35,204	35,056
Total Liabilities	9,407,708	8,873,064
NET POSITION		
Unexpended Appropriations	72,317	68,270
Cumulative Results of Operations	48,782	46,644
Total Net Position	121,099	114,914
Total Liabilities and Net Position	\$ 9,528,807	\$ 8,987,978

Condensed Consolidated Statements of Net Cost

For the Years Ended September 30, 2007 and 2006

(In Millions)

	2007	2006
Cost of Treasury Operations:		
Net Financial Program Cost	\$ 11,735	\$ 12,413
Net Economic Program (Revenue)/Cost	(456)	1,188
Net Security Program Cost *	300	0
Net Management Program Cost	440	428
Total Net Cost of Treasury Operations	12,019	14,029
Net Federal Costs (primarily interest on the Federal Debt)	429,302	399,806
Net Cost of Treasury Operations, Federal Debt Interest, and Other Federal Costs	\$ 441,321	\$ 413,835

* Treasury's Strategic Plan for fiscal years 2007 – 2012 includes a new Security Program. Subcomponent reporting assignments were also realigned with the New Strategic Plan.

Condensed Consolidated Statement of Changes in Net Position

For the Year Ended September 30, 2007

(In Millions)

	Combined Earmarked Funds	Combined All Other Funds	Eliminations	Consolidated Total
UNEXPENDED APPROPRIATIONS				
Beginning Balance	\$ 202	\$ 68,068		\$ 68,270
Budgetary Financing Sources				
Appropriations Received	390	450,832		451,222
Appropriations Used	(390)	(446,667)		(447,057)
Other	(2)	(116)		(118)
Total Budgetary Financing Sources	(2)	4,049		4,047
Total Unexpended Appropriations	200	72,117		72,317
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balance	31,614	15,030	0	46,644
Budgetary Financing Sources	708	446,666	(43)	447,331
Other Financing Sources (Uses)	299	(3,679)	(492)	(3,872)
Total Financing Sources	1,007	442,987	(535)	443,459
Net Cost of Operations	2,764	(444,620)	535	(441,321)
Net Change	3,771	(1,633)	0	2,138
Cumulative Results of Operations	35,385	13,397	0	48,782
Net Position - Year End	\$ 35,585	\$ 85,514	\$ 0	\$ 121,099

Condensed Consolidated Statement of Changes in Net Position

For the Year Ended September 30, 2006
(In Millions)

	Combined Earmarked Funds	Combined All Other Funds	Eliminations	Consolidated Total
UNEXPENDED APPROPRIATIONS				
Beginning Balance	\$ 202	\$ 62,980		\$ 63,182
Budgetary Financing Sources				
Appropriations Received	298	417,468		417,766
Appropriations Used	(298)	(412,116)		(412,414)
Other	0	(264)		(264)
Total Budgetary Financing Sources	0	5,088		5,088
Total Unexpended Appropriations	202	68,068		68,270
CUMULATIVE RESULTS OF OPERATIONS				
Beginning Balance	30,817	21,309	0	52,126
Budgetary Financing Sources	441	412,061	(30)	412,472
Other Financing Sources (Uses)	4	(3,653)	(470)	(4,119)
Total Financing Sources	445	408,408	(500)	408,353
Net Cost of Operations	352	(414,687)	500	(413,835)
Net Change	797	(6,279)	0	(5,482)
Cumulative Results of Operations	31,614	15,030	0	46,644
Net Position - Year End	\$ 31,816	\$ 83,098	\$ 0	\$ 114,914

Condensed Combined Statements of Budgetary Resources

For the Years Ended September 30, 2007 and 2006

(In Millions)

