

**THE DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING**

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

2. Summary of Significant Accounting Policies (continued)

Equipment and Spare Parts

In July 2005, the Bureau permanently completed production of postage stamps for the U.S. Postal Service. All remaining postage stamp related production equipment and spare parts have been fully depreciated and will be disposed of in accordance with applicable government regulations.

In 2004, the disposal of idle equipment and repair parts no longer needed to produce U.S. postage stamps was completed. The equipment and related spare parts were turned over to the General Services Administration (GSA) for disposal in accordance with applicable government regulations.

Estimation Process

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future as more information becomes known, which could impact the amounts reported and disclosed herein.

Inventories

Inventories are valued at standard cost, except for finished goods inventories, which are valued at weighted average unit cost. Both methods approximate actual cost. Cost elements included in work-in-process and finished goods inventories are direct materials, direct labor, manufacturing overhead and manufacturing support.

Other Assets

Other assets consist principally of machinery repair parts, tools and supplies which are used in the production of the Bureau's products. Other assets are valued at standard cost, net of reserve for obsolescence, which approximates actual costs.

Property and Equipment

Property and equipment are recorded at cost. Major alterations and renovations are capitalized, while maintenance and repair costs are charged to expense as incurred. The capitalization threshold is \$50,000.

The Bureau occupies and uses buildings and land owned by the U.S. Government. In accordance with the Act establishing the revolving fund, the Bureau is not charged for the use of the buildings or land, but is responsible for maintenance and repair of all buildings and land improvements. The land and building shell for the Bureau's Western Currency Facility were donated by the City of Fort Worth, Texas to the United States Government. See Note 6 for details.



**THE DEPARTMENT OF THE TREASURY
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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

2. Summary of Significant Accounting Policies (continued)

Depreciation

Depreciation of property and equipment is calculated using the straight-line method over the following estimated useful lives:

Machinery and equipment	3 - 15 years
Building improvements	3 - 40 years
Information technology (IT) equipment and software	3 - 5 years
Office machines	5 - 10 years
Furniture and fixtures	5 - 10 years
Motor vehicles	3 - 9 years

Employee Retirement Plans

Bureau employees participate in the contributory Civil Service Retirement System (CSRS) or Federal Employees' Retirement System (FERS), to which the Bureau and employees make contributions according to plan requirements. Employer contributions to the retirement plans for 2005 and 2004 were \$15.7 million and \$14.8 million, respectively. The CSRS employer contribution rate for fiscal years 2005 and 2004 was 7.0%. The FERS agency contribution rates for fiscal year 2005 and 2004 were 11.2% and 10.7%, respectively. The cost of providing the CSRS and FERS benefits is more than the amounts contributed by the Bureau and the employees to the Office of Personnel Management (OPM). The full cost of providing pension benefits, including the cost financed by OPM, which is not included in the Bureau's Statement of Operations, totaled \$23.6 million and \$23.9 million in 2005 and 2004, respectively.

Consistent with reporting under multi-employer pension plans, the Bureau does not report CSRS and FERS assets, accumulated plan benefits or future liabilities, if any, applicable to its employees. This data is reported for plan participants by OPM.

Postretirement Benefits Other than Pensions

Postretirement benefits for former Bureau employees, specifically health care costs and life insurance, are administered and paid by OPM through appropriations received from the United States Government. The Bureau does not reimburse OPM for these payments. OPM paid such retirement benefit costs totaling \$10.5 million and \$9.8 million, as calculated by OPM, for the Federal Employees Health Benefits Program (FEHBP) and Federal Employees Group Life Insurance (FEGLI) programs in 2005 and 2004, respectively. These costs are not included in the Bureau's Statements of Operations.

Consistent with reporting under a multi-employer plan arrangement, no accrued liability is required to be recorded by the Bureau for recognition of postretirement benefits other than pensions.



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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

2. Summary of Significant Accounting Policies (continued)

Cost of Employee Pensions and Postretirement Benefits Paid by OPM

As noted above, the Bureau's financial statements do not include the cost of employee pensions and postretirement benefits paid by OPM, or the actuarial liability for such benefits. There have been proposals made to have such costs and liabilities included at the Bureau level. If this change were made, it would have a material effect on the Bureau's financial statements.

