

DEPARTMENT OF THE TREASURY

The President's Proposal:

- Increases efforts to combat terrorism by strengthening the Customs Service to protect our borders, enhancing Secret Service efforts to protect government officials and foreign dignitaries, and expanding anti-money laundering efforts to thwart terrorists and their fundraising activities;
- Invests in Customs technology to allow importers to convert to a highly efficient paperless, account-based processing system;
- Invests in IRS technology and staffing to improve customer service and ensure fair tax compliance; and
- Supports breakthroughs in electronic government, including new options for individual and business tax filing.

Department of the Treasury

Paul H. O'Neill, Secretary

www.ustreas.gov 202-622-2000

Number of Employees: 150,532

2002 Spending: \$16.8 billion (debt financing and tax credits account for another \$365.8 billion)

Field Offices: 16 bureaus with field offices nationwide.

The Department of the Treasury collects taxes, taking in 98 percent of the federal government's \$2 trillion in revenue. Treasury also helps the President make economic policy by regulating financial institutions and managing the government's finances. Its law enforcement bureaus protect citizens from illegal drugs, financial crime, violence and terrorism, and provide protection for government officials and foreign dignitaries.

Homeland Security and Law Enforcement

Treasury is redoubling its efforts to fight terrorism while continuing to implement critical programs to guard against other threats, such as violent crime and illegal drug use.

The first strike in the war against terror targeted the terrorists' financial support.

President George W. Bush
September 24, 2001

Financial Crimes and Terrorist Fundraising

Stopping Terrorist Financing

On November 7, 2001, with the help of Treasury's new counter-terrorism financial task force—Operation Green Quest—Treasury blocked the U.S. assets of 62 individuals and organizations connected with two terror-supporting financial networks—the al Taqwa and the al Barakaat financial networks. These networks raise, manage, invest, and distribute funds for Osama bin Laden's al Qaeda terrorist organization. Senior al Qaeda leaders are also senior leaders in other terrorist organizations. Al Barakaat and al Taqwa have a presence in over 40 nations, including the United States, and the United States carefully coordinates its actions with allies around the world to defeat them.

Treasury leads the nation's war against the financing of global terrorism. Treasury's Financial Crimes Enforcement Network (FinCEN) and Office of Foreign Assets Control (OFAC) identify the numerous methods used by terrorist networks to finance their operations and move quickly to freeze those assets and provide information to law enforcement agencies.

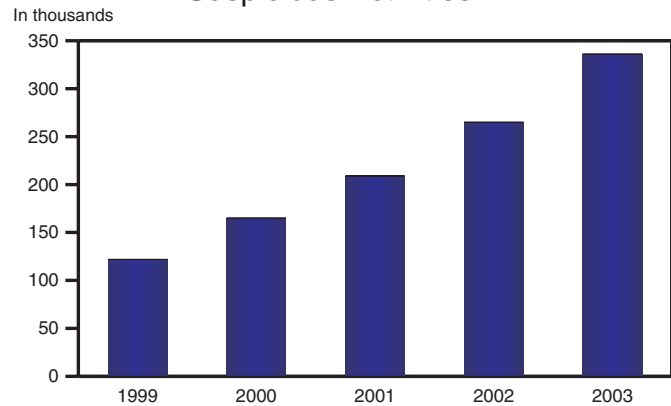
Armed with suspicious activity reports and financial transaction records maintained by financial institutions and required by the Bank Secrecy Act, FinCEN assists law enforcement efforts to prevent and detect money laundering and other financial crimes. These data, along with other commercial and law enforcement information, allow FinCEN to link business associates, bank accounts, property records, and other information to form a more complete financial trail. FinCEN also works with foreign financial intelligence

units to extend its reach beyond U.S. borders. The budget provides \$52 million for FinCEN's operations.