	2007	2006
Budgetary Resources:		
Unobligated Balance, Brought Forward	\$ 57,540	\$ 64,670
Recoveries of Prior Year Unpaid Obligations	474	380
Budget Authority	474,974	446,742
Other Budget Authority	(10,008)	(8,701)
Total Budgetary Resources	\$ 522,980	\$ 503,091
Status of Budgetary Resources:		
Obligations Incurred	\$ 465,530	\$ 445,551
Unobligated Balance	46,455	47,093
Unobligated Balance Not Available	10,995	10,447
Total Status of Budgetary Resources	\$ 522,980	\$ 503,091
Change in Obligated Balance		
Total Unpaid Obligated Balances, Net	\$ 52,448	\$ 45,738
Obligations Incurred, Net	465,530	445,551
Gross Outlays	(460,302)	(438,494)
Recoveries of Prior Year Unpaid Obligations, Actual	(474)	(380)
Changes in Uncollected Customer Payments from Federal Sources	191	33
Total Unpaid Obligated Balance, Net, End of Year	\$ 57,393	\$ 52,448
Net Outlays		
Gross Outlays	\$ 460,302	\$ 438,494
Offsetting Collections and Distributed Offsetting Receipts	(24,232)	(25,467)
Net Outlays	\$ 436,070	\$ 413,027

Condensed Statements of Custodial Activity

For the Years Ended September 30, 2007 and 2006

(In Millions)

	<u>2007</u>	<u>2006</u>
SOURCES OF CUSTODIAL REVENUE		
Revenue Received		
Individual and FICA Taxes	\$ 2,201,464	\$ 2,034,209
Corporate Income Taxes	395,320	380,426
Other Revenues	142,005	146,937
Total Revenue Received	2,738,789	2,561,572
Less Refunds	(292,684)	(277,778)
Net Revenue Received	2,446,105	2,283,794
Accrual Adjustment	5,588	554
Total Custodial Revenue	2,451,693	2,284,348
Disposition of Custodial Revenue:		
Amounts Provided to Fund the Federal Government	2,445,619	2,283,420
Other	6,074	928
Total Disposition of Custodial Revenue	2,451,693	2,284,348
Net Custodial Revenue Activity	\$ 0	\$ 0

Auditors' Report on the Treasury Department's Financial Statements

The Department received an unqualified audit opinion on its fiscal year 2007 financial statements. The auditor reported a material weakness in financial management and other significant deficiencies in: (1) Information Controls and Security Programs Over Financial Systems, and (2) Financial Management Practices at the Department Level.

Summary of Financial Statement Audit

Audit Opinion	UNQUALIFIED				
Restatement	NO				
Material Weakness	Beginning Balance	New	Resolved	Consolidated	Ending Balance
Financial Management Practices at the IRS	1	0	0	0	1

Limitations on the Principal Financial Statements

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

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

Financial Highlights

The following provides the highlights of Treasury's financial position and results of operations for fiscal year 2007.

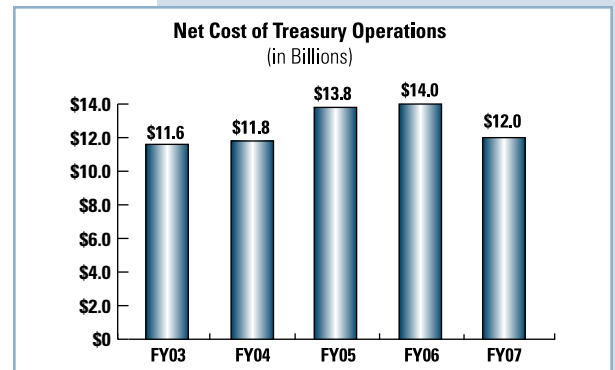
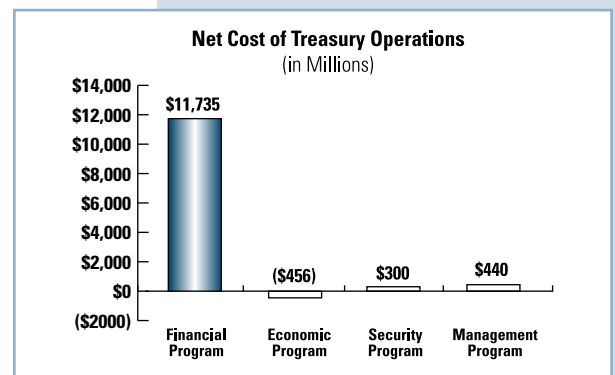
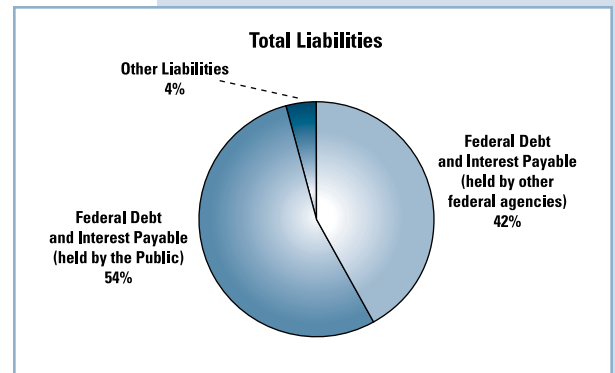
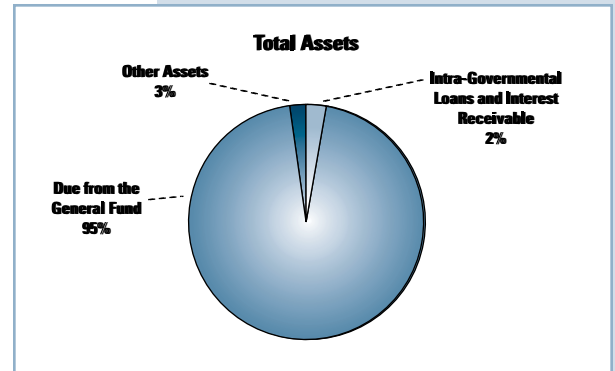
Assets. Total assets increased from \$9.0 trillion at September 30, 2006 to \$9.5 trillion at September 30, 2007. The primary reason for the increase is the rise in the federal debt, which causes a corresponding rise in the “Due from the General Fund of the U.S. Government” account (\$9.1 trillion.) This account represents future funds required from the General Fund of the U.S. Government to pay borrowings from the public and other federal agencies.