Workers' Compensation Costs

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered Federal civilian employees injured on the job, employees who have incurred a work-related occupational disease and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for the Bureau's employees under FECA are administered by the Department of Labor (DOL) and are ultimately paid by the Bureau. These future workers' compensation estimates were generated from an application of actuarial procedures developed to estimate the liability for FECA benefits. The actuarial liability for future worker's compensation benefits includes the expected liability for death, disability, medical and miscellaneous costs for approved compensation cases, plus a component for incurred but not reported claims. The liability is determined using a method that utilizes historical benefit payment patterns related to a specific incurred period to predict the ultimate payments related to that period. These annual benefit payments have been discounted to present value using the OMB's economic assumptions for 10-year Treasury notes and bonds, which resulted in a discount rate of 4.528% in year one and 5.020% thereafter. Based on information provided by the DOL, the Department of the Treasury (Treasury) allocated the overall liability to Treasury components based on past claims paid. The Bureau's estimated liability for workers' compensation costs was \$59.4 million and \$62.3 million as of September 30, 2005 and 2004, respectively.

Annual, Sick and Other Leave

Annual leave is accrued as a liability when earned and the accrual is reduced as leave is taken. The balance in this accrued liability account reflects current pay rates.

Sick leave and other types of nonvested leave are expensed as the leave is taken.

Revenue Recognition

Revenue from sales to the Federal Reserve System and United States Postal Service is recognized when finished goods are delivered to the on-site Federal Reserve Depository Vaults or United States Postal Service Vault, and they are released for shipment. Finished goods are released for shipment in accordance with customer requirements.



**THE DEPARTMENT OF THE TREASURY
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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

2. Summary of Significant Accounting Policies (continued)

Advertising Cost

The Bureau incurred \$7.4 million and \$20.4 million in advertising costs for the years ended September 30, 2005 and 2004, respectively, related to the Next Generation Currency Notes public education program. These costs are expensed as incurred.

3. Cash

The year-end cash balances are as follows:

	September 30	
	2005	2004
	<i>(In Thousands)</i>	
Bureau of Engraving and Printing		
Revolving Fund	\$181,286	\$168,442
Mutilated Currency Revolving Fund	740	461
Other	1,224	25
Total	\$183,250	\$168,928

Other cash at September 30, 2005, consists of a deposit-in-transit of \$818 thousand and \$406 thousand from the sale of uncut currency awaiting transfer to the Treasury general account. Other cash at September 30, 2004, consisted of a deposit-in-transit of \$25 thousand.

4. Accounts Receivable

Accounts receivable consist of the following:

	September 30	
	2005	2004
	<i>(In Thousands)</i>	
Billed	\$40,790	\$42,024
Unbilled	1,248	2,583
Total	\$42,038	\$44,607

The Bureau had intragovernmental accounts receivable of \$0.1 million and \$2.2 million as of September 30, 2005 and 2004, respectively. Historical accounts receivable loss experience does not warrant the establishment of an allowance for uncollectible accounts.



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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

5. Inventories

Inventories consist of the following:

	September 30	
	2005	2004
	<i>(In Thousands)</i>	
Raw materials and supplies	\$32,814	\$47,819
Work-in-process	28,818	43,546
Finished goods - postage stamps and special products	1	3,610
Finished goods - uncut currency	13,613	8,416
Total	\$75,246	\$103,391

6. Net Property and Equipment

Property and equipment consist of the following:

	September 30	
	2005	2004
	<i>(In Thousands)</i>	
Machinery and equipment	\$393,518	\$442,786
Building and land improvements	206,575	210,997
IT equipment and software	14,592	26,157
Office machines	1,201	1,195
Furniture and fixtures	1,385	3,108
Donated assets - art work	125	125
Motor vehicles	212	265
	617,608	684,633
Less accumulated depreciation	385,623	429,586
	231,985	255,047
Construction-in-progress	17,418	5,995
Net property and equipment	\$249,403	\$261,042

Fully depreciated assets in use as of September 30, 2005 and 2004 were \$201 million and \$167 million, respectively.

The Bureau occupies and uses buildings and land owned by the U.S. Government. The land and building shell for the Fort Worth, Texas facility were donated by the City of Fort Worth to the U.S. Government in 1987, and title is held by the U.S. Government. At the time of donation, the land had an appraised value of \$1.5 million and the building shell cost was \$5.6 million. In accordance with the provisions of Public Law 81-656, Bureau financial statements include only the costs to complete the facility.