The complex task of blocking transactions and freezing assets held by terrorist and other criminal organizations and individuals is carried out by OFAC. OFAC uses information from FinCEN and the law enforcement and intelligence communities to identify terrorist groups that threaten our national security and to assess their methods of transferring funds. This information is then used to deny these groups access to international financial systems, impair their fundraising capabilities, and expose their financial backers. OFAC also assists the nation's allies in similar actions. Since September 11, 2001, OFAC has frozen \$34 million in terrorist assets (Taliban, Hamas, and al Qaeda) and assisted our nation's allies in freezing \$33.9 million. Prior to September 11th, OFAC successfully froze \$236 million in Taliban assets. The budget provides \$22 million for OFAC's operations.

Financial Institutions Reports of Suspicious Activities



Source: Department of the Treasury.

Border Control

Homeland Security

Following the September 11, 2001, terrorist attacks, the Customs Service threat level was changed from Alert Level 4 (normal operations) to the highest level, Alert Level 1 (Code Red). The U.S.-Mexico and U.S.-Canada borders remained open to traffic and commerce while Customs maintained an Alert Level 1 status. Land borders and all ports of entry into the United States are subject to intensive anti-terrorism operations. The fight against terrorism has now become the number one priority of the Customs Service. Customs is present at 301 ports of entry into the country—international airports, seaports, and land border crossings across the country. Customs' budget has been substantially increased in 2002 and 2003 to provide more staffing and technology to further improve border security.

The U.S. Customs Service is one of the primary enforcement agencies protecting the nation's borders, deploying an extensive air, land, and marine interdiction force supported by an investigative division. It enforces trade and tariff laws (2001 tariff collections were \$20 billion) and interdicts illegal drugs and contraband. On a typical day, the Customs Service processes 1.3 million passengers, 51,000 trucks/containers, 590 vessels, 2,600 aircraft, and 355,000 vehicles. The budget provides \$3.2 billion for Customs operations.

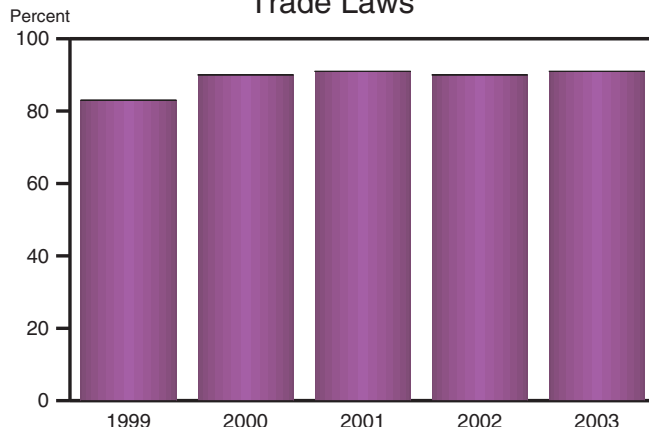
Protecting our borders from illegal entry of narcotics is a core mission of the Customs Service. Drug trafficking often raises the funds terrorists need to operate. American demand for contraband unwittingly aids their efforts. However, it is difficult to assess the effect of Customs' drug interdiction actions on the war against drugs, since Customs uses the amount of illegal drugs seized as a performance measure.

In 2001, 191,000 pounds of cocaine, 3,600 pounds of heroin, and 1.5 million pounds of marijuana were seized by Customs. However, seizures do not tell how much contraband gets through the nation's borders. Customs is working with the Office of National Drug Control Policy to craft better measures to evaluate effectiveness.

Customs' mission includes both facilitating trade and ensuring compliance with import and export laws. Customs' efforts have been largely successful. In 2001, an estimated 91 percent of imports were compliant with trade and tariff requirements. To cope with trade activity that it expects to double by 2005, Customs is modernizing its automation systems and using risk management to target high-risk cargo.

