

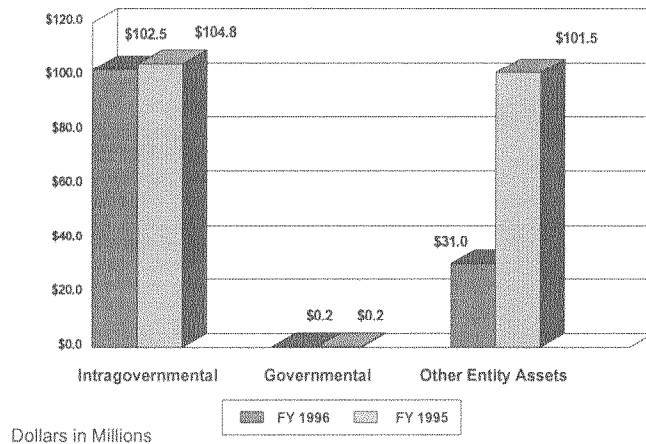
ENTITY ASSETS AND LIABILITIES

The Bureau's intragovernmental entity assets for the periods ending September 30, 1996 and 1995, include fund balance with Treasury and receivables due to ATF resulting from reimbursable work performed for other Federal agencies. Governmental entity assets include receivables and advances due from employees and court ordered restitutions for violations of laws and regulations. Entity assets also include cash (imprest funds) and property and equipment, net of depreciation. In

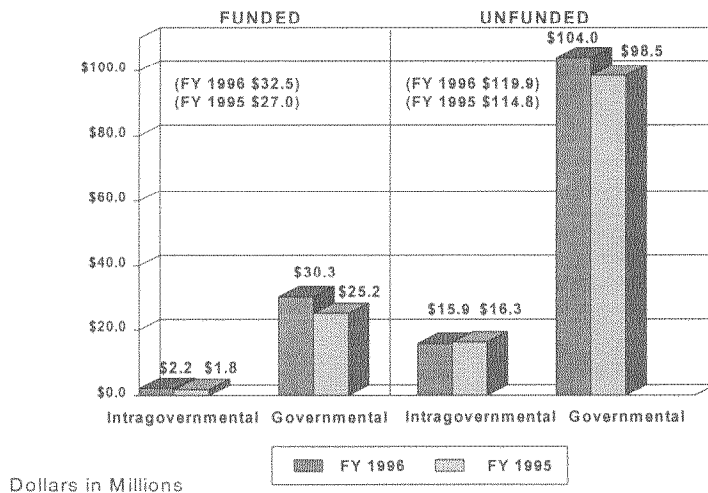
FY 1996, the Bureau entered into an interagency agreement with the U.S. Customs Service to provide aircraft operations support to ATF for investigative requirements. Thus, after obtaining Department of the Treasury and General Services Administration approvals, ATF, at the close of FY 1996, transferred all of its aircraft and related assets to the Department of State. The net book value of the aircraft and support equipment transferred totaled \$20.5 million. Transferred aircraft materials and supplies totaled \$50.2 million.

Entity liabilities are incurred during the performance of the Bureau's mission. Liabilities funded by appropriations include accounts payable to vendors, employees, and other government agencies as well as accrued payroll expenses as of September 30, 1996 and 1995. Unfunded liabilities that will be paid through future appropriations include employee claims for leave and workers' compensation benefits as well as future capital lease and contingent liability payments.

Entity Assets



Entity Liabilities



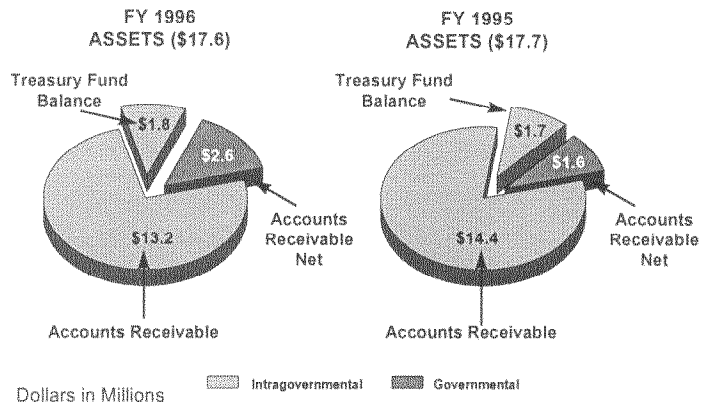
NON-ENTITY ASSETS AND LIABILITIES

Non-entity assets primarily relate to the Bureau's revenue collection function for the Federal Government. Components of intragovernmental non-entity assets at September 30, 1996 and 1995, include fund balance with Treasury and accounts receivable due to ATF from the Treasury to refund certain excise tax and license fee claims. Governmental non-entity assets consist of accounts receivable less amounts deemed uncollectible. These receivables include outstanding excise and Special Occupational