**THE DEPARTMENT OF THE TREASURY
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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

7. Current Liabilities

All current liabilities are funded and consist of the following:

	September 30	
	2005	2004
	<i>(In Thousands)</i>	
Intragovernmental	\$7,222	\$4,847
Other	38,038	45,861
Total	\$45,260	\$50,708

Accrued current liabilities consist of the following:

	September 30	
	2005	2004
	<i>(In Thousands)</i>	
Payroll	\$12,709	\$15,677
Annual leave	10,183	9,606
Workers' compensation	4,420	4,536
Other	503	1,161
Total	\$27,815	\$30,980

8. Workers' Compensation Liability (Non-Actuarial)

The Bureau has recorded a liability for claims incurred and paid to claimants by the Department of Labor (DOL) as of September 30, 2005 and 2004, but not yet reimbursed to DOL by the Bureau. Such amounts, associated with workers' compensation, which will be paid in subsequent years, are approximately \$5.7 million and \$5.6 million, respectively (See Note 2).

9. Revenue from Sales

Revenues are derived from the following principal customers:

	September 30			
	2005		2004	
	<i>(In Thousands)</i>			
Federal Reserve System	\$476,762	93.1%	\$491,179	93.6%
United States Postal Service	17,336	3.4%	19,501	3.7%
Other	17,966	3.5%	14,072	2.7%
Total	\$512,064	100.0%	\$524,752	100.0%



**THE DEPARTMENT OF THE TREASURY
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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

9. Revenue from Sales (continued)

Other revenue consists principally of the sale of security products to government agencies, the sale of uncut currency to the public, and fees charged to the Federal Reserve for the redemption of mutilated currency.

Revenue from sales decreased approximately 2.4% in 2005 as the result of a reduction in currency billing rates and a decrease in the number of Federal Reserve Notes delivered.

In 2001, the Bureau and the U.S. Postal Service entered into an agreement that gradually phased out production of postage stamps at the Bureau over a five-year period ending in 2005, with delivery services continuing through 2006.

10. Principal Suppliers

The Bureau is dependent upon sole suppliers for distinctive currency paper, certain advanced counterfeit deterrent inks and currency paper fibers.

11. Commitments and Contingencies

The Bureau is involved in various lawsuits incidental to its operations. Judgments resulting from litigation against the Bureau are paid by the Department of the Treasury Judgment Fund. The Bureau is required to reimburse the Judgment Fund for paid claims related to employee discrimination and contract disputes. There were no unreimbursed payouts from the Judgment Fund in fiscal years 2004 and 2005. In the opinion of management, the ultimate resolution of pending litigation will not have a material effect on the financial statements.

In 2004, the Bureau contracted to purchase currency production equipment, costing \$23.7 million, to be delivered in 2006.

The Bureau does not carry commercial insurance on its physical assets because by law the Federal Government is self-insured.

The Bureau has not entered into any long-term leasing arrangements.

12. Staffing

In 2005 and 2004, in order to reduce staffing and better match facility staffing and production requirements, the Bureau offered voluntary employee separation incentives. As a result, approximately 100 employees accepted the incentives and the Bureau incurred expenses of \$2.6 million in 2005. In 2004, approximately 200 employees accepted the incentives and the Bureau incurred expenses of \$5.1 million.



REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL STATEMENTS IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Inspector General, Department of the Treasury, and
the Director of the Bureau of Engraving and Printing,
Department of the Treasury

We have audited the financial statements of the Bureau of Engraving and Printing (Bureau), a bureau of the Department of the Treasury, as of and for the year ended September 30, 2005, and have issued our report thereon dated October 25, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*, as applicable. We also have examined, in accordance with attestation standards established by the American Institute of Certified Public Accountants, the effectiveness of the Bureau's internal control over financial reporting as of September 30, 2005, based on criteria established in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission, and the applicable requirements of Appendix A of OMB Circular A-123, *Management's Responsibility for Internal Control*, and our report dated October 25, 2005 expressed an unqualified opinion.

Internal Control Over Financial Reporting

In planning and performing our audits, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition based on standards generally accepted in the United States as established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Bureau's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described below.