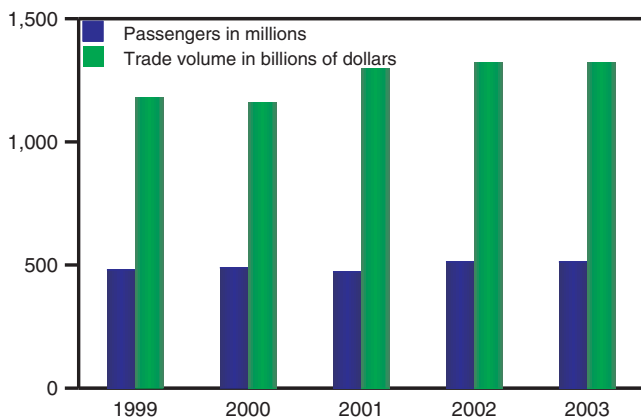
Customs' current automation systems are outdated, often break down, and cannot dependably handle an increasing volume of trade. The replacement system, the Automated Commercial Environment (ACE), will enable Customs to convert to a paperless process for importers and an account-based system. Customs is working with partners in the trade industry and government to ensure that ACE is completed promptly and effectively. The budget supports this modernization effort with \$313 million for the third year of ACE investments.

Percent of Imports Compliant with Trade Laws



Source: Department of the Treasury.

Customs Workload



Source: Department of the Treasury.

The Customs Service is responsible for collecting several user fees for services provided by Customs and other agencies that aid the traveling and importing community. The Administration proposes increasing two of these Customs fees: the Air/Sea passenger fee and the Cruise Vessel Passenger fee. The costs incurred by Customs have increased due to inflation, and the fees should reflect this reality. The Air/Sea passenger fee has been in place since 1986, but has not been increased. The budget proposes to increase this fee from \$5 to \$11 per passenger. The Cruise Vessel passenger fee would increase from \$1.75 to \$2 per passenger. The increased receipts from these fees will enhance Customs' Homeland

Security efforts through payment of inspector overtime and related expenses.

United States Secret Service

Our country and its leaders live in a world of increasing domestic and global threats. The Secret Service is incorporating new technology to accomplish more effectively its unique mission of protecting the President and other public officials. In response to increasing homeland security threats, the Secret Service now protects more people, and its protection workload has increased significantly. To support the Secret Service’s expanding responsibilities during the war on terrorism, the budget proposes additional funding for the travel and overtime of current Secret Service agents and officers. Funding proposed in 2003 also supports over 400 new agents and officers being hired in 2002.



Secret Service agents must remain vigilant at all times to protect our leaders.

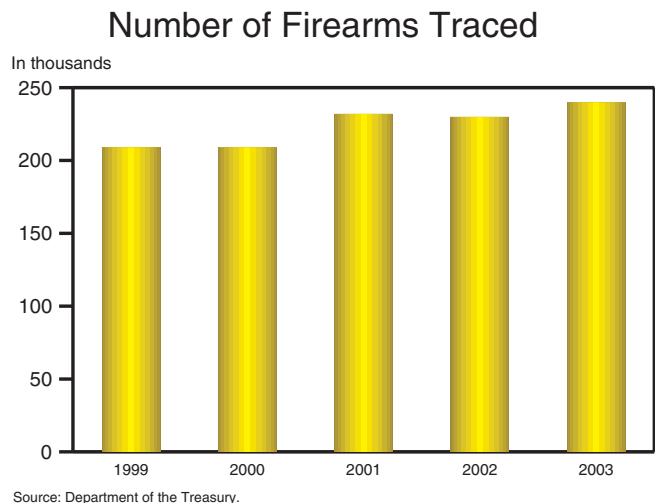
While much of what the public knows about the Secret Service relates to protecting the President, the Secret Service also plays a major role in protecting our nation’s currency and financial integrity. Over the last several years, the percentage of Secret Service financial crimes cases adopted for federal prosecution has remained relatively stable at around 50 percent. The looming threat of cyber-terrorists and increasingly sophisticated counterfeiters makes it more critical that the Secret Service make more efficient use of its current resources to reduce the vulnerability of our nation’s currency and financial networks.

The budget provides \$1 billion for the Secret Service.

Alcohol, Tobacco, and Firearms

The Bureau of Alcohol, Tobacco, and Firearms (ATF) enforces the federal laws and collects revenue relating to alcohol, tobacco products, firearms and explosives (2001 revenues were \$14 billion).