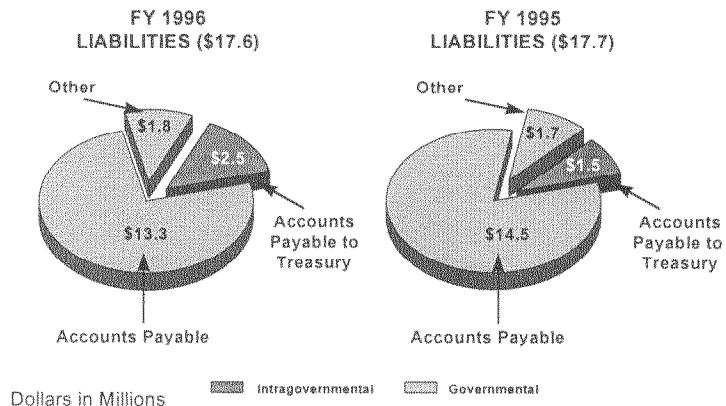
Taxes, fees, fines, penalties and interest that have been assessed and remain unpaid at year end.

Non-entity liabilities, primarily governmental, relate to the Bureau's custodial function for revenue collection. Amounts include accrued accounts payable to refund taxpayers for claims approved by ATF but not disbursed as of September 30, 1996 and 1995, as well as amounts held in escrow for cash bonds and offers-in-compromise. Intragovernmental liabilities represent taxes which will be transferred to the Treasury when collected.

Non-Entity Assets



Non-Entity Liabilities

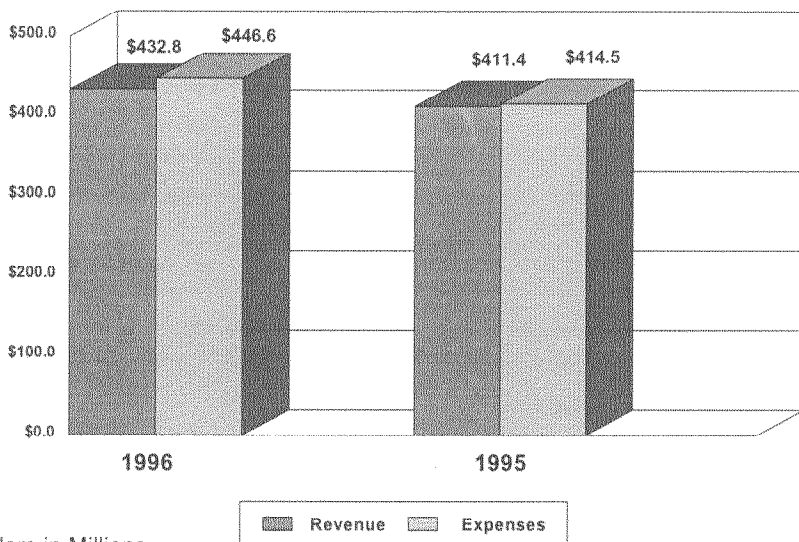


ENTITY REVENUE AND EXPENSES

Entity revenue represents the Bureau's appropriations and financing sources used to fund its mission. Revenue includes reimbursement for services provided to others. The Bureau incurs expenses in excess of revenue for each fiscal year due to unfunded contingency and actuarial liabilities, which are expensed in the year they are recognized as liabilities.

Expenses reflect program and operating costs, depreciation, amortization, and changes in Federal Employees Compensation Act actuarial liabilities. Expenses also include bad debts, Prompt Pay Act interest paid, and losses on the disposition of assets.

Entity Revenue And Expenses



Dollars in Millions

REVENUE MANAGEMENT

ATF ensures the collection of Federal Excise Tax and protection of the revenue through a system of laws, regulations, tax returns, permits, bonds, and disbursement (refund) functions in accordance with the Internal Revenue Code of 1986. The Bureau collects, records and accounts for a variety of taxes and registration and license fees from the alcohol, tobacco, firearms, ammunition and explosives industries.