The majority of loans and interest receivable (\$236.9 billion) included in “Other Intra-governmental Assets” are the loans issued by the Federal Financing Bank to other federal agencies for their own use or to private sector borrowers, whose loans are guaranteed by the federal agencies. In addition, \$175 million loans and interest receivable from non-federal entities include certain loans and credits issued by the United States to various foreign governments. These loans are due and payable in U.S. denominations.

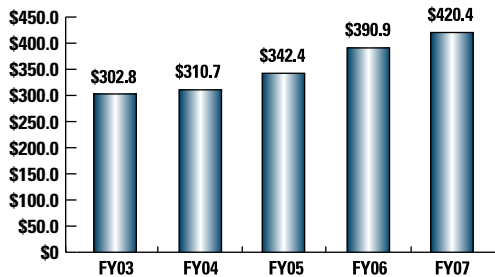
Liabilities. Intra-governmental liabilities totaled \$4.3 trillion, and include \$4.0 trillion of principal and interest payable to various Federal agencies such as the Social Security Trust Fund. These borrowings do not include debt issued separately by other governmental agencies, such as the Tennessee Valley Authority or the Department of Housing and Urban Development.

Liabilities also include federal debt held by the public, including interest, of \$5.1 trillion; the majority of this debt was issued as Treasury Notes. The increase in total liabilities in fiscal year 2007 over fiscal year 2006 (\$534.6 billion and 6.0 percent), is the result of increases in borrowings from various federal agencies (\$293.8 billion), and federal debt held by the public, including interest, (\$206.2 billion). Debt held by the public increased primarily because of the need to finance budget deficits.

Net Cost of Treasury Operations. The Consolidated Statement of Net Cost presents the Department’s gross and net cost for its four strategic missions: financial program, economic program, security program, and management program. The majority of the Net Cost of Treasury Operations is in the financial program. Treasury is the primary fiscal agent for the Federal government in managing the Nation’s finances by collecting revenue, making Federal payments, managing Federal borrowing, performing central accounting functions, and producing coins and currency sufficient to meet the demand. Treasury’s Strategic Plan for FY



Net Federal Debt Interest Costs
(in Billions)

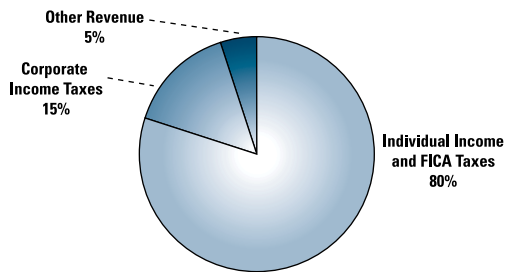


2007 – FY 2012 includes a new Security program, which resulted in a reclassification between the four programs in fiscal year 2007.