ATF stands in the front ranks of the nation’s battle against terrorism. Explosives are a preferred terrorist tool, and ATF is in the unique position of not only regulating commerce in explosives, but also of having the requisite expertise and authority to investigate explosives-related crimes. Through these programs, ATF investigators are positioned to thwart terrorist activity at every level of the execution process—from the theft or illegal purchase of explosives to the interdiction and neutralization of those explosives for terrorist purposes at public events. The budget provides \$913 million to support ATF.



The budget reflects the Administration's strong commitment to use coordinated community efforts to prevent youth and gang violence. This is epitomized by ATF's Youth Crime Gun Interdiction Initiative (YCGII), which provides ATF agents and technical support to work with local law enforcement to develop firearms trafficking cases against those supplying guns to youths and to initiate comprehensive tracing of firearms. In 2001, for example, the number of YCGII defendants increased to 1,342 from a total of 535 in 2000. The initiative currently includes 50 participating sites located in 32 states and the District of Columbia. The budget proposes to expand YCGII and includes \$96 million, an increase of \$11 million above 2002 for ATF, to add 10 additional YCGII sites.

Tax Administration

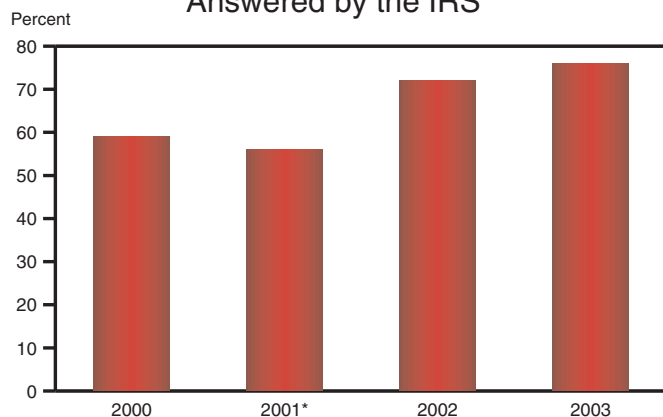
The Internal Revenue Service (IRS) serves as the principal revenue collector for the government, collecting \$1.9 trillion in 2001. The budget provides \$10.4 billion for IRS operations.

IRS runs the tax filing process despite being saddled with outdated and often ineffective technology and an increasingly complex tax code. In 2001, it processed 220 million tax returns and over 1 billion information returns (e.g., W-2 wage reports from employers), and it delivered 97 million refunds. IRS has successfully responded to recent challenges by updating its systems to avoid the Year 2000 problem and collaborating with the Treasury's Financial Management Service to deliver 86 million tax rebate checks in 2001.



IRS workers process millions of tax returns by hand each year.

Percent of Telephone Calls Answered by the IRS

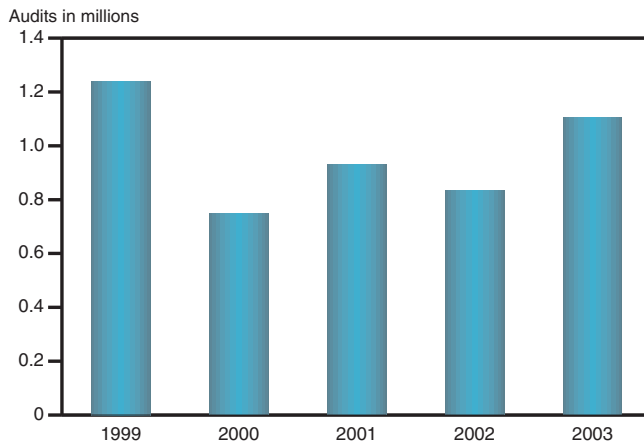


Source: Department of the Treasury.

*Performance decrease due to 24 million tax rebate calls.