None of the non-entity revenue collected by ATF is used in any Bureau operations; all funds are transferred to the Treasury or other Federal agencies for further distribution in accordance with various laws and regulations.

Responsibility for collection of taxes and fees belongs to the regulatory enforcement offices. In FY 1996, the Bureau began a six-year effort to consolidate the five Technical Services offices located throughout the country into a single office located in Cincinnati, Ohio, which is also the site of ATF's Tax Processing Center. The consolidation goals are to integrate and streamline administrative and technical functions, increase overall effectiveness, and realize cost savings. ATF expects that claims refund and tax return processing will improve through efficiency and consistency.

REVENUE SOURCES

Tax and fee revenue dollars are presented as "gross" revenue before refunds and include related interest and penalties. In general, FY 1996 revenue decreased from FY 1995 due to an accelerated payment schedule for excise taxes in FY 1995, mandated by Public Law 103-465, Section 712.

Alcohol and Tobacco Excise Tax

ATF collects taxes from manufacturers of alcohol and tobacco products. Taxes are generally levied at the manufacturer level when products are removed from the business premises. For FYs 1996 and 1995, the Bureau collected \$12.4 billion and \$12.9 billion, respectively, in excise taxes on alcohol and tobacco products.

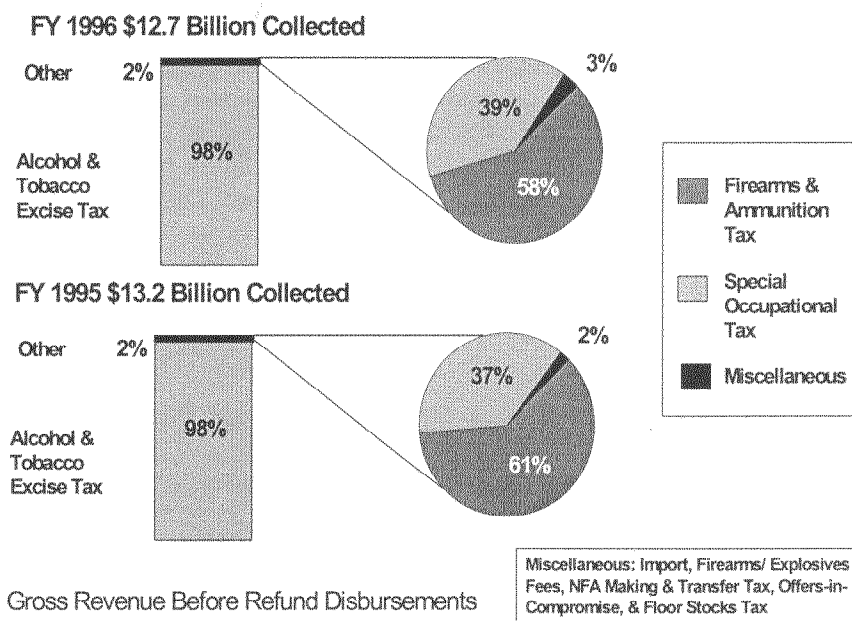
Firearms and Ammunition Tax

Section 4181 of the Internal Revenue Code imposes taxes on the sale or use of firearms and ammunition by the manufacturer, producer, or importer of the article. ATF assumed the responsibility for collection of the firearms and ammunition excise tax from the Internal Revenue Service in January, 1991. ATF collected \$161.0 million and \$186.6 million in excise taxes on firearms and ammunition sales in FYs 1996 and 1995, respectively. The Pittman-Robertson Wildlife Restoration Act of 1937 requires that the entire revenue (less refund payments) collected from Federal firearms and ammunition excise taxes be transferred to the Interior Department's Federal Aid to Wildlife Restoration Fund to support their mission.