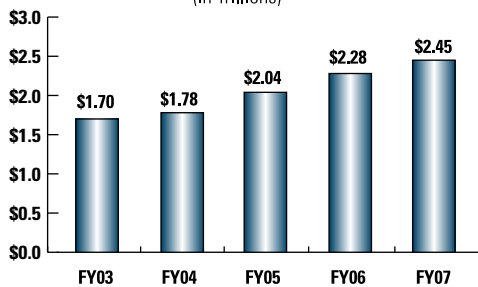
Net Federal Debt Interest Costs. Interest costs have increased significantly (\$29.5 billion in fiscal year 2007 and \$48.5 billion in fiscal year 2006) over the past two years due to the increase in the federal debt and higher interest rates.

Custodial Revenue. Total net revenue collected by Treasury on behalf of the federal government includes various taxes, primarily income taxes, user fees, fines and penalties, and other revenue. Over 94.3 percent of the revenues are from income and social security taxes. Following a 12 percent (\$247.4 billion) increase in fiscal year 2006, net revenue increased by 7.1 percent (\$162.3 billion) in fiscal year 2007, due to a continuing high level of economic activity. The majority of increase in revenue was from the individual income and FICA taxes, which was primarily attributed to the growth in wages and overall taxable income.

Total Revenue



Net Revenue Received
(in Trillions)



IMPROPER PAYMENTS INFORMATION ACT AND RECOVERY ACT

SUMMARY OF FY 2007 ACTIVITIES

Background

The Improper Payments Information Act of 2002 (IPIA) requires agencies to annually review their programs and activities to identify those that are susceptible to significant erroneous payments. According to OMB Circular A-123, Appendix C, Requirements for Effective Measurement and Remediation of Improper Payments (A-123, Appendix C), “significant” means that an estimated error rate and a dollar amount exceed the threshold of 2.5% and \$10 million of total program funding. A-123, Appendix C also requires the agency to implement a corrective action plan that includes improper payment reduction and recovery targets.

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

Treasury’s Risk Assessment Methodology and Results for FY 2007

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

Earned Income Tax Credit

The EITC is a refundable tax credit that offsets income tax owed by low-income taxpayers and, if the credit exceeds the amount of taxes due, provides a lump-sum payment in the form of a refund to those who qualify. The FY 2007 estimate is that a maximum of 28% (\$12.3 billion) and a minimum of 23% (\$10.4 billion) of the EITC total program payments are overclaims.

Since June 2003, IRS has focused on reducing erroneous EITC overclaims through a five-point initiative designed to:

- Reduce the backlog of pending EITC examinations
- Minimize the burden and enhance the quality of communications with taxpayers
- Encourage eligible taxpayers to claim the EITC
- Ensure fairness by refocusing compliance efforts on income-ineligible taxpayers
- Pilot a certification effort to substantiate qualifying child residency eligibility

RECOVERY AUDITING ACT

Background

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

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

Results for FY 2007

During FY 2007, \$5.1 billion in contracts (defined as issued and obligated contracts, modifications, task orders, and delivery orders) were issued. Improper payments in the amount of \$843,230 were identified from recovery auditing efforts and, of this amount, \$821,667 has been recovered with \$21,564 outstanding as accounts receivable on September 30, 2007. Additional detail on Treasury's Recovery Auditing Act Program can be found in Appendix C.

MANAGEMENT ASSURANCES

THE SECRETARY’S LETTER OF ASSURANCE

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

Treasury provides reasonable assurance that the objectives of the Federal Managers’ Financial Integrity Act over operations have been achieved, except for the material weaknesses noted below. In accordance with OMB Circular A-123, Appendix A, we provide qualified assurance that internal control over financial reporting is effective as of June 30, 2007. Treasury is not in substantial compliance with the Federal Financial Management Improvement Act due to the material weakness involving revenue accounting systems; this weakness is a significant reason for our qualified overall assurance level for A-123, Appendix A.