IRS has trouble providing minimally acceptable customer service and ensuring that all taxpayers pay what they owe under the law. Due to outmoded technology and management practices, IRS's \$775 million telephone service program is unable to answer millions of phone calls each year. IRS has worked hard in recent years to improve this situation. The percentage of calls answered was only 49 percent in 1997. Its goal is to improve to 76 percent in 2003 (see accompanying chart). However, more progress is needed—what business would survive for long if it failed to pick up the phone one time in four? In addition, even when IRS answers, it often provides incomplete or incorrect answers. In 2001, only 75 percent of tax law answers fully met IRS's strict quality standards.

Number of IRS Audits



Source: Department of the Treasury.

taxes are collected fairly, efficiently, and with minimum hassle for honest taxpayers.

IRS is in the midst of a major reform effort required by the 1998 Restructuring and Reform Act. IRS has reorganized around operating divisions serving specific customer groups, and is in the process of modernizing its technology and management practices. The budget supports these efforts by providing \$450 million for technology investments and \$102 million for new customer service and compliance staffing. Modernization will yield substantial improvements in IRS's efficiency and effectiveness because IRS staff will have up-to-date, accurate information about taxpayer accounts. Too often, IRS data is incomplete and out-of-date. In addition, IRS is now able to target services and employee training to specific types of taxpayers. For example, some groups of IRS employees now specialize in earned income tax credit issues while others specialize in helping small businesses. Until the reorganization, employees had to try to understand all areas of the highly complex tax system.

These technology and process shortcomings also have reduced the effectiveness of IRS's compliance programs. Audit numbers have fallen significantly in recent years, but there have been no improvements in IRS's ability to target limited audit resources on the least compliant taxpayers.

These problems burden honest taxpayers in two important ways. First, taxpayers often do not receive the help they need to accurately file their returns. Second, honest taxpayers bear a heavier financial burden because noncomplying taxpayers are not paying what they owe. The Administration is committed to solving the problems at IRS and ensuring that

Modernized Technology Will Improve IRS Service

Millions of taxpayers call IRS each year to ask whether their returns have been received and when they will get their refunds. The time it takes to answer these calls diverts IRS away from helping other taxpayers resolve more complex problems. IRS modernization will help. For example, starting in 2002 taxpayers will be able to log onto a secure website and receive information on their return status. If there is an issue with the return, such as a math error or missing signature, the taxpayer will be informed of the nature of the problem and provided with information to help resolve it expeditiously. IRS estimates that this will result in a 50-percent reduction in calls from people asking for information on the status of their return.

Electronic Tax Return Filing

Today, individuals have to pay accountants, buy software, and pay fees just to file their tax return. It should not be so hard to pay taxes. For example, electronic filers must purchase an electronic filing service from a private vendor at an average cost of \$12.50 – compared to 34 cents for a first-class stamp on a paper return.

The EZ Tax Filing E-Government initiative will reduce the cost and burden of filing taxes. Electronic filing is quick, easy, and far less prone to error than traditional paper returns. The Administration proposes an easy, no-cost option for taxpayers to file their tax return online. Further, legislation will be proposed to extend the April filing date for electronic returns by at least 10 days.

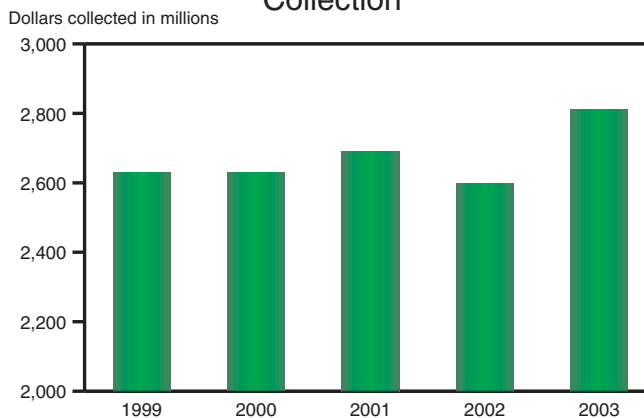
IRS is also renewing its efforts to measure taxpayer compliance. This will allow it to focus more effectively its enforcement resources on noncompliant taxpayers, and reduce the burden of unnecessary audits on honest taxpayers. Finally, IRS will employ private sector contractors where appropriate and where they can more efficiently provide services currently provided by federal employees.