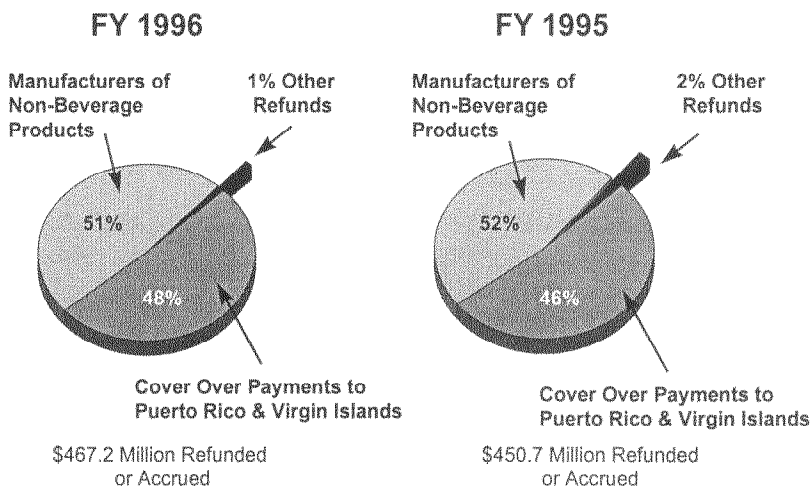
Special Occupational Tax

ATF collects the Special Occupational Tax imposed by Section 5121 of the Internal Revenue Code on certain alcohol, tobacco and firearms businesses. This tax is due annually on July 1, and is applicable to producers, wholesalers, and retailers of alcohol beverages, manufacturers of tobacco products, and dealers/users of industrial alcohol, as well as to importers, manufacturers, and dealers in National Firearms Act firearms (e.g., machine guns). For FYs 1996 and 1995, \$108.3 million and \$111.0 million, respectively, was generated in Special Occupational Taxes.

Tax And Fee Revenue



Revenue Tax And Fee Refunds



**Import Fees
Firearms/Explosives Fees**

The Bureau collects registration fees from persons engaged in importing firearms, ammunition, and implements of war as mandated by the Arms Export Control Act. ATF's licensing center in Atlanta, Georgia processes applications for firearms licenses (to manufacture, import, deal in, and collect firearms) and explosives licenses (to manufacture, import, deal in, and use explosives). Combined collections for these fees were \$5.0 million and \$4.1 million in FYs 1996 and 1995, respectively.

National Firearms Act Making and Transfer Tax

Additional taxes are imposed on the making and transferring of Title II firearms by persons not subject to the Special Occupational Tax. (Title II firearms include machine guns, short-barreled rifles or shotguns, silencers, and destructive devices.) The Bureau collected \$1.4 million and \$1.3 million in National Firearms Act Making and Transfer Taxes during FYs 1996 and 1995, respectively.

Offers-in-Compromise

The Bureau negotiates offers-in-compromise on receivables for taxes, penalties and interest that have already been assessed but not collected due to taxpayer inability or unwillingness to pay. Additionally, the Federal Alcohol Administration Act imposes monetary penalties for violations of trade practices, labeling, or advertising by beverage alcohol businesses. Under certain circumstances, ATF accepts these reduced offers of payments from assessed parties rather than write off the entire assessed amount due as uncollectible. For FYs 1996 and 1995, the Bureau collected \$82 thousand and \$423 thousand, respectively, in offers-in-compromise.

Floor Stocks Tax

Collection of a floor stocks tax is generally required when an excise tax is first imposed or increased on a particular commodity. The manufacturer, importer, distributor, or retailer must inventory the commodity on-hand as of the effective date of the legislation and pay any incremental taxes on these goods in inventory. In FY 1996, the Bureau collected \$103 thousand in floor stocks taxes imposed in prior years. FY 1995's collection of floor stocks taxes totaled \$239 thousand.

TAX AND FEE REFUNDS

In addition to collecting revenue, ATF makes various types of disbursements for taxes and fees paid to the Federal Government. Disbursement amounts include accounts payable accrued as of September 30, 1996 and 1995.

Manufacturers of Non-Beverage Products

Manufacturers may file claims to recover (drawback) all but \$1 per proof gallon on excise taxes paid on distilled spirits used in the manufacture or production of medicines, medicinal preparations, food products, flavors, or flavoring extracts which are unfit for beverage purposes. For FYs 1996 and 1995, \$235.9 million and \$235.2 million, respectively, was refunded to manufacturers as drawback for taxes paid on alcohol used in non-beverage alcohol products.