Depository Account for Public Sales

During our FY 2005 audit, we became aware that a depository account maintained by the Bureau had not been approved by the Department of Treasury's (Treasury) Financial Management Service (FMS). We were informed that this account was opened in 1995 and, subsequent to 1997, was used to secure daily cash receipts from sales to the public from the Bureau's gift shop and, more recently, has been used for orders through the Internet. The Bureau deposited the cash receipts into the account each day. Beginning in FY 2005, the number and dollar amount of the transactions increased due to additional activity from a new customer. As a result of this increased activity, the Office of Financial Management (OFM) worked with personnel from the Office of External Relations (OER) to improve controls and accounting related to public sales in the fourth quarter of FY 2005. The Bureau's policy was to accumulate the daily deposits, then transfer funds from the account to their approved revolving fund account monthly. At September 30, 2005, the Bureau appropriately recorded the balance remaining in the account on their financial statements. However, this practice was not implemented until the final quarter of FY 2005. While public sales activity was appropriately recorded on the financial statements at year-end, we noted the following items related to the cash account that indicated management controls need additional strengthening:

- The cash account was maintained by OER with limited involvement by OFM until the fourth quarter of FY 2005. While OER personnel performed certain informal reconciliation procedures to match deposit slips from receipts to the account statements, no formal reconciliations were prepared until August 2005. Prior to the fourth quarter of FY 2005, OFM personnel were recording sales activity as deposits were made to the revolving fund, not as of the day of the original sale.
- Funds were not deposited to an account approved by FMS timely.
- A check for approximately \$800,000 was drawn from the outside depository account but not deposited with FMS for over a week. Instead, the check was maintained in a safe within OFM. As of September 30, 2005, this amount appears as a deposit in transit on the balance sheet.
- One of the authorized signatories on the account had not been employed by the Bureau for approximately 8 years. This former employee was removed as an authorized signer in October 2005.



In addition to the internal control issues discussed above, we noted instances where the Bureau may not have complied with certain laws and regulations. For instance, the Bureau was unable to locate documentation from FMS for authorization to designate the holder of the account as a depository and financial agent of the federal government, did not deposit funds timely, and maintained balances in the account exceeding the FDIC-insured threshold of \$100,000 without obtaining the required collateral security.

We reviewed our finding with Bureau management, and management concurred. We also noted that the Bureau has taken steps to remediate the situation by notifying appropriate personnel, including FMS, the OIG, and the Bureau's Chief Counsel. In addition, management has informed us that they have stopped the process of depositing public sales receipts in the account, and they are in the process of closing this account. Instead, receipts will be deposited daily in an approved account. We were informed that proceeds from sales to the new customer that led to the more significant activity in this account are now wired directly to an appropriate account.

We recommend that management complete the process of closing the account and transferring funds to FMS, and strengthen the controls surrounding the cash account process to ensure that financial records are accurate and to reduce the risk of errors and irregularities. To the extent that formerly relatively minor sales to the public of collectible items continue to grow, we also encourage management to revisit and strengthen its control process in the area, including daily recognition of activity in the Bureau records.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions. However, we do not believe the reportable condition described above is a material weakness.

In addition, with respect to internal control related to performance measures reported in the Chief Financial Officer Performance and Accountability Report, we obtained an understanding of the design of significant internal control relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02, as applicable. Our procedures were not designed to provide assurance on internal control over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Bureau's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 01-02, as applicable. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, and OMB Bulletin No. 01-02, as applicable.

In addition to the reportable condition described above, we noted certain other matters involving internal control over financial reporting and its operation that we have reported to management of the Bureau in a separate letter dated October 25, 2005.

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

Ernst + Young LLP

October 25, 2005
Washington, DC



REPORT OF INDEPENDENT AUDITORS ON OTHER FINANCIAL INFORMATION

To the Inspector General, Department of the Treasury, and
the Director of the Bureau of Engraving and Printing,
Department of the Treasury

Our audits were conducted for the purpose of forming an opinion on the basic financial statements of the Bureau of Engraving and Printing taken as a whole. The accompanying additional information in the Statements of Operations (by Product Line) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such additional information has not been subjected to the auditing procedures applied in our audits of the basic financial statements and, accordingly, we express no opinion on it.