Treasury has six remaining material weaknesses as of September 30, 2007, as follows:

Operations:

Internal Revenue Service

- Systems modernization management and controls
- Overclaims in the Earned Income Tax Credit Program
- Systems security controls

Financial Management Service

- Systems, controls and procedures to prepare the Government-wide financial statements
- Departmental Offices
- Systems security

Financial Reporting:

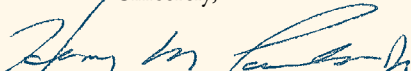
Internal Revenue Service

- Revenue accounting systems

We identified no new material weaknesses in FY 2007, and made progress toward addressing our existing weaknesses. (Refer to Appendix E for detailed information.) We will continue to achieve positive results in FY 2008 by:

- Emphasizing internal control program responsibilities throughout Treasury
- Ensuring senior management attention to management controls
- Developing and implementing capital planning investment control processes
- Focusing on the need to develop and carry out responsible plans for resolving weaknesses

Sincerely,



Henry M. Paulson, Jr.

MATERIAL WEAKNESSES, AUDIT FOLLOW-UP, AND FINANCIAL SYSTEMS

SUMMARY OF MANAGEMENT ASSURANCE

Effectiveness of Internal Control over Financial Reporting (FMFIA § 2)						
Statement of Assurance	Qualified Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS - Revenue Accounting Systems	0	0	0	0	1	1
Total Material Weaknesses	0	0	0	0	1	1

Effectiveness of Internal Control over Operations (FMFIA § 2)						
Statement of Assurance	Qualified Assurance					
Material Weaknesses	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS - Systems Modernization Management and Controls	1	0	0	0	0	1
IRS - Overclaims in the Earned Income Tax Credit Program	1	0	0	0	0	1
IRS - Systems Security Controls	1	0	0	0	0	1
FMS - Systems, Controls, and Procedures to Prepare the Government-wide Financial Statements	1	0	0	0	0	1
DO - Systems Security	1	0	0	0	0	1
Total Material Weaknesses	5	0	0	0	0	5

Conformance with Financial Management System Requirements (FMFIA § 4)						
Statement of Assurance	Systems do not conform to financial management system requirements					
Non-Conformances	Beginning Balance	New	Resolved	Consolidated	Reassessed	Ending Balance
IRS -Accounting for Revenue	1	0	0	0	(1)	0
Total Non-conformances	1	0	0	0	(1)	0

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

Federal Managers’ Financial Integrity Act (FMFIA)

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

- programs achieve their intended results.
- resources are used consistent with overall mission.
- programs and resources are free from waste, fraud and mismanagement.
- laws and regulations are followed.
- controls are sufficient to minimize any improper or erroneous payments.
- performance information is reliable.
- system security is in substantial compliance with all relevant requirements.
- continuity of operations planning in critical areas is sufficient to reduce risk to reasonable levels.
- financial management systems are in compliance with Federal financial systems standards.

Deficiencies that seriously affect an agency’s ability to meet these objectives are deemed “material weaknesses.” Treasury can provide reasonable assurance that the objectives of FMFIA have been achieved, except for the remaining material weaknesses noted in the Secretary’s Letter of Assurance. Currently, the last identified material weakness is targeted to be closed in fiscal year 2011.

Material weaknesses, both the resolution of existing ones and the prevention of new ones, received special attention during fiscal year 2007. Over the past five years, we have made great progress in reducing the number of material weaknesses Treasury-wide. During fiscal year 2007, we made material weakness resolution a performance requirement for every executive, manager, and supervisor to continue our path of resolving the current material weaknesses and preventing new ones before they occur.

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

The Department of the Treasury continues to strengthen and improve the execution of our mission through the application of sound internal controls over financial reporting. In response to Office of Management and Budget (OMB) Circular A-123, *Management’s Responsibility for Internal Controls*, Appendix A, Treasury developed and implemented an extensive testing and assessment methodology that identified and documented internal controls over financial reporting at the transaction level integrated with the Government Accountability Office’s Standards for Internal Control. The testing and assessment were completed across all material Treasury bureaus and offices by June 30, 2007. Treasury provides qualified reasonable assurance that internal controls over financial reporting are effective as of June 30, 2007, due in large part to the revenue accounting system weaknesses at the Internal Revenue Service.