Cover Over Payments to Puerto Rico and the Virgin Islands

The Internal Revenue Code of 1986, as amended (26 U.S.C. 5314 and 7652) provides that taxes collected on articles produced in Puerto Rico and the Virgin Islands transported to the United States (less the estimated amount necessary for payment of refunds and drawbacks) shall be covered over (paid to) to the

treasuries of Puerto Rico and the Virgin Islands. ATF's responsibility is to ensure the collection of these taxes on distilled spirits, wine, beer and tobacco products, and to determine amounts to be paid to the insular governments.

The Treasury of Puerto Rico is paid directly from the excise taxes collected by ATF on a monthly basis. Excise tax payments are based on Secretary of the Treasury approved prescribed formulae for bulk and cased distilled spirits from Puerto Rico. Excise tax payments generated from rum imports from other foreign sources are also paid directly to the treasuries of the Virgin Islands and Puerto Rico on a monthly basis.

The Government of the Virgin Islands receives a fiscal year advance of funds based on agreed upon domestic rum production estimates made by their treasury and the U.S. Department of the Interior. ATF provides actual tax payment and usage data to the Department of the Interior on a monthly basis to ensure that the Government of the Virgin Islands receives full payment. Disbursements to the governments of Puerto Rico and the Virgin Islands totaled \$223.7 million in FY 1996 and \$207.7 million in FY 1995.

Other Refunds

ATF refunds fees paid in advance by those applicants who do not meet the criteria to qualify for a license or permit. Additional refunds are made for approved taxpayer claims of overpayment in all categories of revenue. ATF refunded \$7.6 million in FY 1996 and \$7.8 million in FY 1995 for these claims.

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT HIGHLIGHTS

The Bureau centrally manages the Federal Managers' Financial Integrity Act (FMFIA) program, with oversight responsibilities assigned to the CFO. However, each executive office maintains responsibility for a cost-effective system of controls to provide reasonable assurance that Government resources are protected against fraud, waste, abuse, mismanagement, or misappropriation. The Executive Staff's responsibilities include ensuring that new and existing programs and administrative support activities are managed efficiently and effectively. All Executive Staff members and managers are accountable for safeguarding resources and are also evaluated as financial managers.

POLICIES AND PROCEDURES

Successful initiatives that began during FY 1995 (emphasis on improving organization, policies and procedures, and systems) were continued in FY 1996. The Bureau actively pursued corrective actions to address the reportable conditions discovered by the OIG in their FY 1995 audit of the Bureau's Statement of Financial Position:

Improve Non-Entity Accounts Receivable Reconciliation Procedures
Status and Accomplishments: Complete. Procedures were developed to reconcile accounts receivable balances

in FMIS with the tax and fee databases. Periodic reconciliations began at the end of FY 1996.

Strengthen Controls Over Accountability for Reimbursable Work Agreements

Status and Accomplishments: Complete. ATF implemented a mechanism to track all reimbursable agreements, amounts authorized, and amounts billed. The Monthly Accountability Plan includes reimbursable agreement data and is reviewed monthly to ensure that billings and costs related to reimbursable agreements are not exceeded. Procedures were implemented to ensure all pertinent officials have signed the agreements, and differences identified during the reconciliation of expenditure reports are properly adjusted in the general ledger.

Improve Implementation and Adherence to Accounting Policies and Procedures

Status and Accomplishments: Complete. Written procedures to estimate allowances for uncollectible accounts were drafted, which included analyses of the collectibility for both individual and group accounts. These procedures were used to calculate FY 1996 allowances. ATF implemented written policies to account for bulk purchases and improved procedures to update the property management system upon receipt of source documents.

Improve Closing Procedures to Account for all Expenses and Liabilities in the Proper Period

Status and Accomplishments: Complete. Year-end closing procedures for both entity and non-entity accounting were amended to improve the year-end liability accrual process. Open obligation reports were distributed to customers to ensure all goods and services received before October 1 are captured in the correct accounting period. ATF designed new year-end accrual worksheets and refund claim procedures

to ensure accurate estimation of liabilities.

Strengthen Controls Over the Retention of Supporting Documentation
Status and Accomplishments: Complete. ATF's property section now maintains all documents supporting property adjustments for four years. Invoices supporting capitalized property acquisitions are retained for five years. Telephone bills are retained for the current year and year under audit.