Fiscal Services

The Financial Management Service (FMS) serves as the central financial management office of the government, disbursing nearly one billion payments each year (\$1.2 trillion) and collecting \$2 trillion in receipts (mostly IRS tax collections).

In 1996, FMS became the government's central debt collector. Agencies are required to transfer non-tax debt over 180 days delinquent to Treasury for centralized collection. Treasury employs two tools to collect this debt: payment offset and cross servicing. Offset involves matching federal payments (e.g., tax refunds, vendor payments) against debt owed to the government. Cross servicing involves issuing demand letters, referring debt to private collection agencies, and a variety of other methods. Treasury is working to ensure that agencies refer their debt that is eligible for cross servicing. Currently, they refer only 74 percent.

Financial Management Service Debt Collection



Source: Department of the Treasury.

Treasury manages the \$5.9 trillion federal debt, including \$3.4 trillion held by the public and \$2.5 trillion in Trust Fund balances (e.g., Social Security). Each year, the Bureau of Public Debt sells approximately 43 million savings bonds and pays \$360 billion in interest. Treasury also produces 23 billion coins and 7 billion currency notes per year.

Community Development Financial Institutions

The Community Development Financial Institutions (CDFI) Fund seeks to expand the availability of credit, investment capital, and financial services in distressed urban and rural communities through assistance to CDFIs. Since the Fund's creation, it has made more than \$539 million in awards to community development organizations and financial institutions. However, the impact of these investments is difficult to measure. The key outcomes that the Fund monitors, such as businesses or housing units financed, do not consider that CDFIs and traditional financial institutions may have made some or all of these investments in the absence of government support. In response to this concern, the Fund's management plans to build a data repository on the CDFI industry. The Fund can then use this information to measure the impact of its awards on low-income communities and better target future assistance.

Status Report on Select Programs

Treasury has a diverse set of programs, including manufacturing (producing coins and currency), financial management (managing public funds and borrowing), tax collection, and various law enforcement functions. The table that follows evaluates the current performance of several of these programs.




Program	Assessment	Explanation
Financial Management Service (FMS) Collection and Payment Processing	Effective	In 2001, FMS collected over \$2 trillion in federal taxes and other receipts, and disbursed more than \$1.2 trillion in federal payments. By volume, roughly 75 percent of collections and 72 percent of payments were processed electronically, with 99.9998 percent of payments made on time. Seventy-seven percent of payments to citizens and 60 percent to businesses were made electronically.
Customs Trade Compliance	Effective	The Customs Service maintains a sound trade management system that maximizes compliance with import and export laws and moves cargo efficiently. In 2001, Customs achieved its goal of ensuring that 91 percent of imports were compliant with trade and tariff requirements.
Customs Drug Interdiction	Unknown	The Customs Service seizes large amounts of drugs at the border. However, the government does not know how much contraband gets through our borders.

Program	Assessment	Explanation
IRS Customer Service	Ineffective	Due to outmoded technology and management practices, IRS provides poor service to taxpayers. However, technology investments and improving work processes are gradually improving performance.
IRS Tax Compliance Enforcement	Ineffective	Due to outmoded technology and management practices, IRS is unable to ensure that all citizens pay the taxes they owe under the law. IRS's current modernization program will give it the tools to improve performance in this area.

Strengthening Management

While Treasury faces challenges to improve management and implement the President's Management Agenda, the Department is committed to making improvements in these initiatives in 2002 and 2003.