Ernst & Young LLP

October 25, 2005
Washington, DC



**THE DEPARTMENT OF THE TREASURY
BUREAU OF ENGRAVING AND PRINTING**

STATEMENTS OF OPERATIONS (BY PRODUCT LINE) (UNAUDITED)

	Year Ended September 30	
	2005	2004
	<i>(In Thousands)</i>	
Currency program revenues	\$494,728	\$505,251
Cost of goods sold	<u>458,839</u>	<u>472,430</u>
Gross margin on operations	35,889	32,821
Operating costs:		
General and administrative	48,850	49,592
Research and development	<u>7,648</u>	<u>8,564</u>
Currency-excess of expenses over revenues	<u>(20,609)</u>	<u>(25,335)</u>
Postage program revenue	17,336	19,501
Cost of goods sold	<u>13,639</u>	<u>20,825</u>
Gross margin on operations	3,697	(1,324)
Operating costs:		
General and administrative	<u>1,615</u>	<u>2,147</u>
Postage-excess of expenses over revenues	<u>2,082</u>	<u>(3,471)</u>
Net results of operations	<u>(\$18,527)</u>	<u>(\$28,806)</u>

NOTE: Revenues and expenses for the currency product line include small amounts related to the production and sale of miscellaneous special products and services. Support, a component of cost of goods sold, and general and administrative expenses are allocated to the currency and postage product lines based upon the currency and postage manufacturing costs estimated at the beginning of the year.

PRODUCT LINE STATEMENT OF OPERATIONS

Deliveries of Federal Reserve Notes in 2005 decreased by 300 million notes over 2004, while postage stamp deliveries decreased by 1 billion stamps. The decrease in currency deliveries and a reduction in currency billing rates resulted in a revenue decrease of approximately 2.1 percent in 2005, while postage stamp program revenue decreased approximately 11 percent. Superior performance in the manufacturing areas coupled with Bureau-wide cost containment efforts resulted in positive gross margin on operations in both programs. When setting 2005 currency prices, the Bureau planned for a net operating loss because the anticipated level of capital investment was less than the annual depreciation expense. Public Law 95-81 granted the Bureau legal authority to include capital surcharges in the billing rates. Because higher cost assets are funded prior to their installation, the customer is not billed for depreciation expense after installation which would result in them paying for the same capital asset twice.



SUPPLEMENTAL INFORMATION

<i>Currency Capacity Utilization</i>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Washington Currency Program			
a. Printing	71%	73%	72%
b. Processing	66%	67%	68%
Fort Worth Currency Program			
a. Printing	77%	84%	78%
b. Processing	68%	76%	71%

Average capacity utilization in the currency program decreased slightly in 2005 from 2004 because the currency order decreased from 8.7 billion notes in 2004 to 8.6 billion notes in 2005. Capacity utilization in 2006 is expected to decrease because of a planned decrease in the 2006 currency order to 8.2 billion notes.

<i>Postage Capacity Utilization</i>	<u>2003</u>	<u>2004</u>	<u>2005</u>
a. Printing	17%	33%	18%
b. Processing	17%	56%	31%

In 2005, printing and processing capacity utilization decreased significantly as a result of continuing postage production decreases and the effects of the disposal of idle production equipment in 2004. This is consistent with a five-year agreement between the U.S. Postal Service and the Bureau that resulted in the permanent completion of postage stamp production at the Bureau in 2005.

PROMPT PAYMENT

To ensure that Federal agencies pay invoices in a timely manner, Congress passed the Prompt Payment Act and the Office of Management and Budget (OMB) issued Circular A-125, which is now codified as part of the Code of Federal Regulations (CFR). Generally, the CFR requires payment within 30 days from the later of either the receipt of a proper invoice or acceptance of the goods/services. If this timeframe is not met, an interest penalty must be paid to the vendor. Within the Department of Treasury, the standard for the late payment rate is that no more than two percent of the invoices subject to prompt payment shall be paid late (at least 98 percent paid within 30 days.)

The Bureau's prompt payment performance for the past three years is presented below. As the percentages indicate, the Bureau has continued to exceed the Departmental standard for late payments. In 2005, there was a significant decrease in the number of late payments largely due to more experienced personnel and increased efforts to ensure timely payment of invoices.

	<u>2003</u>	<u>2004</u>	<u>2005</u>
1. Number of Invoices Paid Late	148	94	35
2. Interest Penalties Paid	\$7,741	\$6,619	\$790
3. Percentage of Invoices Paid Late	1.9%	1.3%	0.5%