During FY 1996, the Bureau completed action on a FY 1994 OIG survey recommendation to automate the reconciliation between refund claims in the tax subsidiary systems and the general ledger. ATF provided training on a new mainframe claims database to all technical service and tax processing center personnel. Benefits of the new system include automated reconciliation of payments with the financial system and feedback of payment and cancellation data from FMIS to the subsidiary systems.

Keeping with the team approach to tackle significant issues, ATF established a new team to address the FY 1995 EDP reportable conditions, which were:

Improve Effectiveness of Access Control Software

Status and Accomplishments: In progress. In FY 1996, ATF reconfigured the Resource Access Control Facility (RACF) for better mainframe data protection; implemented an improved password management process; reduced the number of persons with special attributes to only essential access privileges; eliminated user defined operating functions; and restricted the user's ability to submit operator commands.

Use Access Control Software to Separate Incompatible Duties
Status and Accomplishments: In progress. In FY 1996, the Bureau created separate system partitions to

“There were no new FMFIA deficiencies identified during FY 1996. One deficiency remains pending from a previous FMFIA Report.”

enable future separation of development and production access; instituted a process for monitoring system programmer activity; and restricted computer operator access to operating system programs and sensitive files. Additional longer term solutions will be required to fully address all deficiencies.

Develop and Implement Program Maintenance Procedures

Status and Accomplishments: *In progress.* In FY 1996, the Bureau acquired a software configuration management control package to manage the software change control process. After product evaluation, ATF will decide whether to expand this management tool to additional applications. ATF is attempting to increase the staffing level for senior systems programmers to support computer operations.

Enhance Controls Over the Information Security Management Function

Status and Accomplishments: *In progress.* In FY 1996, ATF drafted an Automated Information Security Policy Order incorporating all current, pertinent Federal information security standards. This policy will provide guidance to Bureau employees and management concerning their roles and responsibilities within the ATF information security environment. Additionally, the Bureau issued a policy letter advising all application systems owners of their ownership security and operational responsibilities. Future efforts will focus on establishing a certification and accreditation process for all major Bureau information systems.

1996 FMFIA STATUS

ATF’s FY 1996 annual statement of assurance to the Secretary of the Treasury indicated that the Bureau could reasonably assure that:

- (1) obligations and costs are in compliance with applicable laws and assets are safeguarded;
- (2) operational revenues and expenditures are properly recorded and accounted for; and
- (3) accounting systems conform to the Comptroller General’s accounting principles and standards.

The reasonable assurance was based on the Bureau’s continued effort to improve its systems of management controls and aggressive steps to improve automated systems.

There were no new FMFIA deficiencies identified during FY 1996. One deficiency remains pending from a previous FMFIA Report:

Title and Description: Compliance Operations Revenue Accounting System. Title since changed to Integrated Collections System (ICS). ICS is not fully integrated with the Bureau’s core revenue accounting system (FMIS). The lack of an integrated system hinders the ability to expeditiously and effectively reconcile summary accounting and individual transaction data. Year Identified: 1988.

Status and Accomplishments: Pending corrective actions. Accounting for revenue collections and disbursements is fully integrated with the FMIS and under one general ledger with administrative accounting (since FY 1994). Work remains on integrating the FMIS with subsidiary tax and fee databases, which will comprise the ICS when fully developed. In FY 1996, software was implemented that permits the reconciliation of FMIS accounting data with regulatory tax and fee databases for refund claims and cover over payments. Development of an entire revenue system with full integration of program management and accounting functions is a long-term effort currently anticipated to be completed by FY 1999.

MANAGEMENT RESPONSIBILITIES

Bureau management is responsible for the fair presentation of information contained in the principal financial statements, in conformity with the accounting hierarchy described in Note 1, Summary of Significant Accounting Policies, which constitutes an “other comprehensive basis of accounting.” Management is also responsible for the fair presentation of ATF’s performance measures in accordance with Office of Management and Budget requirements. The quality of the Bureau’s internal control structure rests with management, as well as the responsibility for identification and compliance with pertinent laws and regulations.

LIMITATIONS OF FINANCIAL STATEMENTS

The financial statements were prepared to report the financial position and results of operations of ATF. The Bureau prepared the statements from the books and records of ATF according to formats prescribed by the Office of Management and Budget. However, these statements differ from the financial reports used to monitor and control budgetary resources that are prepared from the same books and records.

The 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.