Initiative	2001 Status
<p>Human Capital—The Treasury Department is facing many human capital-related questions, such as how to deal with an aging workforce (10 percent of Treasury's workforce is eligible to retire now; in five years this will rise to 30 percent) and make fundamental restructuring changes to increase performance for citizens. While some bureaus have taken steps to face these challenges, Treasury has not developed a coordinated strategy that addresses skills imbalances in mission-critical occupations; succession planning; better use of existing personnel management tools and technology; and how the agency rewards high performers and addresses low performance. The Department will complete a comprehensive plan in 2002 to address these challenges.</p>	●
<p>Competitive Sourcing—Treasury has not yet completed public-private or direct conversion competition on any of the positions that it has identified as commercial in nature. However, the Department has committed to achieving the 15 percent goal by the end of 2003.</p>	●

Initiative	2001 Status
<p>Financial Management—Treasury received an unqualified opinion on its 2000 financial audit. However, substantial weaknesses in financial management systems and controls at Customs and IRS, the two largest bureaus in Treasury, hamper effective management and make it difficult for Treasury to sustain an unqualified opinion in the future. Improvements are also needed to reduce the number of improper payments. An estimated 25 percent of Earned Income Tax Credit payments were made incorrectly for tax year 1997. Treasury is working to improve its financial systems and has a \$154 million compliance program to reduce errors in the Earned Income Tax Credit program. The Department is also moving aggressively to accelerate the preparation of monthly financial statements and expects to set the standard for the government in timely statements by the summer of 2002. In addition, the budget proposes legislative change to allow IRS to match the income reported on student aid applications with tax return data. This will help reduce errors in the Education Department’s student aid programs and save an estimated \$138 million in 2003.</p>	
<p>E-Government—Treasury has made progress in recent years in improving its technology investment planning and execution (i.e., using business cases and monitoring progress against performance targets). However, improvements are still needed to ensure that all investments are managed carefully to achieve maximum benefits. Treasury has also made progress in implementing electronic government options for citizens (e.g., electronic tax filing and benefits payments). The budget proposes to further expand electronic government, including new taxpayer services and expanding the Treasury’s <i>Pay.gov</i> on line payment system.</p>	
<p>Budget/Performance Integration—Treasury needs to continue to improve its performance measures to include more outcome indicators and to make certain that all programs have balanced measures of outputs, quality, and customer satisfaction. The Department has committed to provide a full performance plan/review to the Congress in support of the budget, and will work through 2002 to improve its measures in time for the 2004 Budget process.</p>	

Department of the Treasury

(In millions of dollars)

	2001	Estimate	
	Actual	2002	2003
Spending:			
Discretionary Budget Authority:			
Tax Administration.....	9,442	9,927	10,416
Customs Service:			
Existing law	2,642	2,785	3,185
Legislative proposal			
Other Law Enforcement	2,024	2,148	2,316
Fiscal Services	377	431	432
Management and Inspector General.....	492	455	479
Community Development Financial Institutions.....	118	80	68
Subtotal, Discretionary budget authority adjusted ¹	15,095	15,826	16,646
Remove contingent adjustments.....	-618	-659	-710
Total, Discretionary budget authority	14,477	15,167	15,936
Emergency Response Fund, Budgetary Resources:			
Customs Service.....	36	429	—
All other Treasury programs	12	251	—
Total, Emergency Response Fund, Budgetary resources	48	680	—
Mandatory Outlays:			
Payments Where Tax Credits Exceed Liability for Tax:			
Existing law	27,105	35,672	38,077
Legislative proposal	—	—	774
Miscellaneous receipts and other mandatory spending	-2,764	-841	-2,884
Subtotal, Mandatory outlays adjusted ¹	24,341	34,831	35,967
Remove contingent adjustments.....	-5	-5	-5
Total, Mandatory outlays.....	24,336	34,826	35,962
Interest:			
Financing the public debt and other interest.....	352,033	330,998	345,595
Credit activity:			
Direct Loan Disbursements:			
Community Development Financial Institutions.....	9	10	10
Guaranteed Loans:			
Air Transportation Stabilization Board.....	—	5,000	5,000

¹ Adjusted to include the full share of accruing employee pensions and annuitants health benefits. For more information, see Chapter 14, "Preview Report," in *Analytical Perspectives*.