Federal Financial Management Improvement Act (FFMIA)

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

As of September 30, 2007, the Treasury Department's financial management systems were not in substantial compliance with FFMIA due to deficiencies with the IRS's financial management systems. The IRS has a remediation plan in place to correct the deficiencies. For each FFMIA recommendation, the remediation plan identifies specific remedies, target dates, responsible officials, and resource estimates required for completion. This plan is reviewed and updated on a quarterly basis. (Refer to Appendix E for detailed information.)

Audit Follow-Up

During fiscal year 2007, Treasury continued its efforts to improve both the general administration of management control issues throughout the Department and the timeliness of the resolution of all findings and recommendations identified by the Office of the Inspector General (OIG), the Treasury Inspector General for Tax Administration (TIGTA), the Government Accountability Office, and external auditors.

Treasury management at every level will maintain the momentum on accomplishing Planned Corrective Actions (PCAs) to resolve and implement sound solutions for all audit recommendations. Although we have made great progress, we have considerably more work to do. Specifically, we must provide timely and accurate performance in addressing PCA schedules and implementation and integrate the effects of those actions more fully into our management decision-making processes. We need to identify more precisely what it costs to accomplish our varied missions and develop ways to improve overall performance. This will entail building upon the progress we have made in expanding the communication and coordination among offices variously involved in strategic planning, budget formulation, budget execution, performance management and financial management.

Financial Management Systems Framework

The Department's overall financial management systems framework consists of a Treasury-wide financial data warehouse, supported by a financial reporting tool and separate bureau financial systems. Bureaus submit their monthly financial data to the data warehouse within three business days of the month-end. The Department then produces its monthly financial statements and reports for management analysis. This framework satisfies both the bureaus' diverse financial operational and reporting needs as well as the Department's internal and external reporting requirements. The financial data warehouse is part of the overarching Treasury-wide Financial Analysis and Reporting System (FARS), which also includes applications for bureaus to report the status of their performance measures and the status of their planned audit corrective actions. Treasury has also implemented a budget application which is used by Departmental Offices (DO) in the management of DO's budget expenditures. Additional FARS applications are being planned to improve the Department's financial management and operations. This includes asset management and enhanced reporting functionality.

Treasury's FARS applications operate at a contractor operated hosting facility. In accordance with the guidance contained in the American Institute of Certified Public Accountants' Statement of Auditing Standards (SAS) No. 70, *Service Organizations*, the service provider's independent auditors examined the controls for the dedicated hosting service. In the opinion of the auditors, the description of the controls presents fairly, in all material respects, the relevant aspects of the provider's controls that had been placed in operation as of September 30, 2007. Also, the controls described are suitably designed to provide reasonable assurance that

the specified control objectives would be achieved if the described controls were complied with satisfactorily and customer organizations applied the controls contemplated in the design of the provider’s controls.

The Department continues to enhance its financial management systems structure. As of September 30, 2007, the number of financial management systems decreased to 64, down from 69 at the end of fiscal year 2006.

The Bureau of Public Debt’s Administrative Resource Center (ARC) has been designated by the Office of Management and Budget as a Financial Management Line of Business Shared Service Provider. ARC currently services 28 Federal entities for core financial systems, including twelve Treasury bureaus and reporting entities. Annually, under a contract monitored by the Office of Inspector General, an independent public accountant performs an examination of ARC’s accounting processing and general computer controls related to certain services provided to its customer agencies. Treasury will continue to evaluate opportunities to consolidate financial management systems and better utilize existing resources.

ARC also provides systems and service support to eleven Department bureaus in the processing of their travel needs as part of the Department’s E-Gov Travel initiative. Of the three remaining bureaus, two are exempt from the Federal Travel Regulations and do not plan to migrate at this time. The IRS, which is not currently cross-serviced by ARC, is working towards a May 2008 E-Gov Travel implementation date.

The Department’s FARS applications are also used to support other Federal agencies. Treasury currently hosts two agencies for consolidated financial processing and reporting. In addition, the Department has demonstrated various FARS applications to other agencies. Several Federal agencies have already implemented FARS applications to run in their own systems environment, reducing their capital investment in systems software.

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